



A Guide To:

THE USE OF TRUSTS IN SPAIN

There has been a lot of inaccurate commentary in the media recently regarding the use of trusts by foreigners resident in Spain. Like many such short commentaries in this complex area, it is easy for less experienced advisers to misunderstand one of the most important weapons in the armoury of those seeking a number of key financial planning advantages including, but not limited to, significant tax savings.

Spain does not have any statutory Trust Law but that does not mean that a properly drafted Trust, in appropriate circumstances, cannot provide significant advantages for Spanish residents that not available from any other financial planning medium.

The Legal Position

Spain has recognised Offshore Trusts by signing the Hague Convention on the Law Applicable to Trusts and their Recognition 1985 (even though it has not been formally ratified).

British Nationals resident in Spain have the freedom to pass assets into any structure allowable under English private law. This was established in the Denney case in Spain (*TS Sala 1 21st May 1999*). Some quasi Trust relationships are, in any case, already recognised in Spain such as *usufructos* (the right to use an asset in one's lifetime with the underlying asset being the property of a third party) or *Testaferros* (nomineeship). *Indeed, even the Spanish Double Tax Treaty with the USA refers to Trusts.*

Codigo Civil Art 9.8 states that a foreign national can apply their law in relation to his/her private affairs:

It states:

“The private law that applies to individuals is determined by their nationality [not residence]. The said law determines their legal capacity, their civil state, their family rights and duties and succession *mortis causa*.”

It is, therefore, quite legal under Spanish law for British Nationals to set up a Trust.

The Tax Benefits

There are considerable tax benefits, as long as the Trustees are in an appropriate offshore jurisdiction such as the Isle of Man. The 2005 edition of “*Fiscalidad Internacional*” published by *Centro de Estudios Financieros* explains that the benefits of a Trust include:

1. Transfers of non-Spanish assets into a Trust are free from any Spanish succession taxes.
2. Income and gains within the Trust are free from Spanish tax
3. The assets themselves are free from Spanish wealth tax.

Spanish Succession Tax

Non-Spanish assets that are gifted, or transferred on death, to a non-Spanish resident are free from Spanish succession taxes. However if you were to die and leave your assets to your Spanish resident spouse or partner, then even though there might be non-Spanish assets in your estate, Spanish succession tax would be payable in most provinces on your worldwide assets. A Trust is an excellent way to avoid this tax charge. By leaving the assets in a Trust, there would be no Spanish succession tax. Indeed, if under UK tax law you are no longer a UK domicile, then the assets would also be free from UK inheritance tax. It *usually* makes far more sense to pass assets on to your heirs by way of a Trust, rather than directly to them under your Will. Note it is your nationality, not residence or domicile, at the time the Trust is established which is important.

A Trust which is settled by someone who is no longer a UK domicile (even though they may remain a UK national) is often referred to by experienced tax practitioners as a *Golden Trust*. The assets within the Trust are not only free from UK inheritance tax on the death of the settlor, but will be free for up to 100 years. The only assets that might be liable to UK inheritance tax are any UK assets owned by the Trust (but this can usually be avoided simply by interposing an offshore company between the Trustees and the UK property).

Income and Gains within the Trust

There is no Spanish tax payable on income and gains that are made within the Trust. If the Trustees are in one of a number of jurisdictions such as Malta, the Channel Islands, the Isle of Man or Switzerland, then there would be no taxes in those jurisdictions either.

Spanish Wealth Tax

Where Trustees own assets, and the Trustees are resident outside of Spain, then there would be no wealth tax unless the assets within the Trust consisted of Spanish property. It usually does not make sense to own Spanish property within a Trust, since there would be an annual 3% tax charge by so doing in Spain relating to freehold property owned by offshore entities. You cannot hold Spanish property directly in a Trust. However, a *usufruct*, as mentioned above, may be worthy of consideration as this normally reduces the tax payable on transfers following death.

Receipts from a Trust to a Spanish Resident

To the extent that the capital and income remains within the Trust, there are no Spanish taxes.

If the settlor has lent monies to the Trust, then the repayment, for part or that entire loan by the Trustees to the settlor (or indeed to any other person) would be free from tax in Spain. Note, however, that as a loan has a redemption value, it should be included in the lender's wealth tax return in Spain.

Receipts of other monies from the Trust would normally be classed either as a gift or as income under Spanish tax law. If it were an irregular payment, it is more likely to be classed as a gift liable to Spanish gifts tax. This is because any gift received by a Spanish tax resident is liable to tax; regardless of the relationship between the donee and donor (the only

exception to this is that certain provinces in Spain have started to recognise that transfers between husband and wife are tax free).

Where the receipt is regular, then the Spanish tax authorities may seek to tax it as income.

Spanish Anti-Avoidance Provisions

There is a new Spanish anti avoidance law (IRPF Law, RTL 3/2004) and Art. 88 deals with overseas entities whereby the income or gains of the overseas entity can be taxed on the person who set it up if Spanish tax resident. It has been confirmed by specialist Spanish tax counsel that this does not apply to Offshore Trusts.

Bonds owned by a Trust

Certain insurance bonds, if owned directly by a Spanish tax resident, receive favourable tax treatment in that only the gain element is liable to tax, and the tax rate is especially reduced after two years. Where a bond is owned by a Trust, the Spanish tax authorities often prefer it to be treated as if owned by the individual, in which case the favourable tax treatment would be given but it should also be included on the individual's wealth tax return. Such treatment is not guaranteed, and it is possible that receipts from an offshore bond owned in a Trust could be taxable in full to Spanish income tax. In practice, however, the Spanish tax authorities often tax the bond in the same beneficial manner as if owned by the individual. Like many things in Spain, there's no statutory base for this treatment; it's a matter of how the asset or any income is included on your self-assessment tax return.

UK Rental Income

If offshore Trustees receive UK rental income, the tax payable in the UK is usually significantly reduced. Where such rents are in the name of an individual, the top rate of tax in the UK can be 40%. This is halved if instead it is owned by offshore Trustees. As long as the settlor does not require the income to be paid to him or her as a tax resident of Spain, there would be considerable tax savings made by placing UK property into an Offshore Trust. The Trust should be an appropriate one in order to avoid any possibility of UK inheritance tax, and the position of any capital gains tax payable by the donor should be reviewed (but usually there is none in Spain nor in the UK if a non-UK resident).

Benefits of a Trust in Spain

So the benefits of a Trust can be summarised as follows:

1. There is no liability to Spanish succession tax nor Spanish wealth tax on assets in an Offshore Trust. However, if a bond is in the Trust and is treated as owned by the individual, then wealth tax would be payable
2. Where the settlor dies in Spain as a non-UK domicile, and the Trust was set up as a non-UK domicile, then there is no liability to UK inheritance tax on assets held in the Trust (other than directly owned property in the UK).
3. The Spanish succession laws do not apply to assets in an Offshore Trust. Indeed, any foreign succession law does not apply to an Offshore Trust.

4. The assets within a Trust pass to the heirs without any probate.
5. Where the Trust asset consists of an insurance bond, any receipts by a Spanish tax resident in practice are likely to obtain the preferential tax treatment if the bond is an approved one, although this situation cannot be guaranteed.
6. The Trust allows various family situations to be dealt with fairly. For example
 - a) Capital can be left to provide for a second wife (or second husband) with the benefit to pass to the children of an earlier (or later) marriage. The Trust avoids the problem of leaving assets outright to the surviving spouse (or indeed children of an earlier marriage). This way, both the surviving spouse and the children are protected.
 - b) Where a spouse, or even a settlor, becomes incapacitated the Trustees can co-ordinate protection for them in dealing with medical and care needs, as well as full financial support.
 - c) Asset protection: assets in the Trust are protected from any beneficiary becoming bankrupt.
 - d) Assets in a Trust are usually protected if a beneficiary suffers divorce. Thus if your son, a beneficiary of your Trust, has a divorce, the Trust assets would not normally be included in the divorce settlement.
 - e) Assets in a Trust are protected from a beneficiary squandering money. Professional Trustees will take care of the interests of all of the beneficiaries and be mindful of the settlor.

Conclusion

Despite claims to the contrary there is a body of legal precedent (as it would be called in the UK) to show that offshore trusts are acceptable in Spain.

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