The Offshore Tax Planning Review

FISCAL RESIDENCE OF INDIVIDUALS IN SPAIN

Jonathan Miller[1]

Introduction

Many foreigners take up residence in Spain, which is to say that in one way or another they live here, either partly or wholly. There is much general misapprehension amongst the foreign population as to, inter alia, the tax consequences of their patterns of residence. The position is not aided by the proliferation of anecdotal and usually incorrect lay - and sometimes professional - advice as to what constitutes residence for tax purposes, and what the consequences thereof may be. Proper understanding is further impeded by the routine confusion of residence for tax purposes with the *permiso de residencia* (residence permit[2]), which latter is a matter for the immigration laws and has absolutely no connection whatever with the tax laws.

Much of the misapprehension, it has to be said, is wilful. Much of it also is visited upon its victims by knowledgeable-sounding chaps who've been in Spain for absolutely ages old boy, and know all there is to know, especially whose round it is next. And, regrettably, some of it has as its source professionals (both Spanish and occasionally in the clients' jurisdictions of origin) who should jolly well know better, but unhappily don't.

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2 Even citizens of member states of the European Community are required to apply for and hold (and carry and produce on demand) a *Tarjeta de Residente Comunitario* (Community Resident's Card).

Background

The law is contained in the current Ley del Impuesto sobre la Renta de las Personas Fisicas.[3] In translation, that Article says:

[4]*Article 12. Habitual residence*

***One**. It shall be understood that an individual is habitually resident in Spanish territory when either of the following circumstances occurs:*

a) when he remains more than 183 days in the calendar year in Spanish territory

b) when the principal centre of his business or professional activities or his economic interests lies in Spain

***Two**. Save proof to the contrary, an individual shall be presumed to be habitually resident in Spanish territory when his spouse from whom he is not legally separated and minor dependent children are habitually resident in Spain.*

***Three**. In computing the number of days spent in Spanish territory absences therefrom shall be included[5] unless the taxpayer can demonstrate habitual residence in another country during 183 days of the calendar year.*

Prima facie, those words look straightforward enough, and at first blush capable of a simple interpretation. Unhappily, simple is about the level of it. Only slightly closer inspection reveals some lack of rigour in the drafting. When applied to other than the most straightforward of circumstances it is often difficult to determine with any certainty what is their effect (or, commonly more to the point, what interpretation the fiscal authority[6] is likely to place upon them), and hence what should be one's advice to a client.

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3 "Law of Tax on the Income of Physical Persons" - Law 18/1991 of 6th June.

4 This is a faithful translation.There is no effective difference between "Spain" and "Spanish territory". "More than 183 days" and "183 days" are correctly given. The word "and" in Art 12 Two has the same sense in the original as it has in the translation. "Another country" is just that.

5 (As days spent within Spain) - JM.

6 For this purpose the appropriate office of Spain's equivalent of the UK's Inland Revenue, commonly known as Hacienda.

Little guidance is available elsewhere. The regulations are silent as to questions of interpretation. The often illuminating practice of the UK Inland Revenue in issuing statements of practice and other extra-statutory writ is not known in Spain. There is to date no jurisprudence addressing the interpretation or application of Ley 18/1991 Article 12 (indeed, authoritative commentators[7] regard this law as still somewhat wet behind the ears and in consequence unlikely yet to have attracted any noteworthy judicial attention).

The earlier Law 44/1978 (repealed by Law 18/1991 Disposición Final Segunda Dos) said of the subject:

Article 6

1. Habitual residence shall be understood to be the stay in Spanish territory for more than 183 days in the calendar year.

2. In computing the period of residence there shall be excluded from account absences of which it may be deduced from the circumstances in which they occur that they will not have a duration greater than three years

3. ...

4. ...

The parentage of the current law is apparent, in its clumsy and involute expression[8], in its uncertainty of application, and in its lack of clarity as to the underlying intentions of the legislator. It has been argued that, given the absence of other media, Law 44/1978 is a useful mirror through which to view the present law. I find it difficult to share this view. My own opinion of the matter is that the mirror, if such it is, does not provide any useful reflection of the provenance of the current legislation, nor of the intentions of the legislature. In short, examination of the repealed law contributes little to the interpretation of the effect of the present law. I reproduce it here solely to add some historical perspective.

Some General Observations

Returning now to that present law, it is useful to note the following:

> Despite a superficial similarity, the concept of fiscal residence in Spain is not one which entirely accords with the UK concept. It is rather one of habitual residence

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7 Including, inter alia, Antonio Gómez Arellano, lawyer in practice in Madrid, friend, all-round good egg, and respected teacher of fiscal law to the staff of august professional bodies. I thank Antonio for his thoughtful responses to my enquiries in preparing this article.

8 I hope to have reflected accurately not only the words but also the style in this translation.

(and indeed is so called), with an initial similarity to residence in the UK, but much of the adhesion of ordinary residence.

Whilst in the UK one is used to considering the joint effects of residence, ordinary residence and domicile, in Spain the single criterion of habitual residence does for all. Nationality of the taxpayer used to play a part in some areas of domestic personal tax law, but has not done so since 1st Jan 1988.

Whilst considering the (183) day-count rule, one must not overlook the parallel and simultaneous test of centre of vital interests. Many immigrants[9] (and long-term visitors) to Spain would find that on examination they would be caught by this latter test. Inter alia, they might be caught by virtue of the real property in Spain which they own and occupy. Such property could have both a quantitative effect, in that it often represents a significant portion of their wealth (and especially that wealth which they are prepared to reveal) and a qualitative effect in that it may be said to be a permanent home (whether exclusively or principally). Whilst taking pragmatic note of the climatic effect of my latter point (and of course its effect in treaty tie-breakers), it is right to observe that a permanent home (and here I do not refer to the bricks and mortar) does not contribute anything per se to the test in its strict words. A home is not necessarily an element in either business, professional or economic interests.

The fiscal residence in Spain of the spouse and minor dependent children is a significant factor, given the provision for presumption of co-residence albeit defeasible by proof to the contrary.

Interpretation

An overly academic analysis is probably not too helpful in practice, but an attempt to define and interpret some of the key words may assist in the formulation of advice to a client. The following reflects principally my own thoughts, though I have sought to test these on other minds, amongst them those of Antonio Gómez Arellano and Professor César Albiñana Quintana.

"Habitual residence".

This expression is used in four places in Art 12, once in each of clauses One and Three, and twice in clause Two.

In the first instance it appears to be defined in the two sub-clauses of clause One. In reality it is not so defined, but rather the condition of habitual residence is "understood" to arise when either of the two tests is met.

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9 I use this word for want of a better one to describe the foreigner moving to set up home in Spain, including the very many of those who do so planning - if that is not too strong a word - to engage in whatever travel or other manoeuvres seem necessary for them to maintain that they are not fiscally resident and hence not liable to pay taxes in Spain.

The two instances in clause Two suffer from the same defect as that above, though I suppose that in practice there is not too much mileage to be made out of this.

The use of the expression in clause Three is more potentially interesting. There is nothing directly to say if this is a term of art, to be defined in a particular way, or whether to be read as ordinary language. If it is a term of art, there is nothing directly to say whether the definition thereof is that of the condition which arises following clause One, or whether according to the rules of " ... another country".

There are other references to what must surely be the same concept, but regrettably they tend to confuse rather than clarify the issue.

The rather elderly Ley General Tributaria (General Tax Law)[10] in Article 45, 1(a) provides that an individual's "fiscal domicile" shall be that of his habitual residence. Unhappily, there is no definition of habitual residence in LGT. Interestingly, though parenthetically at this point, LGT Article 45 also provides in clause 2 (as amended by Law 10/1985) that Hacienda may demand that a taxpayer[11] declare his fiscal domicile. Art 45, 2, together with Royal Decree 2572/1975, also requires the taxpayer to declare to the tax authority any change in his fiscal domicile and stipulates penalties for non-compliance. Albeit in an elliptical way, therefore, Hacienda is in a position to require a taxpayer to declare whether or not he is resident in Spain. This piece of news is often disappointing to those who disingenuously claim that, since Spain's is a self-assessment regime and Hacienda therefore essentially reactive, utter silence by the taxpayer inhibits Hacienda's ability proactively to establish liability.

LGT Article 46 requires "those taxpayers who reside abroad during more than 6 months of the calendar year" to nominate a fiscal representative with fiscal domicile in Spain to deal on their behalf with the tax authority. This provision patently refers to those who are not fiscally resident in Spain, and the context is incapable of permitting otherwise.

LIRPF - Law 18/1991, referring to individuals, reiterates in Art 22 the same requirement, but in terms different from LGT Art 46. It says that "those taxpayers not resident in Spanish territory" must appoint a fiscal representative. The term "resident" is exactly that, and lacks the adverb "habitually" which one would expect from a study of the same law in its earlier Article 12. There is once again, however, no doubt whatever that the "residence" in question must be fiscal residence.

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10 - Law 230/1963, which has been amended piecemeal over the years, but is now in need of a thorough overhaul.

11 A non-resident may be a taxpayer by way of "*obligación real*", if he has any asset or income source in Spain. Residents are taxpayers by way of "*obligación personal*".

This inconsistency of terminology can lead one down endless meandering tracks seeking to establish whether different concepts, or different facets of the same concept, are meant by the different terms. It is clear that there is in fact only one concept, but that it is mighty difficult to put an absolute shape with clear edges upon that concept. More to the point it is difficult to achieve a consistent and reliable definition thereof in all the circumstances which may present themselves.

Days in or Days out?

As signalled earlier, many immigrants to Spain wish so to arrange their lives as to spend the largest possible chunk of those lives living in Spain, but simultaneously to avoid becoming tax resident. The commonly asked question, therefore, is "How much time do I have to spend outside Spain to avoid becoming taxable there?" A superficial interpretation - from which many clients have suffered - suggests that the answer is 182 days in, the balance out. Regrettably, perhaps, it ain't necessarily so.

LIRPF Art 12 Three offers a particularly difficult problem for interpretation. Its adhesive effect has some analogous similarities with that of ICTA 1988 s.334, but without the relative clarity thereof. Art 12 Three provides that absences from Spain shall not be regarded as such unless the specified test is met. That test has, in essence, three legs:

> "habitual residence". I have earlier raised the question of how these words are to be interpreted. The options available are, firstly, as a term specifically described in the earlier parts of the same Art 12; secondly, according to the laws or customs of the overseas jurisdiction in question; or thirdly, as ordinary language. Unsatisfactory though it may be, I am forced to the conclusion that the only absolutely safe interpretation is the first of those options, and some of the reasons for my conclusion emerge below.
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> "183 days of the calendar year". This is clear. The calendar year is a clear reference in this context to Spain's fiscal year on the one hand, and a clear exclusion of any period other than the calendar year (for example, the fiscal year of other jurisdictions) on the other hand.
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> "in another country". This, it seems to me, is seeking to establish that there are relatively long-term links with another, specific, singular, named jurisdiction, and not merely a period of time spent outside Spain, possibly travelling.

A central question is whether the requirement for habitual residence in another country is seeking to establish that there is genuine physical presence in the other country, or whether the individual is merely taxable in that other jurisdiction on the basis of fiscal residence there. Again, beyond the words of the statute there is nothing to guide us. One is therefore forced to consider what one may establish as, and what one may reason to be, the policy behind and the logic of the words of the legislation. I conclude:

> Principally, the requirement is prima facie for evidence that the individual is physically present in the other jurisdiction for the stipulated period of time.

> Nevertheless, it cannot possibly require such presence in the other jurisdiction to the exclusion of occasional absences (for example, holidays and business trips outside that jurisdiction).
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> It must therefore require that, on balance, the individual is present in a manner which may be described as habitual, but not to the exclusion of occasional absences therefrom. Whether such absences are, in turn, permitted to follow the pattern established (i.e., absences count as presence, unless for a period of 183 days ..... and so forth) is a moot point.

As will be evident, the problem becomes in many ways less one of technical definition, and more one of the standard of proof required or acceptable. It is likely to be extremely difficult in practice to adduce official documentation of any nature, let alone of the quantitative nature apparently envisaged by Art 12, from the great majority of " .... other countries". One is therefore most likely to be forced back into proffering evidence of a qualitative nature. Somewhat perversely, perhaps, it seems likely that the probable best evidence for such presence of that nature, duration, and quality, may be that the individual is tax resident in the other jurisdiction where the said jurisdiction operates the six-month residence rule, ideally over a calendar year.

As will, by now, have become apparent, the whole business is deeply unsatisfactory. The standard of proof apparently required is in practice almost guaranteed to be unavailable. The sort of proof likely in practice to be available does not lead to any certainty of outcome for the taxpayer. Antonio Gómez Arellano, writing to me about this point, characterises it as " ..... a question of fact, of an extraordinary practical complexity". He adds: "No incontrovertible document exists which formally[12] demonstrates such residence."

Conclusion

Clients tend to seek prescriptive advice. We are all used to issuing caveats. The practitioner accustomed to the relatively sane atmosphere of the UK's rules of residence and the corresponding expectation of reasonable certainty, should beware of assuming similar sanity in Spain's fiscal legislation. For sure, a great number of immigrants who are, according to the law, clearly resident for tax purposes in Spain continue to escape Hacienda's attention. I confess to being, quite simply, stunned by the number of professional advisors who take this extra-legal state of affairs to represent a sort of unspoken, unwritten, statement of practice and advise clients to adopt a course of action based thereon. I have always been of the view[13] that hoping to get away with it cannot possibly constitute planning. Of course, in this *Review* I am, with due deference, preaching to the converted, but there is quite simply no substitute for instructions containing the fullest possible details

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[12] The word he actually uses here is "*fehacientemente*", which means "in a sworn manner" and refers to the reliance of the (inter alia) Spanish legal system on Notaries, and other sworn functionaries, to attest to the genuineness of documents.

[13] With apologies to the reader for the apparent pomposity of the statement.

of the client's intentions; this permits of an analysis and recommendations which are pertinent to the individual concerned, but will rarely be of general application .

That being so, it seems to me clear that the intending immigrant who has income and assets sufficient for him to be properly concerned about the potential tax take merits the tough news, and should be man enough to take it. There is no easy general answer, unless it be that he who lives predominantly in Spain is most likely to be taxable[14] here. The "now you see me, now you don't" approach has a limited chance of success.

[14] On a worldwide arisings basis.