Non-residents income tax

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Introduction

Now the concept of *residency* has been defined, this module contains an analysis of the applicable tax regime for non-residents in Spanish territory, whether they are natural persons or legal entities. Income obtained by these persons is taxed under non-residents income tax.

In this case, there are two issues to consider in addition to those shared with other income taxes (general characteristics, taxable events, exemptions, etc.). Firstly, the personal elements of the tax need to be analysed, given that the nature of the taxpayers themselves – the fact they don't live in Spanish territory – means other subjective figures come into play to ensure the tax is paid.

In effect, once a person is considered a non-resident in Spanish territory and subject to IRNR (*Impuesto sobre la renta de no residentes*, or non-residents income tax), it is a good idea to take a look at the people connected to the tax other than the taxpayer, such as the guarantor and the representative, who become particularly relevant when it comes to difficulties in the effective control and collection of incomes obtained by non-residents. The issue of fiscal domicile in Spain for the purposes of Spanish taxation of non-residents also needs to be addressed.

Secondly, particular attention must be paid to tax quantification rules, which separate the taxation of non-residents with a permanent establishment in Spain from non-residents that operate without an establishment, given that there are significant differences between both cases.

Therefore, it is essential to determine the concept of a *permanent establishment* (PE), given that with scenarios when a taxpayer may or may not operate using a PE, the regulation sets out two completely different tax regimes for calculating the IRNR tax base.

Objectives

The main objectives for students to strive for when taking this module are as follows:

1. To define income obtained in Spain and non-resident income tax exemptions.
2. To master the concepts of *taxpayer*, *guarantor*, *representative,* and *withholder* for non-resident income tax.
3. To understand the non-resident income tax regime for income obtained through a permanent establishment.
4. To learn about the non-resident income tax regulations for income obtained without a permanent establishment.
5. To examine the optional regime for EU residents.
6. To understand the basic aspects of the special taxation on non-resident entity real estate.

1. Income obtained in Spain and exemptions

Income obtained by non-resident natural persons and legal entities in Spain is taxed under the non-residents income tax regime. The law for the aforementioned tax is found in Royal Legislative Decree 5/2004, of 5 March, which approves the consolidated text of the non-residents income tax act (TRLIRNR). And the regulatory development of this law is based on Royal Decree 1776/2004, of 30 July, by which the non-residents income tax regulation is approved.

The non-residents income tax[1] is a direct tax that taxes income earned on Spanish territory by both non-resident natural persons and legal entities. It is applicable throughout Spanish territory, without affecting the agreed provincial tax regimes and economic agreement with the Basque Country and the EU of Navarre. Furthermore, the applicable particularities[2] for the Canary Islands, Ceuta, and Melilla are to be considered.

(1)Art. 1 TRLIRNR.

(2)Art. 2 TRLIRNR.

When it comes to the concept of *Spanish territory* as a spatial component in which tax obligations are generated for non-residents, article 2 of the TRLIRNR states that:

> "The Spanish territory comprises the territory of the Spanish state, including the air space, both inland waters and territorial waters, and the contiguous zone in which, in accordance with International law and by virtue of their internal legislation, the Spanish state exerts or can exert their jurisdiction or sovereign rights over the seabed, the subseabed, the overlying waters, and its natural resources."

The IRNR[3] subjects all income obtained by a non-resident in Spanish territory to taxation, whether monetary or in kind. In effect, the **taxable event** of this tax consists of "income obtained, either monetary or in kind, by payers of this tax in Spanish territory", in connection with the object of the tax, defined in article 1 of the TRLIRNR as "income obtained by non-resident natural persons and legal entities in Spanish territory".

(3)Art. 12 TRLIRNR.

Consequently, it has to be determined when income is considered obtained in Spain in order to specifically define the IRNR taxable event.

The non-taxable scenarios and the exemptions set out in the tax regulation also need to be identified. In the first case, this is when income is not considered to have been obtained on Spanish territory and is not subject to paying tax, and in the second case, this is when income is exempt, meaning it is considered to have been obtained in Spain, but is exempt from taxation.

In addition, if there is an international double taxation avoidance convention, applying the IRNR regulation will depend on whether the convention attributes competency to tax the exempted income in the source country, whether exclusively or jointly with the country of residence.

1.1. Income obtained in Spain

As previously indicated, it is essential to establish the income obtained in Spain, given that it will determine how the tax applies to the taxable event.

The IRNR regulation does not set out a general rule for determining income obtained in Spain, but rather contains a number of income scenarios in order to determine the applicable criterion[4]. In this context, income obtained using PEs (permanent establishments) may or may not be differentiated, which can limit its application in some scenarios for non-resident natural persons.

(4) Art. 13 TRLIRNR.

There are four main **specific criteria** when it comes to taxation by IRNR:

- In accordance with the territoriality criterion, the following are subject to taxation in Spain: income and capital gains generated or obtained in Spanish territory by a non-resident (the location of the assets, the rights, or the economic operations generating the income).
- The payment criterion (for pensions, director remunerations, etc.), which is a criterion that only applies to income for which it is specifically defined.
- The criterion involving the location of the operation or the use of business activities (income from economic operations or activities).
- The criterion for bond issues (for capital gains).

Territoriality

Territoriality does not only determine the spatial scope of application of tax regulations, rather it is one of the criteria determining taxation in a country.

Such criteria are applied based on the analytical configuration of the tax, and for each type of income determine when it is considered obtained in Spanish territory. The income types contained in the TRLIRNR are much more detailed than those in the IRPF (Personal Income Tax Law), and are along the same lines as the OECD Model Double Taxation avoidance agreement.

When it comes to describing the different income concepts based on their origin, article 13.3 of the TRLIRNR refers to the criteria set out in the IRPF, although the criteria in the LIS (Company Tax Law) must also be kept in mind, particularly when it comes to the regime applicable to non-residents operating using a PE.

The existence of a Double Taxation avoidance agreement

If there is a double taxation avoidance agreement, this interpretive criterion no longer applies (as it is the principles in the agreement that are followed), unless the agreement refers to the national regulation when it comes to defining which concepts to include in a specific type of income.

Let's now take a look at the different scenarios for **income obtained in Spain** provided by the IRNR regulatory law.

1) Income from economic operations or activities

The following scenarios of income from economic operations or activities obtained through a PE located in Spanish territory, as well as those undertaken without a PE, are considered as income obtained in Spain[5]:

(5)Art. 13.1 TRLIRNR.

- When they are a result of economic activities undertaken in Spanish territory, except revenue from the installation or assembly of foreign-sourced installations or machinery, as long as those operations are undertaken by the supplier and their cost being less than 20% of the cost price. However, income from the international sale of goods is not considered to be obtained on Spanish territory, including ancillary expenses and comissions[6].

(6)Art. 13.2 TRLIRNR.

- When providing services used in Spanish territory, although if the aforementioned services partially aid economic activities undertaken in Spanish territory, they are only considered to be obtained in Spain for the part assisting the activity in Spain.

- When artists and sportspersons earn from their personal performances on Spanish territory, including when they are received by a different person or entity.

2) Work income

The following incomes from work are considered to be obtained in Spain:

- As a general rule, income derived from a personal activity undertaken on Spanish territory.

- Public service payments from the Spanish government, unless the work is entirely undertaken abroad and that income is subject to a personal tax abroad.

- The salaries of international airline and ferry company employees, paid by resident business owners or entities, or by permanent establishments located in Spanish territory, with the exception of the scenarios whereby the work is undertaken entirely abroad, and that income is subject to a personal tax abroad.

Example

Mr. Núñez, a resident in Pakistan, a country with which Spain has not entered into a double taxation avoidance agreement, is hired by a Spanish company to work in Pakistan.

As it is income from work that doesn't result directly or indirectly from an activity undertaken in Spanish territory, it is understood that the aforementioned income is not subject to taxation under the IRNR, given that it was not obtained on Spanish territory.

Mr. Núñez, a resident in Pakistan, is transferred to Spain for a month by his Pakistani employer to work on a bridge construction project. He has earned double his regular salary from the Pakistani company for doing the job.

Given that Mr. Núñez is still a Pakistan resident, he pays tax in Spain as an IRNR taxpayer and a 24% rate will be applied to his income, and no cost deductions are available.

On the other hand, if Mr. Núñez became a resident in Spain, he would be subject to taxation by IRPF and should be taxed on all his income in Spain.

3) Pensions and similar benefits

The following benefits are considered to be obtained in Spain:

- When derived from a job undertaken in Spanish territory.
- When paid by a person or entity resident in Spanish territory or by a permanent establishment located in Spain.

Example

Mr. Peláez, a resident in Mongolia, a country with which Spain has not entered into a double taxation avoidance agreement, receives a Spanish Social Security pension of 1,200 euros a month.

The Spanish Social Security pension paid to Mr. Peláez is, in principle, subject to taxation under the IRNR, and it is taxed based on the corresponding scale.

4) Director remunerations

Director and Board of Directors remunerations, as well as the salaries of acting boards or representative bodies, are considered obtained in Spain when they are paid by an entity resident in Spanish territory.

5) Income from movable capital

The following income from movable capital is considered obtained in Spanish territory:

- Dividends and other income derived from shares in the equity of entities residing in Spain.

Recommended reading

C. Checa González (1999). *Impuesto sobre la renta de no residentes*. Pamplona: Aranzadi.

- Interest and other income obtained by assignment to others of own capital paid by residents or by permanent establishments in Spanish territory, or remunerations on capital used in Spanish territory.

- Royalties paid by residents or permanent establishments in Spanish territory for the use or concession of use of, or for use in the Spanish territory of, among others: computer program rights; literary, artistic, or scientific rights; patents; image rights; and industrial, commercial, or scientific data.

- Other income not previously listed, as long as it is provided by natural persons who undertake economic activities in the performance of their activities, by entities resident in Spanish territory or by permanent establishments in Spanish territory.

6) Income from real estate

Income derived directly or indirectly from real estate assets within Spanish territory or from rights related to these assets is considered to be obtained in Spanish territory.

7) Attributed income

This includes income obtained in Spanish territory assigned to natural person taxpayers who are title holders of urban real estate located in Spanish territory that is not performing economic activities.

8) Capital gains

Capital gains are considered obtained in Spanish territory in the following cases:

- When derived from shares issued by residents.

- When derived from other movable goods located in Spanish territory or rights that should be satisfied in the territory.

- When derived from real estate located in Spanish territory.

- When assets located in Spanish territory or rights that should be satisfied or exercised in that territory form part of the taxpayer's assets, even if they do not derive from a previous transfer, such as net gains from gambling activities.

1.2. Non-taxable scenarios

The IRNR regulation contains some scenarios not subject to tax, which include incomes that are expressly declared as not subject to tax and those not considered to be obtained in Spanish territory.

On the one hand, article 12.3 of the TRLIRNR indicates that income from inheritance and gifts are **not subject** to taxation. This regulation applies exclusively to taxpayers who are natural persons, given that they are the only ones that can be taxpayers on inheritances and gifts.

> In accordance with article 7 of Law 29/1987, of 18 December, regulating the inheritance and gift tax, subjection as a non-resident is derived from "the acquisition of goods and rights, of any nature, that are located, exercisable or to be fulfilled in Spanish territory, and from the reception of amounts derived from life insurance contracts when the contract was taken out with Spanish insurance companies or with foreign entities operating in Spain".

Other non-taxable scenarios

There can be other non-taxable scenarios, such as those involving capital gains obtained by a non-resident without a PE, given that article 24.4 of the TRLIRNR refers to article 36 of the LIRPF (IRPF Law) to calculate the taxable base for that type of income.

There are other laws such as the LIS (Corporate Tax Law) that contain non-taxable scenarios, such as those included in articles 108 and 50. The first provision refers to distributed profits and the transfer of a shareholding of an entity holding foreign securities when the beneficiary is a non-resident entity or a natural person in Spanish territory, unless it is obtained through a territory classed as a tax haven. The second provision refers to the dividends and shares in profits and the taxable incomes declared during the transfer or reimbursement of shares and stocks representative of companies' equity and venture capital funds in the event they are obtained by an IRNR taxpaying natural person or entity without a PE, unless they are obtained through a tax haven.

Furthermore, as has been indicated, some income **is not considered obtained in Spain**. This is what occurs in the following scenarios:[7]

(7)Arts. 13.1.c and 13.2 TRLIRNR.

a) Income from paid economic activities related to international goods sales, including service fees, as well as ancillary and related expenses.

b) Incomes paid to non-resident persons or entities through permanent establishments located abroad, with the relevant fees, when the corresponding benefits are directly connected to the activity of the PE abroad.

c) Income from work, when the work is undertaken entirely abroad and the worker is subject to personal tax abroad.

1.3. Exemptions

Different income **exemption** scenarios are provided in the IRNR for income obtained by non-residents in Spanish territory. These scenarios vary widely and have mainly been brought about for economic policy reasons (basically the need and desire to attract investment capital to Spain).

The concept of *tax exemption*

Exemption can be defined as any scenario established by law where, despite a taxable event having taken place, the main effect does not occur, that is, there is no obligation to pay the tax given the exemption. In addition, as it has already been seen, non-residents are excluded from the obligation to withhold taxes on exempted income.

In general, the exemptions recognised in article 14 of the TRLIRNR involve taxpayers that operate without a PE and are characterised by affecting certain incomes obtained by taxpayers residing in other European Union Member States.

The scope of the exemptions

Given that the aforementioned article 14 of the TRLIRNR does not restrict its application to taxpayer categories, as it occurs when determining income obtained in Spanish territory under article 13 of the TRLIRNR, the regulatory exemptions appear to affect non-residents that operate with and without a PE. In practice, however, most of the exemptions provided affect to non-residents that operate without a PE.

There are a range of reasons why the exemptions are established for the different scenarios, but they can be summarised as follows: the will to define and specify taxable events, to favour freedom of movement, to attract foreign investment, and to respect European Union mandates derived from the regulation or case law (as it is the case of interest and royalties, and the profits distributed by subsidiary companies to their parent companies).

The following non-resident incomes are exempt from the IRNR[8] in particular:

(8)Art. 14 TRLIRNR.

1) Incomes that are exempt from the application of the **IRPF regulation** and are obtained by natural persons, such as the case of pensions for absolute permanent disability or severe disability, or public grants and grants awarded by non-profit organisations, among many others. This is a varied group of exemptions that can be grouped into three main categories (work income, economic activities income and capital gains) and which respond to a range of purposes (personal damage compensations, education policy, economic capacity, the promotion of certain activities, etc.).

Retirement pensions are also exempt, acknowledged in the scope of the provisions of Royal Decree 728/1993, 14 May, in favour of Spanish emigrants.

Incomes exempted from the IRPF

By way of example, **pensions** from the Social Security or similar entities for absolute permanent disability or severe disability are exempt. This is also this case for benefits for professionals that are not subscribed to the special Social Security scheme for self-employed workers by the mutual funds that act as alternatives to the aforementioned special Social Security scheme (with a maximum benefit amount recognised by the Social Security for the corresponding concept), as long as these are benefits for identical situations to those intended for full permanent disability or severe disability from the Social Security. Civil service pensions are also exempt.

In addition, **public grants** and those awarded by non-profit organisations are exempt from IRPF, under the regime provided in Law 49/2002, of 23 December, on the tax system of non-profit organisations and the tax incentives for patronage, received for the purpose of official studies, both in Spain and abroad, at all levels and grades of the education system, and also both public grants and those from the aforementioned entities for research (awarded within the scope of the research scholarship and those awarded to civil service workers and other public sector workers, and to university teaching and research staff).

In addition, some **lottery, betting, and draw prizes** are exempt from IRPF. In fact, up to 31-12-2012, prizes from the National Lottery and Gambling Agency, Autonomous Communities, as well the draws organised by the Spanish Red Cross and the National Organisation for the Blind were exempt. This exemption was removed from 1 January 2013, and a special tax on prizes from specific lotteries and gambling was created. Prizes won by IRNR taxpayers without a permanent establishment are subject to this tax in the conditions in the 5th AP TRLIRNR.

Recommended reading

F. Serrano Antón (dir.) (2005). *Fiscalidad internacional*. Madrid: Centro de Estudios Financieros.

2) Grants and other amounts received by natural persons provided by public authorities by virtue of international treaties and agreements for scientific, educational, and cultural cooperation, or by virtue of the annual international cooperation plan approved by the cabinet.

3) In general, **interest** and **capital gains** derived from movable goods obtained by residents in another European Union Member State, such as fixed and variable income securities, or loans that may or may not be represented as securities (apart from those obtained through a country or territory classified as a tax haven).

However, there are three **exceptions** to this exemption. The first, is if the capital gains result from the transfer of shares, stocks, and other rights in an entity whose assets consist principally, directly or indirectly, of real estate located in Spain. Secondly, in the capital gains derived from transfer of shares, stocks, and other rights in an entity when the natural person taxpayer has directly or indirectly had stakes in at least 25% of the capital or assets of said entity at some point in the twelve month period before the transfer. And, lastly, when the transfer does not fulfil the requisites to apply the exemption provided in art. 21 LIS, in the case of non-resident entities.

Regulatory changes for the exemptions

Up to 2014, the second exemption applied to both natural persons and legal entities, and became only applicable to natural persons from 2015 onwards. Meanwhile the third exemption, which only applies to legal entities, was introduced from 2015 onwards.

4) Income derived from the **public debt**, obtained without a permanent establishment.

5) Income and capital gains generated from **securities** issued in Spain by non-residents (bonds, debentures, etc.), independently of the place of residence of the financial institutions that act as payment agents or mediators when issuing or transferring securities.

6) Income from non-resident **accounts**, unless the payment is made to a PE located in Spain from Banc of Spain, banks, savings banks, and other registered entities.

Example

Mr. Martínez, a resident in Sudan, a country with which Spain has not entered into a double taxation avoidance agreement, receives 8,000 euros in interest from a fixed term account he has with a Spanish financial entity.

The interest earned by Mr. Martínez (8,000 euros) is exempt from being taxed under the IRNR (art. 14.1.f TRLIRNR).

In order to apply the exemption to the obligation to withhold with respect to non-resident accounts, the IRNR taxpayer status can be validated before the corresponding entity either by a certificate issued by the Tax Authorities in their country of residence, or by providing a declaration (contained in the corresponding model) that they are taxpayers in another country.

In addition, the Banc of Spain and registered entities referred to in the regulation on overseas financial transactions with non-resident accounts in Spain, should submit the appropriate form in order to provide the tax authority with information related to said accounts.

7) Income obtained in Spanish territory without a PE, derived from the leasing, assignment, or transfer of containers or **boats and aeroplanes** under bareboat charter used for international flights or maritime navigation. In the case of aircraft, the exemption will also apply when their use on international routes represents over 50% of the total flight distances by all the aircraft used by the leasing company.

8) The profits distributed by **subsidiary companies resident in Spain** to their parent companies with headquarters in another EU Member State or to the PEs of the latter in other Member States, as long as they fulfil certain conditions (unless the parent companies' headquarters are in a country or territory classified as a tax haven).

Exemption of profits distributed by subsidiaries resident in Spain

A parent company is defined as having a direct or indirect stocks amounting to at least 5% of the capital of another company, or the purchase value of the stocks is over 20 million euros. The company in which the stocks are held is the subsidiary company. The aforementioned stocks must have been constantly held for the entire year prior to the day of the profit share.

For the purposes of calculating the duration, the period during which the stock was owned by other companies that fulfil the requisites of art. 42 of the Commercial Code when forming part of the same group of companies is to be taken into account, independently of their residence and obligation to file consolidated annual accounts.

The regulation contains three requisites that need to be fulfilled at the same time to apply the exemption. Firstly, both companies must be not exempt but subject to one of the taxes that tax the profits of legal entities in EU Member States and the permanent establishments must be not exempt but subject to taxation in the country in which they are located. Secondly, the distribution of profits must not lead to the winding-up of the subsidiary company. And lastly, both companies must be deemed to take one of the forms established in the annex of Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries from different Member States.

Furthermore, this exemption applies to the profits distributed by subsidiary companies resident in Spain to their parent companies resident in European Economic Area Member States with which an effective tax information exchange exists, when certain requisites are fulfilled.

Lastly, this exemption is not applicable when most of the voting rights of the parent company are owned, either directly or indirectly, by natural persons or legal entities that do not reside in the European Union or in European Economic Area Member States with which an effective tax information exchange exists.

9) Income derived from the transfer of securities or the reimbursement of shares in investment funds in official Spanish secondary securities markets, and obtained by persons or entities resident in a country with which Spain has entered into a double taxation avoidance agreement with an **information exchange** clause, unless they are obtained through a tax haven.

10) The **dividends** and the **profit shares** obtained without a PE from pension funds equivalent to those regulated by the revised text of the Pension Plans and Funds Act, which are residents in another EU Member State or by a PE from the aforementioned institutions located in another EU Member State. This exemption is equally applicable to the pension funds and collective investment institutions resident in the European Economic Area Member States with which an effective tax information exchange exists.

The previous exemption of dividends and profit shares

Up to 2014, **dividends and profit shares**, referred to in art. 7.y) LIRPF, obtained by natural persons, without a permanent establishment, residents in another European Union Member State or in countries or territories with which an effective tax information exchange exists, were exempt to a limit of 1,500 euros (applicable on the total amount of income obtained during a calendar year). All the same, this exemption did not apply if the dividends were obtained through a tax haven.

11) The **dividends** and the **profit shares** obtained without a PE by collective investment institutions regulated by Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009. However, application of this exemption may never lead to taxation less than what would result from applying the same type of tax rate to the same income at which the collective investment institutions are taxed under IS in Spanish territory. This exemption is equally applicable to the pension funds and collective investment institutions resident in the European Economic Area Member States with which an effective tax information exchange exists.

12)Royalties paid by a company resident in Spanish territory or by a PE located in Spanish territory of a company resident in another EU Member State to a company resident in another Member State, or to a PE located in another Member State of a company resident in a Member State when certain requisites are fulfilled. However, this exemption cannot be applied when most of the voting rights of the company receiving income are owned, directly or indirectly, by natural persons or legal entities that are not resident in European Union Member States, unless the constitution and operations of the aforementioned company fulfil valid commercial reasons and substantive business reasons.

13) Furthermore, the Minister for Economic and Financial Affairs can declare exempt, subject to reciprocity, the income from air or maritime navigation entities resident abroad whose **boats or aircraft** enter Spanish territory.

14) Additionally, there is a possible partial exemption in **capital gains derived from the transfer of certain real estate assets.** This is an exemption[9] of 50% of the capital gains obtained without a permanent establishment in Spain, derived from the transfer of urban properties located on Spanish territory bought since Royal Decree Law 18/2012 came into force and until 31 December 2012.

(9)4th AP TRLIRNR.

15) Lastly, from 2015 onwards, the non-resident taxpayer is allowed to exclude **capital gains** obtained due to the **transfer** of what was their **main residence** in Spanish territory, as long as the amount obtained from the transfer is reinvested in the purchase of a new main residence[10].

(10)Supplementary provision to the fourth TRLIRNR.

However, application of the withholding (3%) and the obligation to submit the declaration and pay the tax liability are not exempted. All the same, if the reinvestment occurred before the date the declaration was submitted, the partial or total reinvestment can be taken into account when calculating the tax debt.

2. The taxpayer, the guarantor, the representative, and the withholder

2.1. The taxpayer

1) The taxpayer

An IRNR **taxpayer** is a non-resident natural person or legal entity that obtains income in Spain[11].

(11) Art. 5 TRLIRNR.

In addition, this taxpayer profile applies to entities in the **pass-through** regime, which have a different tax regime based on whether or not they are established in Spain or abroad. For these purposes, this type of entities are only considered taxpayers if they are established abroad and have a presence in Spain (art. 38 TRLIRNR), with a 25% tax rate applicable.

Entities in the pass-through regime

Entities in the pass-through regime are not exactly non-resident taxpayers, but rather established abroad and partially pay tax for their income obtained in Spain.

Example

Mr. Smith's main residence is in the United States of America, where he works for an American company. Mr. Smith has been working in the Spanish subsidiary of the aforementioned company from January to August 2009, earning 60,000 euros.

The Spain-US Double Taxation avoidance Agreement refers to the internal regulation of each country for this point (art. 4.1). Independently of whether or not Mr. Smith is considered a United States resident (an issue that is not being dealt with here), what is certain is that he is a resident for the purposes of the Spanish IRPF, as article 9.1.a of the LIRPF establishes that to be the case for those that remain in Spanish territory for over 183 days in a calendar year. For these purposes, we assume Mr. Smith has remained on Spanish territory throughout the period he has been working for the Spanish subsidiary.

Accordingly, the income obtained in Spain (the 60,000 euros in this case), must be taxed under the Spanish IRPF, and not under IRNR.

Lastly, by way of reciprocity, foreign natural persons, their spouse (from whom they are not legally separated) and their children under adult age residing in Spain are considered IRPF taxpayers due to the application of regulations taken from international treaties under any of the following situations[12]:

(12) Art. 9.2 and art. 10 LIRPF.

- Members of other countries' diplomatic missions (including the chief diplomat, as well as its diplomatic, administrative, technical, and services staff).

- Members of other countries' consular offices (including the director, as well as the civil servants or service personnel, except the honorary vice-counsels or honorary consular agents and their dependent personnel).

- Holders of offices or official posts from other countries (such as delegation members and representations permanently accredited before international organisations or that form part of observer delegations or missions abroad).

- Active civil servants that have an official role or post that is neither diplomatic nor consular in nature.

However, these scenarios are exempted from qualifying as IRNR taxpayers, firstly, when those persons are not active civil servants or holders of an official role or post and had their main residence in Spain prior to acquiring any of the previously listed circumstances, and secondly, in the case of spouses (from whom they are not legally separated) or children under adult age, when they had their main residence in Spain prior to the acquisition of the previously listed circumstances by their spouse, father, or mother.

Recommended reading

N. Carmona Fernández (1999). *Todo sobre el impuesto sobre la renta de los no residentes*. Barcelona: Praxis.

In contrast, Spanish national natural persons, their spouses (from whom they are not legally separated) and their children under adult age living abroad are considered IRPF taxpayers when they are members of Spanish diplomatic missions or consular offices abroad, holders of Spanish government official roles or posts, or active civil servants that have an official role or post that is neither diplomatic or consular in nature.

2) The substitute taxpayer

Lastly, it should be indicated that IRNR taxpayers do not have a connection to Spanish territory that is in any way long-term; they can even obtain income without ever having visited. As such, as it is more likely they will not fulfil their tax obligations, the Spanish legislator has established other personal elements, such as the substitute, the guarantor, or the withholder, with the aim of ensuring the obligations are fulfilled. In this respect, the legislator has also provided for the fact that some non-residents can voluntarily designate a representative to submit declarations in their name, pay the taxes, or request the corresponding refunds.

The provision repealed from article 33 of the TRLIRNR

This provision, repealed by Law 4/2008, for the abolishment of the tax on assets, stated that managing agents of public debt market should – in account entries – withhold and deposit the amount of tax corresponding to the income from Treasury bills and other public debt securities obtained by non-residents in Spain without a PE into the treasury as substitutes for the taxpayer (to the extent that the exemption provided by the IRNR regulatory law on the aforementioned income did not apply).

It is worth indicating here that, technically speaking, residents paying income subject to tax are acting as substitutes when the amount to be withheld is the same as the IRNR amount to be paid.

2.2. The guarantor

The **guarantor** has an important role in this tax[13] given that they do not only ensure the payment but also manage and subject income obtained by non-residents to the effective taxation.

(13) Art. 9 TRLIRNR.

The guarantor for the tax

The guarantor is the subject that is jointly responsible by legal mandate for paying the taxpayer's tax debts (art. 41 General Taxation Act). That is, in the event the taxpayer (taxpayer, withholder, substitute, etc.) does not pay the tax debts for any reason, the guarantor will have to take responsibility for those debts via the corresponding procedure (arts. 174 to 176 LGT). Once the guarantor has paid the debt, they can privately request the corresponding amount from the initial taxpayer.

Responsibility may be joint or subsidiary. In the first scenario, the government can demand payment from the taxpayer or the guarantor when the voluntary payment period has ended without the tax having been paid. In the second scenario, in order to request payment from the subsidiary guarantor, the government must have unsuccessfully tried to receive payment from the initial taxpayer via the corresponding enforced collection procedure.

The following joint responsibility **scenarios** are contained in the IRNR:

a) Firstly, the following parties are considered jointly responsible for paying non-resident tax debts corresponding to income paid or income from assets or rights which they have been entrusted to deposit or manage, respectively:

- The payer of incomes earned without a PE. In these cases, the government can dispense with the legally established procedure to demand payment from the guarantor. A common example involves leasing properties located in Spain owned by non-residents, with the incomes paid by private persons.

- The depositary or manager of assets or rights unconnected to a PE.

Making a payment

Paying an amount on behalf and on request of a third party is not considered a payment of an income for these purposes.

Example

Mr. Menéndez, an investor resident in Paraguay, owns shares in a company resident in Spain, which are deposited in a Spanish financial entity. Mr. Menéndez receives dividends from those shares in his account with the aforementioned financial entity.

In this scenario, the dividend payer is not considered jointly responsible, but rather a tax withholder. On the other hand, the financial institution, as depository for the dividends, is considered as having joint responsibility (art. 9.1 TRLIRNR).

However, this responsibility no longer applies when there is the obligation to withhold and pay account deposits (without affecting possible responsibilities derived from withholding), which is shown by the role of guarantee and control this figure fulfils, as was indicated earlier. As such, when the payer, depositary, or manager is the withholder, joint responsibility will not apply, but they should withhold and pay account deposits or otherwise submit the declaration of negative withholding, as applicable.

b) Secondly, representative persons also qualify as jointly responsible for the payment of tax debts corresponding to non-resident taxpayer permanent establishments and entities in the pass-through regime that were constituted abroad with a presence in Spanish territory.

For both the payer of income obtained without a permanent establishment and the depositary or manager of assets or rights unconnected to a permanent establishment and owned by persons or entities resident in countries or territories considered as tax havens, Tax Authority actions may be directed to the guarantor, who will be required to settle the tax debt, without the need for a prior administrative action to refer responsibility. The aforementioned previous action to refer responsibility would be required for all other scenarios.

Tax withholding obligations

There is an obligation to withhold tax as a general rule when income is subject to taxation. Therefore, entities, business owners, and professionals that pay income to non-residents without a PE are obliged to withhold tax. As such, when it comes to income payers, the withholder is currently the most important figure, meaning that the jointly responsible figure is considered less important. Therefore, responsibility is more important in the case of the depositary or manager.

2.3. The representative

The representative is another personal element of the IRNR who, despite having become less important over time, has to be named in some scenarios.

In their dealings with the tax authority, the non-resident taxpayer must name a **representative** resident in Spain in line with precedents in law. Similarly, they are obliged to communicate the naming of the representative to the tax authority. Non-compliance with these obligations may incur a sanction[14].

(14) Art. 10 TRLIRNR.

The representative can be either a natural person or a legal entity with tax residency in Spain.

The aforementioned obligation to name a representative is only applicable in the following **scenarios**:

- When they operate through a permanent establishment. In this case, as has just been seen, the representative will be jointly responsible for paying the corresponding tax debts.

- When it is an entity in the pass-through regime that is constituted abroad with a presence in Spanish territory. Similarly, the representative of the entity is considered jointly representative for the payment of the corresponding tax debts.

- When providing services, technical support, installation or assembly work under engineering contracts, and in general, from economic operations or activities in Spain without a PE.

The obligation to name a representative

In the first three scenarios, the obligation to name a representative relates to the existence of economic activity from which expenses can be deducted and in which certain formal obligations can exist. This leads to the need for the resident representative to deal with both the tax authority and the non-resident.

- In scenarios in which the tax authority deems it appropriate, given the amount and nature of the income obtained in Spanish territory by the taxpayer.

In this context, article 47 of the LGT imposes the naming of a representative by non-residents "when operating in Spain through a permanent establishment, when expressly established in the tax regulation, or when required by the Tax Authority due of the nature of the operation or activity undertaken, or the amount of income obtained".

- Similarly, a representative must be named in the scenarios of residents in countries or territories with which no effective tax information exchange exists, when they are holders of assets located or rights that are fulfilled or are exercised on Spanish territory, excluding securities traded in official secondary markets.

All the same, it must not be forgotten that taxpayers can in all cases voluntarily name a representative to assist them with their communications and operations with the tax authority.

The communication of the naming of the representative must be undertaken in the agency where the tax has to be declared, and the aforementioned communication must be specifically agreed by the representative.

Confirmation of the representation can be undertaken:

By any means valid in law that shows a credible record (a private document with a signature legitimised by a notary or a public document), and standardised approved AEAT documents available through the Internet are also valid to this effect.

Through an appearance before the relevant administrative body.

Non-compliance with the obligation to name a representative is rated as a very serious infringement and is punishable with a fine of 2,000 euros (although this amount may be reduced by 25%). The aforementioned fine will be 6,000 euros when it involves taxpayers resident in countries or territories with which there is no effective information exchange[15].

(15)Art. 188.3 LGT.

Furthermore, when the aforementioned non-compliance occurs, the tax authority may consider the representative of the permanent establishment or taxpayer as the person listed in the Company Register. In the event there is no named or registered representative, or it is a different person to the named representative, the tax authority could consider the latter as such. In the scenarios of taxpayers resident in countries or territories with which no effective information exchange exists, the tax authority can consider their representative as the depositary or manager of their assets or rights.

2.4. Fiscal domicile

The IRNR regulation[16] defines a **fiscal domicile** in Spain for non-residents in order to make it easier to fulfil their tax obligations.

(16)Art. 11 TRLIRNR.

The regulation differentiates a range of **scenarios**:

Recommended reading

C. M. López Espadafor (1995). *Fiscalidad internacional y territorialidad del tributo*. Madrid: McGraw-Hill.

- When they operate in Spain through a PE, the fiscal domicile will be considered the location in which the administrative management of their business in Spain is undertaken. In the event the domicile cannot be defined by applying this criterion, it will be taken as the location in which their highest value real estate assets are located.

- When they operate in Spain without a PE and obtain rents (income or capital gains) derived from real estate, the fiscal domicile will be the same as their representative, and failing that, it will be considered as the locations of the corresponding property.

- In the other scenarios in which they operate without a PE, the fiscal domicile will be the same as their representative, and failing that, the joint guarantor. As such, in cases where a representative has not been designated, notifications delivered to the fiscal domicile of the joint guarantor will have the same effects as if they were made directly to the taxpayer.

Lastly, according to the provisions of article 11.2 of the TRLIRNR, when a representative has not been designated, notifications delivered to the fiscal domicile of the joint guarantor will have equal value and have the same effect as if they were delivered directly to the taxpayer. Similarly, when a representative has not been designated, notifications delivered to the location of any of the real estate properties owned by taxpayers resident in countries or territories with which no effective information exchange exists will be equally valid.

2.5. The withholder

When the tax residence of a taxpayer is outside Spanish territory and they do not own a PE in Spanish territory, the IRNR tax demand will be made upon the tax withholder as a measure to guarantee payment of the tax.

In general, persons that pay income to **non-residents without a PE** are obliged to withhold and pay in an amount that usually matches the amount of definitive tax the non-resident should pay. In those scenarios[17], the taxpayer is exonerated from having to self-assess their tax.

(17)Art. 31 and art. 28.3 TRLIRNR.

Consequently, the subtraction of the withheld tax is definitive, given that an amount is not withheld on account of a tax, but rather that an amount generally in line with the definitive tax is withheld. In this way, the legislator has a personal guarantee for the tax to be paid, given that the taxpayer is outside the territorial scope of their competencies.

The following are **obliged to withhold** or pay account deposits with respect to the incomes subject to the IRNR[18] paid to non-residents without a PE:

(18)Art. 31.1 TRLIRNR.

- Entities resident in Spain (including entities in the pass-through regime).
- Natural persons resident in Spain that undertake economic activities (business owners and professionals).
- IRNR taxpayers with a PE.
- IRNR taxpayers without a PE with respect to work income they pay, and with respect to other income subject to withholding that may include deductible expenses for obtaining income derived from providing services, technical support, installation or assembly work from engineering contracts, and in general, from economic operations or activities undertaken in Spain.

  Consequently, IRNR taxpayers without a PE should always withhold paid work income, independently of whether or not they have deductible expenses. In contrast, all other incomes paid should only be withheld when they constitute a deductible expense.

Business owners and professionals

As is to be expected, business owners and professionals only withhold with respect to the income paid in relation to their activities, but not for payments made in their private dealings.

- Entities in the pass-through regime constituted abroad with a presence in Spain.
- Representatives acting on behalf of an insurance companies operating with the freedom to provide services with respect to operations undertaken in Spanish territory.

Diplomatic missions

Diplomatic missions or Spanish consular offices in foreign countries are not obliged to withhold or pay account deposits.

- The following persons or entities should undertake operations with financial assets, in accordance with the provisions of article 76.2.b of the RIRPF (Personal Income Tax Regulation): the issuing entity in the event of amortisation or repayment of assets; the financial entity acting on behalf of the transferred party in the transfer of assets, and the public notary in any other case.
- The public debt market managing agent involved in the operation for transfers of public debt securities.
- The managing companies for investment fund stock reimbursements.
- In prizes, the person or entity that pays them.

In general, **incomes subject to withholding** are those subject to taxation (both income and gains).

However, the regulation[19] contains a series of **exemptions** to the obligation to withhold. There is no obligation to withhold when it comes to the following incomes, among others:

(19)Art. 31.4 TRLIRNR and art. 10 RIRNR.

- Incomes exempt within the provisions of article 14 of the TRLIRNR, without affecting the obligation to file a return. Given the incomes are exempt, withholding does not make sense in those scenarios as it may end up being requested as a refund. All the same, there is the obligation to withhold or pay account deposits in the cases of the dividends and profit shares referred to in article 14.1 (letters *j*, *k*, and *l*) of the TRLIRNR. Conversely, there is no obligation to submit a return in the cases of earnings derived from public debt obtained without a PE in Spain, as referred to in article 14.1.d of the TRLIRNR.

- Incomes exempt by virtue of a double taxation avoidance agreement, without affecting the obligation to declare. As in the previous scenario, withholding does not make sense as it may end up being requested as a refund.

- Incomes obtained by taxpayers without a PE when the tax payment or exemption is confirmed. That is, the non-resident taxpayer has the right to declare and pay their tax. If this situation is confirmed, there will no obligation to withhold.

Confirmation of payment or exemption

Confirmation of payment is to be undertaken via a tax return corresponding to the income submitted by the taxpayer or their representative, whilst in the case of exemptions, confirmation is to be undertaken through documents that justify compliance with the circumstances determining its application, without affecting the obligation to present a return.

Observation

In practice, however, it is not easy for the taxpayer to make the tax payment before withholding.

- Income derived from the distribution of the share premium or stocks or capital reduction. However, withholding or payments account deposits must be undertaken in cases of company capital reduction with refunding of contributions and distribution of the share premium as stated in article 75.3.h, paragraph 2 of the RIRPF.

- Incomes referred to in article 108.1.c of the LIS, that is, the profits distributed included in exempt incomes when the beneficiary is a non-resident entity or natural person in Spanish territory (given that they are not considered to be obtained on Spanish territory).

- Capital gains. However, there is an obligation to withhold when it comes to prizes derived from games, competitions, draws, or games of chance; the transfer of real estate located in Spanish territory in the case of non-residents without a PE; and income derived from transfers or refunds of shares representing capital or collective investment institution assets (apart from those from shares in collective investment funds, regulated in article 49 of the regulation of Law 35/2003, on collective investment institutions, approved by Royal Decree 1309/2005, of 4 November). In the first and third cases, the amount withheld matches the tax; in the second case, the amount withheld is 3% of the agreed remuneration.

- Income listed in paragraphs *b* (apart from when obtained through countries or territories classed in law as tax havens), *c*, *e*, *f,* and *h* of section 3 of article 73 of the RIRPF: income from shares issued by the Banc of Spain that are regulatory intervention tools and income from treasury bills; premiums from converting bonds into shares; income derived from the transfer or refund of financial assets with a specified return, and prizes from games organised within the provisions of Royal Decree 16/1977, of 25 February, as well as those with a withholding tax base of no more than 300 euros.

With respect to the **moment the obligation to make withholdings arises**, it should be noted that in general terms, it coincides with the time of accrual of the tax, regulated in article 27 of the TRLIRNR[20].

(20)Art. 12 RIRNR.

The obligation to withhold

Unlike other taxes, such as the IRPF or the IS, with the IRNR, the obligation to withhold does not arise when the income subject to withholding is paid, but rather when the tax is accrued. This may be due to the IRNR being a tax that is accrued instantly, whereas the IRPF and IS are due periodically.

With respect to the **amount to withhold**, it should be an amount equivalent to the tax liability derived from the tax itself (art. 31.2 TRLIRNR) for taxpayers that operate without a PE or rather the provisions of a double taxation avoidance agreement. In those cases, the non-resident is exempted from the obligation of filing a tax return.

However, the withholder will not be able to consider the following expenses or deductions (which are applicable on calculating the tax): staff expenses, procurement and supply expenses in the cases of economic activities without a PE, the special taxation quota for non-resident entity real estate, and the deduction for gifts).

The withholder is obliged to submit the corresponding form and an annual summary[21].

(21)Art. 31.5 TRLIRNR.

Lastly, it should be considered that some scenarios present **particularities** when withholding:

a) The first involves the **transfer of real estate** located in Spain undertaken by non-residents that do not undertake any economic activity on Spanish territory through a PE. The purchaser is obliged to withhold and pay 3% of the agreed price, as a payment on account of the tax the transferring party has to pay, as a result of the existence of a capital gain[22].

(22)Art. 25.2 TRLIRNR.

Transfers of real estate by non-residents

The withholder, which could be a natural person (business owner, professional, or a private person) or a legal entity, must pay the withheld amount within one month of the transfer.

The non-resident must file a return and pay the definitive tax within three months from the end of the withheld tax payment period.

The purchaser of the property is not obliged to withhold in the following scenarios:

- when the transferring party provides sufficient confirmation of their subjection to IRPF through a certificate issued by the relevant body of the tax authority;
- in the scenarios of the contributions of real estate, in the constitution or increase of the capital of companies resident in Spanish territory, and
- in donations, given that no remuneration exists in those cases.

The transferred real estate property is subject to the payment of whichever amount is smaller, either the withheld amount or the corresponding tax.

Example

Mr. Méndez, resident in Switzerland, owns an apartment in Murcia. In 2008 he transferred it to Mr. Fernández, whose main residence is in Madrid, for an amount of 150,000 euros. Capital gains of 70,000 euros were obtained and 12,600 euros in tax must be paid.

Mr. Fernández, as purchaser of the apartment, is obliged to withhold 3% of the remuneration. Consequently, the amount withheld will be 4,500 euros (150,000 x 3%).

If Mr. Fernández did not withhold the corresponding amount, the real estate will be subject to the payment of the tax (12,600 euros), without affecting the sanctions for non-compliance with the obligation to withhold.

b) The second special scenario affects **employed workers when changing their residence**. This is a voluntary procedure[23] that workers can use when working in another country, in order to anticipate the effects of a change of residence to abroad on the amounts withheld for work earnings when the payer is a resident or a non-resident with a PE on Spanish territory.

(23) Art. 32 TRLIRNR.

In effect, workers that will obtain the condition of IRNR taxpayers as a result of their move abroad can communicate this to the tax authority using the corresponding model, informing of the date they leave Spanish territory. The tax authority will issue the workers with a document to give to their employer, so the payer of their income from work can consider them as payers of this tax and the IRNR withheld amounts are applied from the date indicated on the aforementioned document. The aforementioned document is effective for up to two calendar years (the year of travel and the following year, or if the year of travel cannot be calculated, the following two years).

The worker must give proof of the data from the working relationship that shows they will remain in the foreign country to work for more than 183 days during the year of travel or, failing that, the following year. The aforementioned proof is to be given using a supporting document issued by the payer of the income from work in which the working relationship, the relocation country, the contract duration, the start date of the work abroad, the duration of the relocation, and expected date of completion are all included.

Even when using this procedure, the taxpayer is also obliged to confirm their new tax residence with the tax authority.

In addition, it must be mentioned that a similar procedure is envisaged for employed workers, who as non-IRPF payers, will obtain this condition due to their move to Spanish territory.

In this case, along with the communication to the Spanish tax authority, the taxpayer must submit a supporting document from the payer of the income for the work, which specifically acknowledges the working relationship, along with the date the work is to start on Spanish territory, the working location and address, the contract length, and the intentions of the payer that the worker will work for a period of at least 183 years during the calendar year in which the work being performed on Spanish territory starts, or failing that, that this minimum period of permanence will take place during the following calendar year.

3. Income obtained through a permanent establishment

The taxation of non-residents in Spain is determined by whether or not they operate in Spanish territory through a permanent establishment, and there are notable differences in both cases, a clear case of two different tax regimes when it comes to determining the IRNR tax base.

Income obtained by a **non-resident through a permanent establishment** is subject to taxation by IRNR for all income obtained in Spain, independently of the location in which it was generated (as long it can be allocated to the PE). As such, it is similar to the regime for resident entities in Spanish territory, although there are also notable differences in certain aspects compared to this regime. On the other hand, if they operate without a PE, each partial or total event subject to taxation is taxed individually.

As such, it is of critical importance to determine the **concept of *permanent establishment***, which, as covered in double taxation avoidance conventions, is equivalent to a fixed business location through which a company carries out all or part of their operations.

Article 5 of the Spanish-German double taxation avoidance convention

By way of example, the following is a transcription of article 5 (regarding PEs) from the Spanish-German Convention on Double Taxation avoidance and prevention of tax evasion regarding taxes on income and capital, published in the *Boletín Oficial del Estado* (Official State Gazette) of 8 April 1968:

"1. The term 'permanent establishment' means a fixed place of business through which a company carries out all or part of its activity.

2. The term 'permanent establishment' specifically comprises:

a) head office,
b) branches,
c) offices,
d) factories,
e) workshops,
f) mines, quarries, or any other location for extracting natural resources, and
g) building or assembly works that last for longer than twelve months.

3. The term 'permanent establishment' does not include:

a) the use of installations only for storing, displaying, or delivering company assets or merchandise;
b) keeping a deposit for company assets or merchandise with the sole aim of storing, displaying, or delivering them;
c) keeping a facility for company goods or merchandise with the sole aim of processing them for another company;
d) keeping a fixed business location with the sole aim of buying goods or merchandise, or collecting data for another company, and

e) keeping a fixed business location with the sole aim of advertising, providing information, undertaking scientific research, or developing other similar preparatory or auxiliary activities, as long as these activities are undertaken by the company itself.

4. A person that operates in a contracting country for a company from another contracting country (unless they are an independent agent covered in paragraph 5) is considered to constitute a permanent establishment in the former country, and usually exercises powers in that country to finalise contracts in the company's name. An exception to this is when their activities are limited to the buying and selling of goods or commodities for the company.

5. A company from a contracting country will not be considered to have a permanent establishment in another contracting country merely because it operates in that country through a broker, general commission agent, or any other independent agent, as long as such persons act within the normal framework of their activity.

6. The fact a company resident in a contracting state controls or is controlled by a company resident in the other contracting state, or undertakes operations in that other state (whether though a permanent establishment or any other means), does not convert any of those companies into the permanent establishment of the other alone."

On the other hand, the Spanish regulation[24] provides a more extensive concept than the double taxation avoidance agreements, on the meaning of a non-resident operating in Spain through a permanent establishment:

(24)Art. 13.1.a TRLIRNR.

- When there is any type of continuous or regular installation or **workplace** of any nature in Spain in which they undertake all or part of their activity. Specifically, head offices, branches, offices, factories, workshops, warehouses, shops and other establishments, mines, oil or gas wells, quarries, agricultural, forestry or livestock operations, or any other type of location in which the exploration or extraction of natural resources are carried out, as well as building, installation, and assembly works that last for longer than six months.

- When operating in Spain through an **agent** authorised to contract on behalf of and on account of the non-resident person or entity, as long as they habitually exercise those powers.

Example

Mr. Téllez, resident in Namibia, a country with which Spain has not entered into a double taxation avoidance agreement, owns a property in Toledo that he rents out the entire year.

In this case, Mr. Téllez is not considered to operate in Spain through a permanent establishment given that the simple renting of real estate is not one of the scenarios for a permanent establishment set out in the internal regulation (art. 13.1.a TRLIRNR).

Mr. Téllez, resident in Namibia, a country with which Spain has not entered into a double taxation avoidance agreement, owns a farm in Toledo.

In contrast, in this scenario, Mr. Téllez is considered to operate in Spain through a permanent establishment, given that agricultural operations are considered as such (art. 13.1.a TRLIRNR).

The main **characteristics** of a PE, as taken from the IRNR, are as follows:

Recommended reading

E. Albi Ibáñez; J. A. Rodríguez Ondarza; J. J. Rubio Guerrero (1989). *Tributación de los no residentes en España*. Madrid: Instituto de Estudios Fiscales.

- It is exclusively a concept for tax purposes.
- It does not have a separate legal personality, although it is, however, attributable to a resident person or entity. Otherwise, it would involve a subsidiary located in Spain and, as such, would be subject to taxation under corporate tax.
- It is irrelevant whether the non-resident is a natural person or a legal entity.
- The principle of the pass-through regime is applicable in order to determine the tax base, following the separated company regulations.
- To some degree, in a fiscal sense the PE takes the form of a person, which gives rise to taxation similar to resident taxation.
- In the event of more than one PEs from the same company existing in the same company, the principle of independent taxation is applied.

More than one permanent establishment

If an entity has more than one PE in Spain, each is to be taxed separately when the following circumstances occur: they carry out clearly different activities and they are managed separately (and therefore, will each have a different tax number and name). According to article 17 of the TRLIRNR, compensation of incomes between different PEs is not allowed.

- There will be special regimes based on PE characteristics.

The **attributable incomes** for a permanent establishment are as follows[25]:

[25] Art. 16 TRLIRNR.

- Income from economic activities undertaken by the permanent establishment.
- Income derived from assets connected with the permanent establishment.
- Capital gains or losses derived from assets connected with the permanent establishment.

Assets connected with the permanent establishment are considered to be, in particular:

- Those essentially involved with undertaking the activity for which they exist.

- Those transferred within three tax periods following release from the public domain.

- Stocks representative of equity participations when the permanent establishment is a branch registered in the Mercantile Register and series of regulatory defined requisites are fulfilled: that the stocks are shown in the PEs accounting statements and, given it is a PE that can be considered a main company, it has the organisation of personnel and material means to direct and manage such participations.

The PE's **taxable base** is defined by its total attributable income, independently of the location in which it was generated or obtained. Three regimes are set out to define the taxable base: the general regime, the regime for permanent establishments that do not complete an entire trading cycle, and the regime for permanent establishments with activity of limited duration[26].

(26)Art. 18 TRLIRNR.

In accordance with the general regime to determine the taxable base, this is set in accordance with the provisions of the general regime of the consolidated text of the Corporate Tax Law, with the following **particularities:**

a) Payments the PE makes to its parent company or any other of its permanent establishments in terms of royalties, interest, commissions, technical support services, and for use or transfer of assets or rights, are generally non-deductible.

b) The management expenses and general administration expenses attributed to the PE by the parent company are deductible, as long as they are reflected in the PE accounting statements, and they are attributed continuously and rationally.

Management expenses and general administration expenses attributed by the parent company

The main problem with this type of expenses is defining which concepts can be included in this generic definition. The government has allowed for extensive criteria in this respect. For such expenses to be considered deductible, they should fulfil the following requisites: they have to be registered in the PE accounting statements; through an informative report submitted with the return, there should be records of the amounts, the criteria and modules for allocation; and lastly, they should comply with the rationality and continuity of the adopted taxation criteria.

In addition, it is possible for taxpayers to submit proposals for evaluation to the Tax Authority for the part of the management and general administration expenses that may be deductible.

c) Expenses derived from the non-residents own capital connected with the PE are not deductible (interest and other financial charges).

The compensation regime for tax losses against and positive taxable bases for the PE itself applies (eighteen years). However, when applying the principle of separate accounting, the negative taxable bases of one PE cannot be compensated by the positive taxable bases of another PE owned by the same non-resident.

Recommended reading

F. Serrano Antón (dir.) (2005). *Fiscalidad internacional*. Madrid: Centro de Estudios Financieros.

With respect to **the other two regimes to define the taxable base**, firstly, there are PEs that do not complete an entire trading period, that is, PEs that assign products or services obtained in the installation they own in Spain for their own use, without providing any service in return (they do not work for third parties, simply the parent company and its other PEs). In this case, the taxable base is calculated in accordance with the regulations on income and cost related operations, so it will be determined by the difference between the income and expenses. However, there is a subsidiary regime for calculating the taxable base consisting in the application of a percentage fixed by the Ministry for Economic and Financial Affairs on the total expenses, to which deductions and allowances cannot be applied.

And, secondly, there are the PEs whose activity consists in building, installation, or assembly works lasting more than six months, in temporary or seasonal economic operations or activities, and in activities exploiting natural resources. Those PEs can choose between calculating their taxable base in accordance with the general regime established for the PEs or in accordance with a non-resident entity without PE taxation regime.

Meanwhile, it should be taken into account that the taxable base for the income obtained through a permanent establishment located in Spanish territory, in the event of it being **transferred abroad or ceasing its activity**, will be determined by the difference between the market value and the accountable value of the elements connected to the establishment.

When it comes to the **tax rate** applicable to permanent establishments, it will be the same as the Corporate Tax regulation (28% in 2015 and 25% in 2016)[27].

(27)Art. 19.1 TRLIRNR

Previous regulation of the tax rate

From 2008 up to 2014, the general tax rate was 30% (the same rate as the general IS rate). However, if the PE activity involved hydrocarbon research and exploitation, the rate was 35% (Art. 19 and 2nd AP TRLIRNR).

Complementary tax

In addition, a complementary tax of 19% is envisaged on income from PEs transferred abroad, with the aim of equating PE taxation with the foreign company subsidiaries (the principle of neutrality). However, between 1 January 2012 and 31 December 2014, the rate went to 21% (third Additional Provision TRLIRNR). This tax rate in 2015 is 20% (art. 19.2 TRLIRNR).

Activity

Provide an outline of the rules for dividing tax powers included in the Convention between Spain and Argentina currently in force. Depending on the type of income established in the Convention, you must indicate whether the option to tax is attributed to the state of residence, the source state or shared between both states and, as appropriate, the taxation limits contemplated for certain incomes in the source state (articles 6 to 21 of the aforementioned Convention).

When it comes to **deductions**, PEs may apply the following deductions and allowances[28] to their gross income under the same conditions as corporate tax taxpayers:

(28) Art. 19 TRLIRNR.

- Deduction for double taxation avoidance: national and international.
- Allowances: for income earned in Ceuta and Melilla, for exportation activities and providing local public services, and for earnings derived from the sale of tangible goods produced in the Canary Islands.
- Deductions to provide the incentive to undertake certain activities: for undertaking research and development and technological innovation activities; for promoting information and communication technologies; for investment in environmental protection; for investments in cultural interest goods, film productions, book publishings and environmental investments; for measures to support the transport sector; for vocational training expenses; for the creation of jobs for disabled workers; for investment and expenses in facilities for the first year of pre-school education; for employer payments to company pension schemes or mutual social insurance companies; for investments in the Canary Islands, and for donations to non-profit organisations.

Example

Company A, Ltd., with residence in Mongolia, has a permanent establishment in Seville. In 2011, the PE provided services to fit out the interior of a workshop, earning 500,000 euros. Among the expenses incurred, there were 20,000 euros on personnel,10,000 euros on materials, and 5,000 euros on electricity and telephone services. Installments paid during the year add up to 100,000 euros.

The Mongolian company is subject to an IRNR tax rate under the income obtained through a PE. As such, they should be taxed for receiving income for the economic activities undertaken by the permanent establishment: the 500,000 euros for providing services to fit out the interior of a workshop (art. 16.1.a TRLIRNR).

The IRNR taxable base will be the outcome of applying the regulations provided in the LIS, that is, it will be based on the accounting result, and the corresponding tax adjustments will be applied, using the variations contained in article 18 of the TRLIRNR for those cases. As such, the taxable base will be 465,000 euros (500,000 - 20,000 - 10,000 - 5,000).

We will have to apply the 30% tax rate to this taxable base in order to calculate the tax liability (art. 19.1 TRLIRNR): 465,000 × 30% = 139,500 euros

Lastly, the deduction for the installments paid for the permanent establishment during the year will need to be applied to the tax liability. As a result, the payable amount will be 39,500 euros (139,500 - 100,000).

Estimated expenses and imputed income relating to the internal operations of a permanent establishment

A provision is introduced that establishes the rules that must be taken into account for cases, which due to application of the provisions in an international double taxation agreement signed by Spain, and which for the purposes of determining the income of a permanent establishment located in Spanish territory, permit the deduction of estimated expenses and imputed income relating to internal operations with the parent company or with any of its permanent establishments located outside Spanish territory (sixth additional provision TRLIRNR):

- Art.18.1.a of the Income Tax on Non-Residents Act is not applicable, which establishes that in order to calculate the taxable base of the permanent establishment, payments made by the permanent establishment to the parent company or any of its permanent establishments in the form of royalties, interest, or commissions paid in return for technical support services, and for use or transfer of assets or rights are not deductible, and that interest paid for permanent establishments from foreign banks to their parent company or to other permanent establishments for undertaking their activity will be deductible.

- Income imputed to the parent company without the involvement of a permanent establishment, or imputed to any of the permanent establishments that correspond to the estimated expenses located outside the Spanish territory, is considered to be income obtained on Spanish territory.

- The tax corresponding to the imputed income will be accrued on 31 December each year.

- Permanent establishment located in Spanish territory have the obligation to withhold and prepay on account on imputed income.

- The related transactions regime (art. 18 LIS) applies to the internal transactions undertaken by a permanent establishment located in Spanish territory with its parent company or any of its permanent establishments located outside Spanish territory.

The **tax period** coincides with the economic year that is being declared, and cannot exceed twelve months. The tax is accrued on the final day of the tax period[29].

(29)Art. 20 TRLIRNR.

PEs are subject to the same **withholding** regime as entities subject to IS for the incomes they obtain. Similarly, PEs are obliged to pay **installments** on account of the tax under the same terms as entities subject to IS (they must be paid within the first twenty calendar days of the months of April, October, and December). As a result, PEs can deduct the advanced payments from their final tax[30].

(30)Art. 23 TRLIRNR.

PEs must submit the tax **return** using the same forms and within the same deadlines as resident entities subject to the Corporate Tax[31]. That is, they will have to submit the return within the twenty five calendar days six months after the end of the tax period.

(31)Art. 21 TRLIRNR.

Lastly, it is worth highlighting[32] that the PEs must fulfil a series of **formal, registry, and accounting obligations**:

(32)Art. 22 TRLIRNR.

- They should keep separate accounts for the operations they undertake and the assets connected to their activity.

- In addition, they must comply with the remaining formal, registry, and accounting obligations demanded to resident entities.

- As has just been indicated, they are obliged to make advanced payments withholdings, just like resident entities.

Lastly, it is worth **summarising non-resident taxation with a permanent establishment**:

- Non-residents operating in Spain through permanent establishments will be subject to taxation in Spain for all the incomes they earn, independently of the location in which they are earned.

- As a general rule, the taxable base will be determined in accordance with general corporate tax rules, but there are some special cases.

- The general tax rate is 30% (on income from permanent establishments transferred abroad, a complementary taxation of 19% is applied - 21% from 1 January 2012 to 31 December 2013).

- Deductions are applied to the total tax liability (double taxation, allowances, deductions to encourage certain activities provided in Corporate Tax Law, account deposits, etc.).

- The tax is managed in a very similar way to Corporate Tax.

4. Income obtained without a permanent establishment

When the non-resident entity operates **without a PE**, the IRNR is no longer calculated with respect to the general tax regulations applicable to residents, given that the incomes earned are difficult to monitor, a situation that is accentuated when it comes to calculating expenses, given that they occur outside the territory of the country in which the income is generated.

In this context, income earned by **non-residents without a PE**, whether natural persons or legal entities, must be taxed separately for each full or partial accrual of income subject to taxation, applying a tax rate on the entire amount earned by the non-resident.

As such, this is income with instant accrual that should be taxed on an **operation by operation** basis, in such a way that as many tax declarations as income accruals are made (although collective declarations can be presented where applicable).

As a result, firstly, neither the tax period or the taxable base can be calculated beforehand, and secondly, compensation between the different incomes is not possible (capital gains and losses). Furthermore, in order to calculate the taxable base, the tax rate and the accrual, there are a set of rules that differ based on the type of income obtained.

Incomes subject to taxation are both monetary and in kind. The scenarios of incomes presumed for taxation provided in article 12 of the TRLIRNR are applicable, as well as the negative definition when it comes to the tax on inheritance and gifts. With regard to separating the incomes, the criteria contained in article 11 of the LIRPF are applicable to non-resident natural persons.

In order to calculate the **taxable base**, the rules of the IRPF apply for income and capital gains, while specific IRPF rules apply in the cases of income derived from the provision of services, technical support, installation or assembly work, or general economic activities and reinsurance transactions. In general, the taxable base will comprise the total amount accrued, that is, without any expense deductions, calculated in accordance with the IRPF rules[33].

(33) Art. 24 TRLIRNR.

Particularities when calculating the taxable base

The regulation contains certain rules for calculating the taxable base of non-resident taxpayers without a permanent establishment, differentiating between physical persons and legal entities.

In the case of income derived from the provision of services, technical support, installation or assembly work from engineering contracts, and general economic activities in Spain, expenses for personnel (wages and social expenses from personnel relocated to Spanish territory or contracted in Spain) and for material supplies are deductible.

In the case of income derived from reinsurance transactions, the taxable base is calculated from the amounts of the outgoing reinsurance premiums to the non-resident reinsurer.

When it involves capital gains, the taxable base consists of the difference between the transfer value of the corresponding element and its acquisition value for each variation in capital, unless they are donations by non-resident entities, in which case the taxable base is the normal market value of the element as purchased.

And in the specific case of capital gains referred to in article 13.1.i.3.° of the TRLIRNR (derived either directly or indirectly from real estate located in Spanish territory or rights pertaining to it), proceeding from the transfer of rights or stocks in entities resident in countries or territories with which no effective information exchange exists, the transfer value is determined on a pro rata basis to the market value (at the time of the transfer) for the properties located in Spain or for the rights of use over said properties. The aforementioned properties are connected to the tax payment.

For scenarios of capital gains obtained by non-residents through a change of residence or a transfer of shares or stocks that were taxed under IRPF (art. 95.bis LIRPF: "exit tax"), from 2015 onwards, the capital gain corresponding to the transfer is calculated using the market value as purchase price of the shares or stocks that would have to be taken into account to calculate the capital gains in IRPF.

Lastly, scenarios of income attributable to real estate located on Spanish territory involving non-resident natural persons are calculated in accordance with IRPF rules.

Particularities for taxpayers resident in another EU Member State

Natural person taxpayers can deduct the expenses included in LIRPF, and legal entities can deduct the expenses included in LIS, when they confirm they are directly related to income obtained in Spain and when they have a direct economic and inextricable link with the activity undertaken in Spain.

In the case of capital gains, the taxable base is determined by applying the rules contained in section IV of chapter II of title III and in section VI of title X of the LIRPF for each capital variation, except article 94.1.a, second paragraph.

These particularities also apply to resident taxpayers in a European Economic Area Member State with which an effective exchange of tax information exists.

When it comes to the applicable **tax rates**, the general tax rate is 24%. However, a 19% rate is introduced (20% for 2015) for residents in other European Union states or European Economic Area states with which an effective exchange of tax[34] information exists.

(34) Art. 25.1 TRLIRNR

Previous taxation rates

For the period 1 January 2012 up to 31 December 2014, the general rate changed to 24.75% (third additional provision TRLIRNR).

This general rate applies to:

- economic activities income, except incomes taxed under special rates, such as the case of those derived from reinsurance transactions and maritime navigation entities;
- work income, apart from those to which special rates are applied;

- royalties, except when they must be taxed at 10%;
- real estate income;
- capital gains, except those taxed at the 19% rate,
- and income from movable capital, apart from dividends and interest that are taxed at 19%.

However, there are also certain reduced rates for certain types of income:

a) Dividends and other benefits derived from shares in an entity's equity, 19%. However, between 1 January 2012 and 31 December 2014, the rate rose to 21%; it is 20% in 2015.

Recommended reading

M. S. Bokobo Moiche (2004). *Los cánones en el régimen tributario de los no residentes sin establecimiento permanente*. Madrid: Instituto de Estudios Fiscales.

b) Interest and other income from the transfer of own capital to third parties, 19%. However, between 1 January 2012 and 31 December 2014, the rate rose to 21%; and it is 20% in 2015.

c) Allowances and retirement pensions for non-resident natural persons, which are taxed in accordance with a scale (which goes from 8% to 40%).

d) Income from work by non-resident natural persons on Spanish territory, as long as they are not IRPF taxpayers, which provide services on Spanish diplomatic missions and consular representations abroad, when specific rules from international treaties do not apply, 8%.

e) Income from work earned by non-resident natural persons in Spain by virtue of a contract with a specific duration for temporary workers, 2%.

f) Income derived from reinsurance transactions, 1.5%.

g) Maritime or air navigation entities abroad whose boats or aircraft enter Spanish territory, 4%.

h) Capital gains declared due to the transfer of assets, 19%. However, between 1 January 2012 and 31 December 2014, the rate rose to 21%; and it is 20% in 2015. The income is calculated by the difference between the purchase and transfer values. It also has to be taken into account that the purchase value is updated by applying certain coefficients.

Meanwhile, article 25.3 of the TRLIRNR contains certain provisions on **connections to tax payment**. In effect, for the capital gains cases referred to in article 13.1.i.3.º of the TRLIRNR (derived either directly or indirectly from real estate located in Spanish territory or rights pertaining to it), proceeding from the transfer of rights or stocks in entities resident in countries or territories with which no effective information exchange exists, properties located in

Spanish territory will be connected to the payment of IRNR. All the same, if the owner of said real estate was an entity with tax residence in Spain, the rights or holdings in said entity that directly or indirectly correspond to the taxpayer would be connected to the tax payment.

The **tax payable** is obtained by applying the previously indicated general tax rate or the special rates on the taxable base, regulated in article 25 of the TR-LIRNR.

The applicable **deductions** on the tax payable are only the following[35]:

(35)Art. 26 TRLIRNR.

1) The deductions for donations included in article 68.3 of the LIRPF:

- Deductions included in Law 49/2002, of 23 December, of the tax regime for non-profit entities and tax incentives for patronage. The deduction amounts to 25% of the donated amount.

- 10% of the amounts donated both to legally recognised foundations that are accountable to the corresponding protectorate body, as well as associations declared to be of public interest.

2) Pre-payments (withholdings) that have been undertaken on the taxpayer's income.

Given that it involves instantly **accrued** income, there is not a taxable period as a time element to calculate the income earned during that period, in contrast to what occurs with incomes earned through a PE (art. 20 IRNR). As such, the taxpayer remains subject to taxation as income earned (for income subject to the tax and unconnected to a PE in Spanish territory[36]).

(36)Art. 27 TRLIRNR.

Specifically, depending on the income type, the accrual of tax in this scenario occurs at the following times:

- In the case of incomes, when they are claimable or the payment date if earlier.

- In the case of capital gains, when there is a variation in the capital.

- In the case of income attributable to urban real estate, on 31 December each year.

- When the corresponding incomes are claimable for the remaining cases; and as such, the accrual occurs without waiting for payment.

- In the case of incomes included in article 12.2 of the TRLIRNR, when they are claimable, or failing that, on 31 December each year.

- In the event of the taxpayer's death, all income pending payment will be said to be claimable on the date they died.

Taxpayers that operate in Spain without a PE are obliged to **withhold** on incomes that they pay, as well as other incomes subject to withholding that constitute a deductible expense for income derived from providing services, technical support, installation or assembly work from engineering contracts, and in general, economic operations[37] or activities.

(37)Art. 30 TRLIRNR.

There is no obligation to submit the corresponding **return** for the incomes earned with respect to those withheld, except in the case of capital gains derived from the reimbursement of investment fund stocks from collective investment institutions, when the amount withheld is less than the tax payable. This also applies in the case of incomes subject to withholding but exempt from complying with the previsions of the TRLIRNR or conventions to avoid double taxation[38].

(38)Arts. 28 TRLIRNR and 7 RIRNR.

Maintenance of the obligation to declare

All the same, there is still the obligation to declare in the following cases:

- Incomes subject to the IRNR but exempted from the obligation to withhold or pay account deposits, as is the case with capital gains derived from the sale of shares.
- Income attributable to urban real estate, in the case of natural persons.
- Incomes paid by persons without withholder status. This is the case of earnings derived from the leasing of real estate if the tenant is a natural person and pays the income independently of an economic activity.
- Capital gains obtained from transferring real estate.
- If you want to request a refund for an excessive withholding or account deposits in relation to the tax payable.

This tax declaration works for any income type (but only one income) obtained by a non-resident without a PE, unless it involves capital gains from real estate, which are declared in a specific model within three months of the final deadline for the person that purchased the property to pay the withheld amount (which in turn, is one month after the transfer date).

From 2015 onwards, there will be the option for the tax authority to provide the taxpayer with a **draft return** on request, for informative purposes only. Only taxpayers obtaining income attributed to real estate will be able to request it, for each real estate source. Similarly, it is specified that a lack of availability on the taxpayer's part will not exonerate them from their obligation to submit the tax return.

The deadline for presentation of declarations

In general, for declarations requiring payment or a zero result, the tax declaration submission deadline is one month from the date the declared income is accrued (except in the case of income attributed to real estate, which must be declared in the period between 1 January and 30 June following the accrual date).

When the returns involve a refund, they can be presented from the end of the period for returns and payment of withheld amounts that has produced the refund, and up to four years afterwards, although different deadlines may be established in the case of requests for refund derived from the application of a double taxation avoidance agreement.

A collective return does exist, which allows for several incomes generated by one or several taxpayers during the same three month period to be grouped on the same declaration. However, the aforementioned return does not apply for incomes with taxable bases determined by the difference between total income and certain expenses, or when it involves income attributed to urban real estate.

In the event the collective return contains incomes from different taxpayers, the presenter must have the status of common representative, being jointly responsible for all their tax debts (payer, depository, or manager), or sole withholder (in the scenario of leasing premises to business owners or professionals).

The deadline for presenting this collective declaration if payment is required or the result is zero is the first twenty calendar days of the months of April, July, October, and January, and if it involves a refund, the deadline is the same as for non-collective declarations.

The following taxpayers[39] are obliged to fulfil certain **formal obligations**:

(39)Art. 29 TRLIRNR.

- When income is obtained from providing services, technical support, installation or assembly work from engineering contracts, and in general, from economic operations or activities in Spain without a PE, they are obliged to keep a record of income and expenses.

- When they should withhold, they must present the tax register return and bring the income and expenses records.

A summary of non-resident taxation without a permanent establishment

It is an instant tax that applies to each accrual of income.

The taxable base, tax rate, and the accrual vary based on the income type (the general rule is that the taxable base is determined in accordance with IRPF guidelines and the tax rate is 24%).

Only certain donations and account payments can be deducted from the tax payable.

Managing the tax is mainly undertaken by the representative or guarantor (the non-resident must submit a self-assessment within a month of the accrual of the income and they are obliged to withhold certain incomes they pay, but they do not have to fulfil accounting obligations).

To conclude the analysis of this issue, it is worth stopping to examine the taxation of **the most common scenarios** for income obtained without a PE:

1) Work income

Income earned from work undertaken in Spain by non-residents is subject to taxation on the gross amount at a tax rate of 24%.

When it comes to calculating the concept of *gross income from work*, the provisions of article 17 of the LIRPF need to be examined (apart from section 4, relating to contributions made to the protected assets of disabled persons, regulated in Law 41/2003, of 18 November, of disabled persons asset protection, given that, firstly, said law is only applicable to residents in Spanish territory, and secondly, because in accordance with article 13.1.c of the TRLIRNR, donations received by disabled persons are not considered income from work obtained on Spanish territory). In addition, special assessment rules apply in the cases of estimating income and connected transactions, regulated in articles 40 and 41 of the LIRPF respectively.

Lastly, it must be taken into account that the reductions based on the period in which gross income is generated, as established in article 18 of the LIRPF, within the provisions of article 24.1 of the TRLIRNR, are not applicable. Similarly, deductible expenses regulated in article 19 of the LIRPF do not apply either. As a result, the non-resident must calculate their income from work based on the gross amount without considering the generation period or the expenses generated to obtain the income.

Recommended reading

F. Serrano Antón (dir.) (2005). *Fiscalidad internacional*. Madrid: Centro de Estudios Financieros.

Special scenarios for work income

The rate is 2% when said incomes are earned by non-resident persons in Spain through a fixed duration contract for temporary workers, and 8% when earned by non-resident natural persons in Spanish territory; specific regulations from international treaties do not apply when they are not IRPF taxpayers who provide services in Spanish diplomatic missions and consular representations abroad.

Conversely, income from work paid by business owners and entities resident in Spanish territory to non-resident taxpayers for work done outside Spain is not taxed in Spain, as long as the work is carried out abroad in its entirety and the income is subject to a personal type tax abroad.

Example

Mr. González is a Spanish national, but he has lived in Libya since 1990. He travels to Spain in 2015, hired by a Spanish company to do a job lasting one month, for which he earns 15,000 euros.

The taxable base for the income received from Mr. González's work is comprised of the gross amount earned, which is 15,000 euros (art. 24.1 TRLIRNR). The corresponding tax rate is 24% (art. 25.1.a TRLIRNR), meaning he must pay an amount of 3,600 euros (15,000 × 24%).

2) Economic activies income

In the case of income from economic activities (including providing services, technical support, installation or assembly works, liberal professions, artistic or sporting activities, etc.) undertaken in Spain by non-residents without a PE, the taxable base[40] is determined by the difference between gross income and expenses on personnel and material procurement for works and supplies, under the terms of article 5 of RIRNR. The general tax rate of 24% applies.

(40) Art. 24.2 TRLIRNR.

Some considerations about deductible expenses

Expenses on personnel include wages, salaries, and the social contributions of personnel relocated to Spain or hired in Spanish territory, directly employed to undertake economic operations or activities, as long as the payment of the corresponding tax or withholding taxes relating to the incomes for work paid are duly justified. Therefore, for such expenses to be deducted[41], the work must have been performed on Spanish territory and there must be compliance with the tax obligations derived from the income from the work.

(41)Art. 5 RIRNR.

To deduct expenses for the procurement of materials, they must be used definitively in the works undertaken in Spain and justified by an invoice or equivalent document.

Supply expenses can be deducted when they are consumed in Spain to undertake the economic activities or exploitations and are justified by an invoice or equivalent document. Only supplies that cannot be stored are considered, as is the case with water, gas, electricity, and fuel.

3) Income derived from real estate

Income derived from real estate is subject to IRNR. However, its taxation varies based on its use (whether or not they are leased) and the status of the owner (natural person or legal entity).

Article 22 of the LIRPF must be examined to determine the concept of *earnings from real estate*, and when it comes to imputing real estate income, the provisions of article 85 of the LIRPF must be followed. These guidelines state that income is not attributable to a main residence, and this is also the case for rural properties.

Observation

Logically, given that non-residents do not have their main residence on Spanish territory, they must always be taxed under IRNR when they have non-leased real estate in Spain.

In the case of non-leased urban real estate, natural person non-resident taxpayers who own urban real estate for their own use and let it freely or leave it empty are subject to the IRNR. For those purposes, the income is calculated as 2% of the cadastral value of the property (1.1% if the cadastral value has been reassessed) and the 24% tax rate is applicable (24.75% from 1 January 2012 to 31 December 2013). This tax is accrued once a year on 31 December.

If the natural person did not own the property for the entire year or it was only leased for part of the year, just the proportional part has to be declared.

Special assessment rules

There are three scenarios in which special assessment rules are applied when it comes to real estate incomes from non-leased properties when owned by a natural person:

- When the real estate's cadastral value has varied or been reassessed, the attributed income will be 1.1% of the cadastral value, in accordance with the procedures regulated in articles 69 and 70 of the Consolidated text of the Regulation of Local Finance Act, which came into force from 1 January 1994, as previously indicated.

- In cases where the urban property does not have a cadastral value or the owner has not been informed of it by the date of the accrued tax, 50% of the value is to be used when calculating the tax on the asset (in accordance with the criteria provided in article 10 of the LIRPF). The applicable percentage will be 1.1%.

- Lastly, no income is estimated for real estate under construction or those not enabled for urban use.

Example

In 2015, Mr. Antúnez, resident in Paraguay, a country with which Spain has not entered into a double taxation avoidance agreement, owns an apartment located in La Manga del Mar Menor, where he spends his holidays during August. The non-reassessed cadastral value assigned to the aforementioned property is 30,000 euros

Given that the property is not leased, the income is considered as 2% of the cadastral value of the apartment. Consequently, the income will be 600 euros (30,000 x 2%). A tax rate of 24% must be applied to that amount, so the payable tax will be 144 euros (600 × 24%).

For entities owning real estate in Spain that is not being leased, it is taxable under a special regime for non-resident real estate, which will be analysed later. The taxable base is calculated from the cadastral value of the property, and a 3% tax rate applies.

For leased or subleased properties, independently of whether ownership corresponds to a natural person or a legal entity, the income is calculated as the gross amount received from the tenant for all concepts, including where applicable, the amount corresponding to all goods transferred with the property and exempted from VAT, or in the case of the Canary Islands general indirect tax, with no possibility for deducting any expenses. The general tax rate of 24% also applies.

Taxation of non-residents on income generated from leased or subleased real estate

When the real estate is leased for just a part of the year, the income must be calculated for the number of months of the lease, and the proportional part for the remaining months is to be calculated at 1.1% or 2% of the cadastral value.

When properties are leased, and at least one premises in Spain is used to manage that activity, requiring a contracted employee, the activity being undertaken can be understood to be a business and undertaken through a PE, and as such, must be taxed in accordance with the regulations provided for income obtained through a PE.

Example

In 2015, Mr. Antúnez, resident in Paraguay. A country with which Spain has not entered into a double taxation avoidance agreement, owns an apartment located in La Manga del Mar Menor, which has an non-reassessed cadastral value of 30,000 euros. Given that he does not use it, he decides to lease it to a couple from Madrid for 700 euros a month. The communal owner expenses total 25 euros a month, and the property tax is 400 euros.

Given that the property is leased, the IRNR taxable base is comprised of the gross income. Taxation occurs separately for each accrual. As such, the taxable base is 700 euros. No expenses, such as the communal owner expenses or the property tax, can be deducted.

The applicable tax rate is 24%, meaning that the amount payable for each accrual will be 168 euros (700 x 24%).

If Mr. Antúnez passed on the communal costs to the tenants, 25 euros in this case, they will form part of the taxable base of the tax, so the taxable base would be 725 euros and the amount would rise to 174 euros (725 x 24%).

4) Income derived from dividends or interest

Dividends and interest are considered income from movable capital, in accordance with the provisions of article 21 of the LIRPF.

Dividends or interest obtained by a non-resident in Spain, paid by a public or private person or entity resident in Spanish territory is subject to taxation in Spain under the IRNR.

If there is a convention, that income will be taxed at a lower rate than the general rate, and in the case of interest, residents of a EU country are exempt as long as they are not obtained through a tax haven.

Similarly, interest derived from public debt is exempt (unless it is obtained from territories classified as tax havens), as is income from non-residents' accounts.

The taxable base is comprised of the gross amount of said dividends or interest, and the applicable tax rate is 19%, with the exception of residents in a country with a convention, for whom the applicable rate will be established in the convention itself (and which is less than 19% in general).

Example

Mr. Rupérez, resident in Cameroon, a country with which Spain has not entered into a double taxation avoidance agreement, earns 2,000 euros in dividends from shares he owns in Spain.

In this scenario, the taxable base is comprised of the gross amount earned, the 2,000 euros (art. 24.1 TRLIRNR). The appropriate tax rate to apply is 19% (art. 25.1.g.1st TRLIRNR). Consequently, the resulting tax amount is 380 euros (2,000 x 19%).

5) Pensions

Pensions paid by a resident in Spain to a resident abroad are subject to taxation on the gross amount. The following taxation scale is applied to the amount:

Annual pension amount Up to (euros)	Charge (euros)	Remaining pension Up to (euros)	Applicable rate Percentage
0.00	0.00	12,000	8%
12,000	960	6,700	30%
18,700	2,970	Upwards	40%

The person or entity paying the pension must withhold the amount equivalent to the taxpayer's tax.

Example

Mrs. Peláez resides in Sudan and receives a permanent work disability pension from the Social Security of 1,800 euros a month, which she receives as twelve payments a year.

The annual total of the pension must be calculated in order to apply the scale. As such, the monthly amount (1,800 euros) is multiplied by the number of payments a year (12), giving a result of 21,600 euros a year. In accordance with the scale, a charge of 2,970 euros applies up to 12,000 euros. 40% is applied to everything else, that is, (21,600 - 18,700) x 40 % = 1,160. As such, the resulting charge is 2,970 + 1,160 = 4,130 euros.

The average tax rate is obtained as follows: (4,130 / 21,600) × 100 = 19.12%. This percentage when applied on the monthly payment (1,800 euros) gives a total of 344.16 euros, which is the amount Mrs. Peláez must pay for the monthly pension.

6) Capital gains derived from real estate sales

Capital gains derived from the sale of a real estate asset are subject to taxation by the IRNR. In general, the taxable base is comprised of the income calculated from the difference between the transfer and purchase values, and 19% is the applicable rate.

Calculating capital gains derived from real estate sales

The **purchase value** is comprised of the real acquisition amount, the cost of the investments and improvements made to the purchased properties, and the amount of expenses and taxes involved with the purchase (excluding interest). The result is reduced by the amount of the depreciation.

Up to 2014, this value was adjusted through the application of a series of adjustment coefficients based on the year the property was purchased, which allowed the earnings to be adjusted for inflation and updated yearly through the Finance Law. Those coefficients only applied with the transfer of real estate.

The **transfer value** is comprised of the actual transfer value, subtracting the amount of the expenses and tax inherent to the transfer if they are paid by the transferring party. For these purposes, the actual transfer value is considered to have been effectively paid, as long as the result is not below market value, in which case this would apply.

In addition, income obtained in that way is reduced by the application of **updating coefficients** to the capital gains generated from the transfer of assets acquired before 1 January 1994 and unconnected with economic activities (as such, it applies to any capital gains and not only those generated by the transfer of real estate properties). From 2015 onwards, a quantitative limit for this reduction for all the gains is established at 400,000 euros of the transfer value (9th TP, LIRPF), which means that the updating coefficients can only be applied when the property sales price stays under 400,000 euros.

Independently of whether they are a resident, the person purchasing the property is obliged to **withhold and pay** 3% of the agreed remuneration to the public treasury, in accordance with article 25.2 of the TRLIRNR. This withheld amount is on account deposit of the final tax for the seller that corresponds to the income derived from the transfer.

In the case of capital losses or that the withheld amount is higher than the payable tax, there is the right to a refund for the extra amount withheld. Lastly, it has to be considered that if the transferred property is jointly owned by a married couple in which both partners are non-residents, a single return can be presented.

Example

Mr. Pérez has his tax residence in Indonesia. He sells a flat located in Cáceres in 2008 for 340,000 euros. The purchase value of the aforementioned property in 1997 was 240,000 euros, and the non-reassessed cadastral value in 2008 was 120,000 euros. The municipal tax paid by Mr. Pérez for the capital gains obtained came to 500 euros.

He received 340,000 euros from the sale of the flat located in Cáceres. The purchase value of the aforementioned property in 1997 was 240,000 euros (and he paid 16,800 in VAT when making the purchase), and the non-reassessed cadastral value in 2008 was 120,000 euros. The municipal tax paid by Mr. Pérez for the capital gains obtained came to 500 euros.

The capital gains he obtained from the sale of the flat is calculated by subtracting the purchase value from the transfer value (art. 24.4 TRLIRNR, which refers to art. 35.2 LIRPF). The transfer value is calculated by subtracting the expenses incurred by Mr. Pérez from the sales amount, in this case, the municipal tax. As such, the transfer value is 339,500 euros (340,000 - 500). The purchase value is obtained by adding the expenses paid by Mr. Pérez to the purchase amount. As such, the purchase value of the flat is 256,800 euros (240,000 + 16,800). The aforementioned value needs to be adjusted by applying the corresponding percentage from the year of purchase (1997), established by article 64 of Law 51/2007, of 26 December, from the 2008 government budget. As such, the result is 318,560.40 euros (256,800 x 1.2405). As a result, the amount of capital gain is 20,939.60 euros (339,500 - 318,560.40).

The applicable tax rate in 2008 was 18% (art. 25.1.f TRLIRNR). As such, the amount of tax payable is 3,769.13 euros.

It must also be considered that the flat purchaser would have initially withheld 3% of the sale value (340,000 euros), totalling 10,200 euros, so Mr. Pérez has the right to receive a refund for the excess from the Spanish tax authority, which is 6,430.87 euros (10,200 – 3,769.13).

Mrs. Menéndez has her tax residence in Cameroon. In 2015 she sells a flat located in Salamanca for 200,000 euros. The purchase value of the aforementioned property in 2000 was 150,000 euros, and the non-reassessed cadastral value in 2015 was 100,000 euros. The municipal tax paid by Mrs. Menéndez for the capital gains obtained came to 300 euros.

She received 200,000 euros from the sale of the flat located in Salamanca. The purchase value of the aforementioned property in 2000 was 150,000 euros (paying 15,000 euros in VAT when making the purchase, given that the residence is not under official protection and is taxed at 10%), and its non-reassessed cadastral value in 2015 was 100,000 euros. The municipal tax paid by Mrs. Menéndez for the capital gains obtained came to 300 euros.

The capital gains she obtained from the sale of the flat is calculated by subtracting the purchase value from the transfer value (art. 24.4 TRLIRNR, which refers to art. 35.2 LIRPF). The transfer value is calculated by subtracting the expenses incurred by Mrs. Menéndez – in this case the municipal tax – from the sales amount. As such, the transfer value is 199,700 euros (200,000 - 300). The purchase value is obtained by adding the expenses paid by Mrs. Menéndez to the purchase amount. As such, the purchase value of the flat is 165,000 euros (150,000 + 15,000). As a result, the amount of capital gain is 34,700 euros (199,700 - 165,000).

The applicable tax rate is 19%, in accordance with the provisions in art. 25.1.f) TRLIRNR, although it is 20% in 2015. As such, the amount of tax payable is 6,940 euros.

It must also be considered that the flat purchaser would have initially withheld 3% of the sale value (200,000 euros), which comes to 6,000 euros, in accordance with the provisions in art. 25.2 TRLIRNR. As such, Mrs. Menéndez must pay the difference to the tax authority, which is 940 euros (6,940 – 6,000).

5. The optional regime for EU residents

Natural person IRNR taxpayers are allowed to opt for taxation under IRPF, as long as they confirm their residence in another EU Member State that is not rated as a tax haven and comply with other requisites. Similarly, this regime applies to resident taxpayers in a European Economic Area Member State with an effective exchange of tax information[42].

(42)Art. 46 TRLIRNR and arts. 21 to 24 RIRNR, in compliance with the provisions of the European Union Commission Recommendation of 21 December 1993.

This is an optional regime for EU residents that earn a sizeable volume of their income in Spain, meaning those taxpayers can file an application with the Tax Authority. The **aim** of this regime is for the taxation of non-residents in Spain that earn most of their income in Spanish territory to be calculated based on IRPF regulations (which include a minimum subsistence amount and a series of personal deductions), but without losing their status as IRNR taxpayers.

The reason for this regime is found in EU regulations, and the interpretation of the Court of Justice of the European Union on the principle of non-discrimination (art. 12 of the European Economic Community Treaty), based on the Schumacker case (Judgement of 14 February 1995), to avoid possible tax discrimination due to non-residence.

Interpretation of the Court of Justice of the European Union

In accordance with the doctrine of the Court of Justice of the European Union, under certain circumstances it is considered against the principle of non-discrimination to not attend to the personal and family circumstances of the non-resident, thereby not applying the same tax benefits applied to national residents, as it leads to higher taxation than paid by a resident.

In particular, one of the following two **circumstances** need to occur for this regime to apply:

- That, at least 75% of all their income in the tax period is comprised of the total of income from work and economic activities obtained during the tax period on Spanish territory, when these incomes have been effectively taxed under the IRNR (the IRNR is paid first, and then the option is applied).
- That the income obtained in Spanish territory during the period was less than 90% of the personal and family minimum that they would have received in accordance with their personal and family situation as residents in Spain, as long as the income was effectively taxed during the period under the IRNR, and that the income obtained outside of Spain was, similarly, less than the aforementioned minimum.

Recommended reading

Among others, you can look at the judgements of the European Union Court of Justice of 14 February 1995, 11 August 1995, and 12 June 2003.

The **procedure** for applying this regime starts by formulating the corresponding request and confirming compliance with the conditions defining its application. In the absence of a specific period to present the aforementioned application, the applicable to formulate it is that of the statute of limitations (four years).

The tax authority may accept or reject the application depending on the data and history. If they accept it, they will take all the income obtained by the taxpayer during the tax period and their personal and family situation into account, and calculate the corresponding average tax rate in accordance with the IRPF regulation.

The **taxable income** will be comprised of all the income earned in Spain by the taxpayer who subscribes to the optional regime regulated in this article, and these incomes will be used to calculate the net amounts.

The applicable **tax rate**, expressed with two decimals, is the average rate after applying personal income tax regulations to the total amount of income obtained by the taxpayer during the period, independently of the location where they were produced and wherever the payer resides, taking the appropriately confirmed personal and family circumstances into account.

The resulting average tax rate will be applied on the part of the taxable base corresponding to the incomes obtained on Spanish territory and calculated in accordance with IRPF regulations to obtain the **payable tax**. If the aforementioned amount is less than the amounts already paid during the tax period under IRNR on income obtained in Spanish territory, the tax authority will rebate the excess.

Taxpayers forming part of one of the family units established in article 82.1 of the LIRPF can request that the optional regime regulated in this article be applied to them, taking the regulations on joint taxation into account.

Lastly, it should be considered that despite the application of this optional regime, the taxpayer keeps their status as a non-resident in Spanish territory, as previously mentioned. Therefore, the territoriality criterion and the subjection to the source country are fully implemented. As mentioned before, this means exercising the option of taxation under IRPF is a requisite that legitimises the instigation of the refund procedure for the excess, where applicable.

6. The optional regime for relocated workers or tax regime for inbound expatriates

In addition, it should be mentioned that some countries delay acquisition of resident status or limit the taxation of new residents. In this way, during the first years of their stay in the new country, they are only taxed on domestically sourced income and at times, at reduced rates, as if they were non-residents. This is to try to attract directors and top level professionals to the territory (particularly football and basketball players)) and is a tax regime for inbound migrants.

In this context, it is worth noting Spain's **optional regime** for natural persons who become a tax resident in Spain as a result of their **relocation due to a work contract**. In effect, natural persons who become a tax resident in Spain as a consequence of their relocation due to a work contract have the option to be taxed by Spanish IRPF or by IRNR during the tax period when the change of residence occurs and for the following five tax periods.

The Beckham clause or Law

This is a regulation for the so-called Beckham clause or Law, which was modified for the final 13th provision of Law 26/2009, of 23 December, of the Finance Bill for 2010.

Regulatory changes

Art. 93 LIRPF was the objective of a significant reform through Law 26/2014, of 27 November; meaning that, from 2015 onwards, both the subjective and objective definition of this regime and its contents have been changed.

Prior to the aforementioned reform, the following requisites had to be fulfilled:

- That they had not been residents in Spain for the ten tax years prior to this new relocation to Spanish territory.
- That the relocation had occurred as a result of a work contract.
- That the work would be carried out in Spain.
- That the work would be undertaken for a company or entity resident in Spain or for a PE located in Spain of a non-resident entity in Spanish territory.
- That the income from the work generated from the working relationship would not be exempt from taxation under IRNR.
- And, lastly, that the expected remuneration derived from the work contract in each tax period would not exceed 600,000 euros a year (taxpayers that relocated to Spanish territory prior to 1 January 2010 can apply for this regime without having to fulfil this requisite). If they do exceed 600,000 euros, they are taxed under the general IRPF regime. This requisite was a bone of contention among football clubs in particular, which usually pay football players' taxes.

The **requisites** to apply this special regime are as follows[43]:

(43)Art. 93.1 LIRPF.

- That they have not been residents in Spain for the ten tax years prior to this new relocation to Spanish territory.

- That the relocation occurs as a result of a work contract (it does not therefore apply for self employed immigrants). However, professional sportspersons are excluded from its scope of application, without prejudice to the possibility contemplated in the 17th TP LIRPF of applying the regime to those who relocated prior to 1 January 2015.

- That the relocation occurs as a result of the acquisition of status of administrator of an entity in which they have not invested capital, or otherwise, when the stake in the entity does not determine the consideration of a tax related entity in the terms provided in article 18 LIS (a stake below 25%).

- That they do not obtain income that could be qualified as obtained through a permanent establishment located in Spanish territory.

The ten year period

The ten year period requisite is a measure that can discriminate against Spanish nationals (given that they are usually likely to encounter more difficulties in calculating a residence outside of Spain for over ten years) and it is a disproportionate period in accordance with the current economic globalisation conditions.

Example

Mr. Smith's main residence is in the United States of America, where he works for an American company. Mr. Smith worked in the Spanish subsidiary of the aforementioned company from January to August 2009. Mr. Smith worked again in the aforementioned Spanish subsidiary in 2011 from February to September, earning a total of 71,000 euros.

In accordance with the provisions of art. 93 LIRPF, those becoming a Spanish tax resident as a consequence of their relocation for work to Spanish territory can opt to be taxed either under the Spanish IRPF or the IRNR, during the period when changing residence and for the following five years, fulfilling certain requisites.

Therefore, given that Mr. Smith has again remained in Spanish territory for more than 183 days in a calendar year, he is subject to Spanish IRPF (again assuming he has remained in Spanish territory throughout the period he has worked for the Spanish subsidiary), but, in principle, he could opt to be taxed under the IRNR, with proportional rather than progressive tax rates. However, given that one of the requisites provided in art. 93 LIRPF for exercising said option consists in not having been resident in Spain during the previous ten tax periods, Mr. Smith will have to be subject to Spanish IRPF.

The **taxable base** is calculated in accordance with the IRNR regulations for income obtained without a permanent establishment, with certain particularities:

- The exemptions in the IRNR regulation cannot be applied (other than the regulations on taxpayers, residence, income separation, guarantors, representatives, and domicile).

- Income earned from work by the taxpayer is understood, in any case, to be obtained on Spanish territory.

- The incomes obtained throughout the year are taxed as accrued without any possible compensation between any of them.

When it comes to **tax rates**, incomes classified as savings (dividends and other income derived from stakes in an entity's equity, interest and other incomes obtained by the transfer of equity to third parties, and capital gains declared through asset transfers) are separated from other incomes.

Savings income is taxed on the same scale planned for this income type in the IRPF, whilst other incomes will be subject to taxation in accordance with the following scale:

Taxable base	2015 rate	2016 rate
Up to 600,000 euros	24%	24%
600,000 euros and over	47%	45%

Taxpayers that opt for this regime are not considered residents for the purposes of applying a double taxation convention, given that they are subject to taxation only on the income obtained from sources in Spanish territory. In effect, in accordance with the provisions in art. 120 RIRPF, those who have opted for this regime can obtain a tax residence certification, but not tax residence for the purpose of the agreement, unless the tax minister states the opposite in exchange for reciprocity.

The procedure to exercise the option

In particular, the established procedure to exercise this option is found regulated in the RIRPF (arts. 113 to 120 RIRPF). In accordance with this regulation, exercising this option, which must be undertaken using a communication addressed to the tax authority within six months of the start of the activity, means that the subject maintains the status of IRPF taxpayer, and that the calculation of their tax debt for this tax is exclusively undertaken on income obtained in Spanish territory, in accordance with the regulations provided in the IRPF, for incomes obtained without a permanent establishment, which involves separate taxation for each income accrued and the quantification of the tax debt and calculation of the amounts withheld and account deposits in accordance with IRNR regulations.

7. Capital gains from a change in residence or exit tax

From 2015, the IRPF regulates a new **exit tax**, which applies in cases of changes of tax residence by persons owning a significant amount of shares or stocks in entities[44]. This is an anti-circumvention tax to tax capital during the exit of major assets from Spanish territory; although it only applies to a limited set of assets: shares and stocks.

(44) Art. 95 bis LIRPF.

It is configured through the taxation of capital gains calculated by the positive differences between the market values of the shares or stocks in any type of entity (including collective investment institutions) and the acquisition value, when the taxpayer no longer has a tax residence in Spain (even if they have not transferred the shares or stocks). These gains (unrealised gains) will form part of their income from savings and will be attributed to the last tax period for which they must file an IRPF declaration, undertaking, where applicable, a self-assessment, without delay penalties or interest or any charges.

A new regulation

This is one of the main innovations introduced by Law 26/2014, of 27 November, to reform the LIRPF. The aim is to tax large fortunes that enter Spanish territory to invest with the intention of transferring the profits obtained to another country with more beneficial tax regimes while hardly being taxed on them.

Exit tax in other countries

Exit tax already exists in some countries in our economic environment (France, Germany, Denmark, the Netherlands, the United States of America), although with some differences. As such, in the United States of America it is applied to all the taxpayer's assets; in Denmark it is applied to a wide range of values including real estate and pension plan contributions; in Germany and Denmark, it affects more taxpayers given that the application limits are lower.

There are essentially two subjective **requisites** to apply the regime. The first involves the taxpayer having the status for at least ten of the previous fifteen tax periods prior to the the latest period for which they must file a return. And the second requisite is that they have a significant stake in an entity. For these purposes, this requisite is understood to be fulfilled in any of the following circumstances: a) that the market value of the shares or stocks jointly exceed 4,000,000 euros; and b) when that amount is not reached, that the percentage stake in the entity is over 25%, as long as the market value of the shares or stocks in the aforementioned entity exceeds 1,000,000 euros.

In the scenario that the party liable for tax payment acquires the status of taxpayer again without having transferred ownership of the shares or stocks, they could request the amendment of the self-assessment in order to obtain a **rebate** on the amounts paid. In this case, delay interest is attributable from the date when the payment should have been made to the date the rebate payment is requested.

In order to avoid losses to workers relocated for work reasons, a **deferment** of the corresponding tax payment can be requested when the change in residence occurs as a result of a temporary relocation for work reasons to a country or territory that does not have tax haven status. This can also apply for any other reason as long as the temporary relocation occurs in a country or territory with which Spain has entered into a double taxation avoidance agreement that contains a information exchange clause. In the case of the party liable for tax payment acquiring the status of taxpayer again within the period of five years following the last year of filing returns without having transferred ownership of the shares or stocks, the tax debt for deferral will be eliminated, along with the interest that would have been accrued.

Lastly, there are also **particularities** in the regime for moves to European Union countries, or European Economic Area countries, as well as for moves to countries classified as tax havens[45].

(45) Sect. 6 and 7 of art. 95 bis LIRPF.

8. Special taxation on non-resident entity real estate

Non-resident entities owning or possessing, by any type of title deed, any type of real estate or rights to receive benefits from them are subject to taxation under the IRNR[46] through **special taxation**, provided they have their residence in a country or territory that is classified as a tax haven.

(46) Art. 40 TRLIRNR.

This is an assets tax that exclusively affects a certain type of assets, real estate, and is only applicable to non-resident legal entities. It is **accrued** on 31 December each year.

Its **aim** s to monitor the ownership of taxed assets, given that the tenure of property in Spain by financial vehicle operations (sometimes from tax havens) makes it difficult to monitor income derived from the use, exploitation, or disposal of such assets. This is evident from both the limited collection capacity and the number of expected exemption scenarios.

Recommended reading

I. Cruz Padial (2003). *La obtención y el gravamen de la renta de las entidades no residentes: fundamento y antecedentes*. Málaga: Universidad de Málaga.

A series of subjective or mixed nature **exemptions** are provided, with the result that, according to article 42 of the TRLIRNR, this taxation is not applicable to the following entities:

1) Countries, foreign public institutions and international organisations. In this case, they are not obliged to submit the corresponding return.

2) Entities resident in countries with which Spain has signed a double taxation avoidance agreement and have declared as such, as long as the agreement contains an information exchange clause and it is applicable to natural persons that ultimately own the asset or capital of the entity either directly or indirectly (even in the case of the non-resident entity having a stake in the ownership of the assets alongside other persons or entities).

In addition, for the aforementioned exception to be accepted, they must fulfil another set of requisites: firstly, the submission of a tax return containing a list of the real estate properties they own in Spain, a list of the natural persons ultimately holding their capital or assets, and the record of the tax residence, nationality, and domicile of the entity and aforementioned partners; and secondly, the aforementioned return must be accompanied by certification of both the company's residence and the partners, issued by the relevant tax authorities in the country in question. All this documentation must be submitted to the Spanish Tax Agency delegation or Administration in the territorial area where the real estate is located within the same period defined for the tax payment.

3) The entities that operate continuous or regular business activities in Spain that can be differentiated by simple tenancy or leasing of real estate.

4) The companies that are listed on officially recognised secondary markets. This provision is also applicable when the property is owned indirectly or through an entity with rights to apply a double taxation convention with an information exchange clause.

5) Non-profit charity or cultural entities recognised by the laws of a country that has entered into a Double Taxation avoidance Agreement with Spain with an information exchange clause, as long as the real estate properties are used for the stated purposes of the organisation.

When it comes to **quantifying** the tax, the taxable base of this special taxation is the cadastral value of the taxed real estate or, failing that, its corresponding value based on the definitions of tax on assets. The 3% tax rate applies[47].

(47)Arts. 41 and 43 TRLIRNR.

Example

The company, Pedidos, S. A., with tax residence in Mongolia, a country with which Spain has not entered into a double taxation avoidance agreement, owns a block of flats in Madrid that is currently empty. The non-reassessed cadastral value assigned to the aforementioned property is 500,000 euros.

Given that it is a non-resident legal entity in Spain and that the property is not leased, it is taxed under the special taxation for non-resident entity properties. The taxable base is comprised of the cadastral value (500,000 euros), on which the 3% tax rate is applied. As a result, 15,000 euros in tax have to be paid. That amount will be deductible from the corresponding IRNR taxable base.

The tax debt is guaranteed by a **tax lien** on the taxed asset and is a deductible expense to calculate the corresponding taxable base of the IRNR where applicable. The special taxation must be declared and paid in the month of January[48].

(48)Arts. 44 and 45 TRLIRNR.

When the non-resident entity participates in the ownership of the assets or rights alongside other persons or entities, the tax will be attributable for the part of the value of the assets or rights that correspond proportionally to their participation.

In addition, when the residence conditions for claiming exemption for the partners or holders in the non-resident entity are partially fulfilled, the tax will be reduced by the corresponding proportion.

Activities

Case studies

1. Mr. Martín is a Spanish national but his main residence has been in Paraguay for the last fifteen years. He is an information technology engineer and is a computer repairman. He earned the following income in Spain in 2015:

- 24,000 euros for fixing the computers of a company located in Salamanca.
- 1,000 euros as dividends on some shares he owns.
- 300 euros a month for the lease of an apartment in Alicante.
- 3,400 euros from interest on a fixed terms account with a Spanish bank.

Calculate the taxation for each operation under the IRNR.

2. Indicate whether or not the following incomes obtained by a non-resident operating in Spain without a permanent establishment are exempt from taxation under the IRNR:

- The allocation of income from a real estate property located in Cáceres that was empty for the entire year.
- The income derived from a five year bond issued by a Spanish bank.
- The income obtained from the amortisation of a Treasury bill.
- The income derived from personal work.
- The income derived from leasing a house in Seville.
- A pension for permanent disability recognised by the Social Security.

3. A French limited company with a permanent establishment in Ceuta. This establishment has earned business profits of 700,000 euros in the 2015 fiscal year, 200,000 of which were transferred to the parent company, and 150,000 to an Argentinian company. The payment instalments made during the year total 40,000 euros, and among the reported expenses, there are 10,000 euros in payments to the French company for a range of technical support services, and some management and administration expenses totalling 12,000 euros. The permanent establishment has sold machinery to the parent company for 50,000 euros (when its market value is 75,000 euros) and carries forward negative taxable bases from the previous two financial years of 20,000 and 300,000 euros.

Calculate the IRNR amount that would have to be paid.

Self-evaluation

1. For the purposes of the IRNR, the interest paid by a bank with a tax residence on Spanish territory to non-resident natural persons…

a) will not be considered exempted income if the interest corresponds to non-resident current accounts.
b) will be considered exempted income if they involve non-resident accounts and the receiver of the interest resides in another European Union country.
c) will not be considered exempted income in the absence of a double taxation avoidance agreement having been entered into between Spain and the receiver's country of residence, and they will be taxed at 24%.

2. If a company with a fiscal domicile in a country outside the European Union sells shares in a company resident in Spain and experiences capital losses…

a) they will be taxed under non-residents income tax in the event the company operates without a permanent establishment in Spain, and the capital loss may be compensated by other capital gains obtained in Spanish territory.
b) they will be taxed under the non-residents income tax in the event the company operates without a permanent establishment in Spain, without being able to compensate the capital loss with other gains obtained in Spanish territory.
c) they will be taxed under the non-residents income tax in the event the company operates without a permanent establishment in Spain, and the capital loss may be compensated with other incomes and capital gains obtained in Spanish territory.

3. For the purposes of the IRNR, permanent establishments…

a) are not obliged to keep accounts, but they must fulfil the other formal and registry obligations.

b) are obliged to keep accounts and fulfil the remaining formal, registry and accounting obligations when they obtain annual incomes over 60,000 euros.
c) are obliged to keep accounts and fulfil the remaining formal or registry accounting obligations.

4. Not naming a representative within the scope of the non-resident income tax when it is a legal requirement…

a) is not considered a tax infringement and, therefore, is not sanctionable.
b) is considered a sanctionable offence.
c) is not considered a tax offence if there is a guarantor.

5. The following are exempt from the IRNR…

a) profits from subsidiary companies resident in Spanish territory distributed to their parent companies resident in other European Union Member States, as long as certain requisites are fulfilled.
b) profits from parent companies resident in Spanish territory to their subsidiary companies resident in other European Union Member States, as long as certain requisites are fulfilled.
c) profits from subsidiary companies resident in Spanish territory distributed to their parent companies resident outside the European Union, as long as certain requisites are fulfilled.

6. Permanent establishments that undertake temporary economic operations or activities and do not have separate accounting of the income obtained in Spanish territory…

a) are taxed under the IRNR by the rules that regulate income obtained on Spanish territory without a permanent establishment.
b) will only be taxed under the IRNR when certain regulatory requisites are fulfilled.
c) are taxed under the IRNR by the rules that regulate income obtained on Spanish territory through a permanent establishment, but they benefit from significant tax breaks.

7. Under the IRNR, royalties paid by a company resident in Spanish territory to its parent company resident in another EU Member State…

a) are exempt if they fulfil certain requisites.
b) are taxed at the 24% tax rate if they fulfil certain requisites.
c) are taxed under the pass-through regime if they fulfil certain requisites.

8. A branch in Spain belonging to a foreign banking organisation is defined as…

a) a permanent establishment of a non-resident entity.
b) a subsidiary company resident in Spain.
c) a taxpayer under Spanish Corporate Tax Law.

9. A German company operates in Spain through a permanent establishment. For the purposes of the IRNR, this permanent establishment…

a) can compensate negative taxable bases from the fifteen previous years.
b) does not have to withhold tax.
c) does not have to keep accounts.

10. When the IRNR taxpayer has a permanent establishment under any type of tenure…

a) they will be taxed for the total income obtained on Spanish territory attributable to the aforementioned establishment.
b) they will be taxed for the total income attributable to the aforementioned establishment, independently of where it was obtained.
c) they will be taxed in the taxpayer's country of residence.

Answer key

Case studies

1. Mr. Martín is a non-resident operating in Spain without a permanent establishment, meaning the tax must be calculated on an operation by operation basis.

He receives 24,000 euros for fixing the computers of a company located in Salamanca. The income from his professional activities is as follows: the taxable base is comprised of the gross amount earned, that is, 24,000 euros (art. 24.1 TRLIRNR), and the applicable tax rate is 24% (art. 25.1.a TRLIRNR), meaning he will have to pay tax amounting to 5,760 euros (24,000 × 24%).

1,000 euros as dividends on some shares he owns. In this case, the taxable base is comprised of the gross amount earned, that is, the 1,000 euros (art. 24.1 TRLIRNR), and 18% is the applicable tax rate (art. 25.1.g.1st TRLIRNR). Consequently, the resulting tax amount is 180 euros (1,000 x 18%).

He earns 300 euros a month for the lease of the apartment in Alicante. Therefore, the taxable base is comprised of the gross income, and no expenses can be deducted (such as the communal expenses or the property tax). Taxation occurs separately for each accrual. The applicable tax rate is 24%, which means the payable amount for each accrual will be 72 euros (300 x 24%).

Lastly, he earns 3,400 euros in interest on a fixed terms account with a Spanish banking institution, which had a balance of 50,000 euros on 31 December. The interest earned by Mr. Martín is exempt from being taxed under IRNR (art. 14.1.c TRLIRNR).

2. The following is deduced on analysing article 14 of the TRLIRNR:

- The allocation income from a real estate property located in Cáceres that was empty for the entire year. It is a non-exempt income and therefore subject to taxation.
- The income derived from a five year bond issued by a Spanish bank. This is an income exempt from taxation.
- The income obtained from the amortisation of a Treasury bill. This is also an income exempt from taxation.
- The income derived from personal work. These incomes are not exempt and are therefore subject to taxation.
- The income derived from leasing a house in Seville. This type of income is not exempt from taxation either.
- A pension for permanent disability recognised by the Social Security. In contrast, this income is an exemption scenario.

3. The French company must pay tax in Spain under the IRNR in the regime of income obtained through a permanent establishment. On application of letters *a* and *c* of article 16.1 of the TRLIRNR, it has to pay tax for receiving income from economic activities undertaken by the permanent establishment (the business profit of 700,000 euros), as well as for the capital gains or losses derived from the assets connected with the establishment (the sale of machinery to the parent company for 50,000 euros, when the market value is 75,000 euros).

Clearly, the TRLIRNR applies when it does not oppose the provisions of the Double Taxation avoidance Agreement signed by Spain and France on 10 October 1995 (Official Spanish Gazette of 12 June 1997), and articles 5, 7, and 13 in particular, which deal with the concept of the *permanent establishment*, the taxation of business profits, and the taxation of capital gains, respectively.

The IRNR taxable base will be the outcome of applying the regulations provided in the LIS, that is, it will be based on the accounting result, and the corresponding tax adjustments will be applied, using the variations contained in article 18 of the TRLIRNR for those cases.

Firstly, the 10,000 euros in expenses as payments to the parent company for technical support services need to be taken into account, along with the 12,000 euros as management and administration expenses.

In the first case, and unless the French company is a bank, the 10,000 euros cannot be deducted from the tax – letter *a* from article 18.1 of the TRLIRNR. As they appear to have been deducted in the accounts, this gives rise to the need for a positive financial adjustment of 10,000 euros on the accounting result (700,000 euros): 700,000 + 10,000 = 710,000 euros.

When it comes to second expense mentioned (12,000 euros for management and administration expenses), it will only be tax deductible if it fulfils the requisites of letter *b* of article 18.1 of the TRLIRNR: that is accounting that shows a record of the amounts, criteria, and modules for allocation, and rationality and continuity of the adopted taxation criteria. In any event, the French company may reach a prior assessment agreement with the Spanish tax agency on the quantification of this type of expense. As all these points are not specified in the statement, we cannot know whether or not the 12,000 euros are tax deductible.

With this response, we assume the French company manages to show the rationality of the eligible expenditures in their permanent establishment, and therefore, that the accounted expenditure of 15,000 euros is also tax deductible and there is no need to make any financial adjustments (it will also be the correct answer if the opposite was assumed).

When it comes to extraordinary incomes, the statement mentions that the permanent establishment has sold machinery to the parent company for 50,000 euros, when its market value is 75,000 euros. The capital gains or losses obtained for the sale (the difference between the transfer and purchase values) has been entered into the accounts of the establishment on the basis that the actual transfer price was 50,000 euros.

In reality, we do not know capital gains or losses, given that the statement does not include the purchase price or the machinery manufacturing cost, and consequently, we cannot calculate the difference. In this case, we will say the accounted capital gain was A.

In the end, the taxable base of the IRNR is: 710,000 + A = B. We have to subtract the two negative taxable bases for the permanent establishment from this amount B, corresponding to the two latest tax years (art. 18.3 TRLIRNR): B – 20,000 – 300,000 = C.

We have to apply the 28% tax rate to this taxable base in order to calculate the tax liability (art. 19.1 TRLIRNR): C x 28% = D.

Lastly, we have to find out whether or not to apply an additional tax rate of 20% for the part of the income obtained by the permanent establishment transferred outside the European Union, as provided in article 19.2 of the TRLIRNR and in letter *a* of article 19.3 of the TRLIRNR. In our case, the additional tax rate would only apply to the 150,000 euros of profits transferred to Argentina and not the 200,000 euros transferred to the French company.

However, letter *b* of art. 19.3 of the TRLIRNR excludes the additional tax rate even on income transferred to Argentina, as long as a Double Taxation avoidance Agreement has been entered into between Spain and Argentina "in which nothing else is specifically established" and "reciprocal treatment always exists". As such, given the treaty signed with Argentina on 21 July 1992, the additional tax rate scenario does not apply.

To finish, we will apply the deductions provided in numbers 4, 5, and 6 of article 19 of the TRLIRNR to gross income D. In the scenario, taking into account the permanent establishment is located in Ceuta, an allowance of 50% has to first be applied on the gross amount – letter *a* of article 19.4 of the TRLIRNR, with respect to letter *c* of article 33.1 of the LIS. As such: D - (D 50%) = E. The deduction for the payment instalments the permanent establishment made during the year also need to applied to the tax liability: E – 40,000 euros = F.

Self-evaluation

1. b

2. b

3. c

4. b

5. a

6. a

7. a

8. a

9. a

10. b