

## SPANISH TAX TREATMENT FOR FOREIGN TRUSTS

---

*Guillermo Vidal Wagner and Mónica García-Perrote Forn\**

### INTRODUCTION

Trusts are an Anglo-Saxon institution with an extensive use and application in common law legal systems (ie Anglo-Saxon jurisdictions). Trusts are used for various reasons, ranging from the organisation of personal assets of individuals to charitable purposes or business activities.

Trusts are usually used to separate personal assets from risks derived from business activities. In addition, they facilitate mortis causa inheritances by reducing the effects of 'forced heirship' rights or assuring certain persons are protected – particularly children or disabled individuals – while they allow family patrimony to be kept all together preventing it from being broken up over generations or through family disputes.

It is also common in Anglo-Saxon countries to use trusts for charitable and public-interest purposes.

Trusts are gradually being increasingly used for business transactions. For example, they have been used to externalise the management of assets related to the payment of pensions by multinational corporations and locating them in an offshore territory with low taxation. Trusts are also often used as vehicles for investment funds that carry out functions similar to those of collective investment institutions or to structure immovable investments (the so-called, Real Estate Investment Trust or REITs). In these cases, although they have the essence of a trust, ie the separation between legal ownership and beneficial ownership (economic rights), they are structured and operate differently from traditional trusts.

This article is focused on trusts related to the organisation of personal assets of individuals and in particular, the so-called 'family trust' in the context of mortis causa transactions.

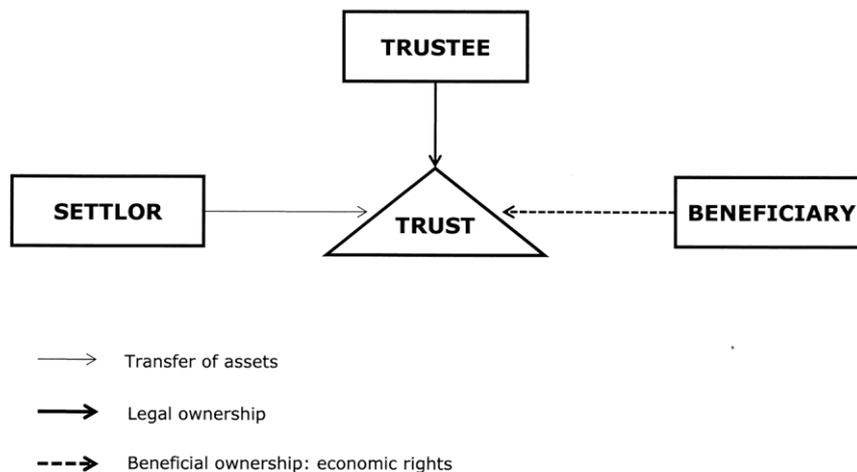
---

\* Partner Cuatrecasas, Gonçalves Pereira, Barcelona, and Associate Cuatrecasas, Gonçalves Pereira, Spain.

## CONCEPT OF TRUST

The Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (the Hague Convention) (in force since 1 January 1992) – signed principally by Anglo-Saxon countries – establishes the general characteristics of a trust and sets out the rules for determining the governing law of a trust when there are cross-border elements.

According to the Hague Convention, the term ‘trust’ refers to the legal relationships created by a person (the settlor) when that person, through an inter vivos act or mortis causa, places assets under the control of another person (the trustee) for the benefit of a beneficiary (the beneficiaries) or for a specified purpose.



The settlor can be an individual or a legal entity. He does not normally keep control over the assets transferred to the trust or their management. In this case, the trust is known as an ‘irrevocable trust’.

However, in certain cases, for example, when the purpose of a trust is not to transfer or to promote the protection of a patrimony, but to undertake economic activities – such as when it is used as a vehicle for a financial product or as the holder of certain assets or rights like share options – the settlor often does keep some control over the assets transferred to the trust, even to the extent of retaining a power to revoke the trust. In this case, the trust will be considered as a ‘revocable trust’. This distinction should be particularly relevant when determining the tax implications of trusts. However, Spanish tax authorities have not made this distinction when determining the Spanish effects for trusts.

The establishment of trusts is usually documented by way of deed (deed of trust) often including instructions for appointing trustees, for the management and destination of the assets, the investment policies to follow and how to determine the beneficiaries.

The trustee can be an individual or an organisation. The trustee holds or manages and invests assets held by the trust (as it has the legal ownership of those assets) and is legally obliged to make all trust-related decisions with the beneficiaries' interests in mind and may be liable for damages in the event of not doing so. Trustees may be entitled to a payment for their services, if specified in the trust deed. A trustee acts in his own name before third parties as the legal owner of the assets held by the trust. A trust has an independent existence so, for example, in case of the trustee's death – when the trustee is an individual – the trust is not extinct.

The beneficiaries can also be individuals or legal entities. The position of a beneficiary is generally determined by the deed of trust and beneficiaries cannot normally give instructions regarding the management of the trust or even require trustees to make distributions.

The main characteristics of a trust, which are essential to understand the implications in the Spanish regime, could be summarised as the following:

- The trust's assets are a separate fund and are not a part of the trustee's personal estate.
- Title to the trust assets is in the trustee's name or in the name of another person on behalf of the trustee (legal ownership).
- The trustee has the power and the duty to manage, employ or dispose of the assets under the terms of the trust and the special duties imposed by law.
- The legal ownership is separate from the beneficial rights (ie economic ownership).

#### **GENERAL COMMENTS ON TRUSTS FROM A SPANISH PERSPECTIVE**

The trust is an institution not regulated by the Spanish legal system. Spain, for example, has not ratified the Hague Convention and there are no signs that it will do so in the short or medium term. In addition, Spanish legislation as a civil law system does not recognise, in general terms, a difference between formal and beneficial ownership while common law does.

The only existing guidelines on the treatment of foreign trusts under Spanish law can be found in academic writings and in a few judgments issued by the Spanish

courts on the matter. Therefore, Spanish implications deriving from a trust must be addressed through the interpretation of general principles which implies a case-by-case analysis in order to arrive at individual conclusions.

## **SPANISH CIVIL LAW AND TRUSTS**

Spanish civil law does not recognise the institution of the trust, so it will not be possible to establish a trust in Spain; however, Spanish law recognises a variety of institutions which in certain cases could have similar effects to those of a trust or could be used to understand the possible effects that a foreign trust could have in Spain. As said before, we will be focusing on the 'family trust' and in particular, trusts regulating mortis causa transfers.

### **Executorships**

The Spanish Civil Code establishes the institution of the 'executor'. The executor is a person with legal capacity, who is appointed by a testator to execute the testator's will. The executor may be universal or special, and if there is more than one executor, they can be appointed severally, successively, or jointly.

The executor has all the lawful powers that the testator expressly grants to him. If the testator does not determine the executor's powers, the executor will have certain duties established by law, such as disbursing property or bequests to the beneficiaries, as designated in the will, or protecting and taking care of all the assets and selling them when no cash is available to pay funeral cost or bequests.

An executor has no automatic right to be paid, as it is a non-remunerated position. However, the will can establish compensation for the executor.

The testator can establish the legal term for the executor's assignment; if the testator does not establish the term, it would be for 1 year, with the possibility for the heirs or the judge to extend it for 1 year or more.

This institution is different from a trust, because the executor is not the legal owner of the assets as the trustees of a trust are. The heirs or beneficiaries of bequests will be considered to have acquired the assets when the testator dies (legal and economic ownership). However, as in the case of the trustee, the executor will agree to carry out the instructions in the will and will be responsible for managing and distributing the assets transferred under the deceased's specific instructions (like the instructions given by the settlor in a deed of trust).

## **Fiducia**

It is said that the trust originated in the Roman institution of *fiducia* (which literally means 'trust'), where, according to a fiduciary agreement, assets were attributed by one party (the settlor) to the fiduciary, so the fiduciary could use it for a specific purpose, with the fiduciary being obliged to transfer the property back to the settlor or to a third party when that aim or condition had been achieved.

Under Spanish regulations, the Roman *fiducia* differs from the institution of *fideicomisary* substitution (*sustitución fideicomisaria*) established by the Spanish Civil Code as a way to transfer assets in a *mortis causa* context. This institution implies that the heir (the fiduciary) acquires the property as designated by the testator in his will. The fiduciary could be an individual or a legal person. The fiduciary is obliged to manage and keep the assets and to transfer part or all, depending on the will, of the inherited assets to a third person (the *fideicomisary*). There are different types of *fideicomisary* institutions, depending on the duties imposed on and powers granted to the fiduciary (first heir) regarding the assets to be transferred to the *fideicomisary* (second heir or heirs), ranging from managing them to selling them.

In our opinion, there is a big difference between the institution of the trust and the *fideicomisary* substitution, because, in the *fideicomisary* substitution, there is no separate fund and there is no separation between the legal and economic ownership, as the fiduciary acquires the legal and economic ownership from the beginning, as if it were a full heir, and the assets are inherited only after the fiduciary dies, when they must be transferred to the *fideicomisary*, who will also be considered a full heir. In addition, contrary to the trust institution, the *fideicomisary* substitution is limited to only two *mortis causa* transfers (from the testator to the fiduciary and from the fiduciary to the *fideicomisary*) so it does not have the trust's enduring quality.

## **Spanish Case-law**

Notwithstanding the above, Spanish courts have had occasion to voice their opinion on the recognition of trusts in Spain. In its judgment of 30 April 2008, the Spanish Supreme Court stated its opinion on the recognition of a US trust in Spain in the case of a *mortis causa* trust established by two US nationals under US laws of which their daughter – the plaintiff – was to become the beneficiary when one of the parents died, acquiring under the trust deed real estate located in Spain, which was held by the trust, and which was the object of the judgment.

In this judgment the Spanish Supreme Court recognised that, under the Civil Code's private international rules, the law that applies to a *mortis causa* inheritance, as in the case at hand, is the personal law of the deceased (in this case, US law). However,

for a Spanish court to apply a foreign law, this law must be proved by the person claiming it. The plaintiff wanted to apply the law governing the trust, so the plaintiff would have needed to prove this law, but it did not. Because the plaintiff did not prove the foreign law, the court could not apply the law governing the trust and was obliged to apply the Spanish regulations, which, as said before, do not recognise the institution of the trust. Consequently, the court did not give effect to the trust in Spain, but this was only because of a formal procedural aspect – not proving the applicable law – and not because the Spanish courts did not recognise it.

Currently, there is no other case-law on trusts, so we cannot confirm other situations in which the foreign law could be proved, and in which the Spanish courts might recognise the effects in Spain of foreign trusts, but this could be possible in the future. However, civil case-law would not necessarily create a new vision of the tax consequence in Spain for trusts, so tax implications would also need to be analysed on a case-by-case basis.

## **SPANISH TAX CONSIDERATIONS**

Spanish tax legislation does not contain any provision on the taxation of trusts, the settlor, trustees or beneficiaries; and this has generated certain legal uncertainty when dealing with trusts for Spanish tax purposes.

Academic writings and a few rulings issued by the Spanish tax authorities on the matter are the only guidelines on the tax treatment of foreign trusts under Spanish law. From a tax point of view, tax consequences deriving from a trust must be addressed through the interpretation of the general principles established by each specific tax being applicable, which implies a case-by-case analysis in order to raise individual conclusions.

The Spanish tax authorities in a couple of recent tax rulings,<sup>1</sup> have disregarded the existence of trusts thus considering that the transactions carried out through trusts are made directly between the settlor/s and the beneficiary/ies even in cases where the trustees had certain discretionary powers to allocate or distribute the assets held by the trusts to the beneficiaries. The rulings do not comment on the revocable or non-revocable nature of trusts, which, in our opinion, would have been crucial to establish the tax effects in Spain of these trusts.

The tax rulings issued by the Spanish tax authorities could be questionable in many circumstances since they simplify the issues arising from the establishment and

---

<sup>1</sup> Tax rulings issued by the Spanish Directorate of Taxes, 30 October 2008, 14 January 2010 and 14 May 2010. See also the earlier tax ruling issued on 4 May 1993.

continuation of a trust, but they provide guidance as to how the use of trusts would be analysed by the Spanish tax authorities. There are no judgments yet on the tax treatment of trusts.

### **Settlement of Trusts**

According to the Spanish tax rulings, trusts are disregarded for Spanish tax purposes, and therefore any transfer made by the settlor to the trust would be considered as not carried out from a Spanish tax perspective. Consequently, the settlor should need to be considered the owner of the assets transferred to the trust until it is understood that there is an effective transfer (ie mortis causa transfer). Therefore, the settlement of the trust should not imply any taxation in Spain for the settlor or the trust in Spain.

### **Holding Period**

Since a trust is disregarded for Spanish tax purposes, the settlor continues to be the owner of the assets transferred to the trust. Income derived by the assets held by the trust – which normally are deemed to be obtained by the trust under the national law regulating the trust – would be considered to be obtained by the settlor and taxed accordingly.

If the settlor is tax-resident in Spain, he will be subject to personal income tax (PIT) in Spain on the worldwide income obtained by the trust, while if the settlor is a non-Spanish tax-resident, he will only be subject to tax in Spain on the Spanish-source income and capital gains of the trust.

#### ***Personal income tax***

The current PIT rates on income of a Spanish tax-resident range from 21%–27% with regard principally to capital gains, dividends and interest. Other income not considered as savings income – principally employment, business and immovable property income – is included in the general taxable base and taxed at the progressive PIT rates, generally ranging from 24.75% up to 54% or 56%, depending on the autonomous region regulations.

### **Distributions Made by the Trust**

No taxation should arise when the trust distributes any income to the settlor since it is considered that the settlor has in fact received that income when it accrued to the trust and not when it is distributed.

## Wealth Tax

Spanish tax-resident individuals are subject to wealth tax in Spain on their worldwide assets (monetary or not). Therefore, it is understood that, according to the Spanish tax authorities' opinion, the settlor (while he is treated as the owner of the assets held by the trust) would be subject to wealth tax in Spain in respect of the assets and rights held by the trust.

### *Spanish wealth tax*

Spain enacted Royal Decree-Law 13/2011, temporarily re-establishing wealth tax for the 2011 and 2012 tax years, abolishing the 100% relief that entered into force for the 2008 tax year onwards.

Spanish tax-resident individuals are subject to wealth tax on the net value of their worldwide assets and rights.

As the regulatory development and collection of wealth tax has been transferred to the autonomous regions, there may be differences in its application in the regions for Spanish tax-residents, but generally the wealth tax rates range from 0.20%–2.50%. In addition, some autonomous regions have established an exemption of 100% of the wealth tax quota while others have only fixed a general exemption ranging from €108,200–€700,000.

The maximum tax due for Spanish tax-resident individuals on their worldwide income is limited, jointly considered with PIT, to 60% of the taxable base for PIT. However, the tax quota paid for wealth tax must be at least 20% of the original wealth tax quota.

## Tax Treatment of Transfers of Assets to Beneficiaries

According to the tax rulings issued by the Spanish tax authorities disregarding trusts, any transfers made from trusts to beneficiaries would be treated as if the transfers had been made directly between the settlors and the beneficiaries. Depending on the nature of the transfers, a distinction should be made between inter vivos gifts and mortis causa transfers.

The tax authorities have only issued their opinion on mortis causa transfers. According to the existing tax rulings, distributions made by trusts to beneficiaries upon the settlor's death will be considered as mortis causa transfers between the settlor and the beneficiaries and therefore, they will be then liable for inheritance and gift tax (IGT) 'at the moment of receipt of the assets, that is, upon death of the testator, disregarding the constitution of the trust for Spanish tax purposes'.

Spanish-resident beneficiaries will be subject to IGT on the value of the assets received and the tax liability would be calculated under the rules set by the autonomous regions or the central state depending on where the settlor was resident when he died. The kinship relationship between the settlor and beneficiaries (relevant to apply lower IGT tax rates) is to be taken into account according to the Spanish tax authorities. Non Spanish-resident beneficiaries will be subject to IGT on the Spanish assets acquired.

Although this does not seem to be the position of the tax authorities, it could also be understood that in the case of a trust where the beneficiary is not entitled to dispose of the trust assets until certain conditions are met and does not have any economic right over the assets, the beneficiaries of the trust are not subject to IGT since the beneficiaries do not hold the ownership of the assets until they become entitled to them and, therefore, they have not inherited anything yet.

The gratuitous contribution of assets to an irrevocable trust upon its establishment could be considered a gift or a mortis causa transfer from the settlor and, therefore, taxed under IGT rules. On the contrary, in the case of a revocable trust, it is likely that from the Spanish tax point of view it will be considered that the assets have not left the settlor, who still owns them. However, it should be taken into account that the Spanish tax authorities have not commented on this distinction.

### **Holding Period and Distributions Made by the Trust after the Settlor's Death**

The beneficiary would be understood to be subject to PIT on the profit obtained by the trust whether or not such profit is effectively distributed by the trust.

#### ***Spanish IGT***

Spanish IGT follows the principle of effective residence of the recipient taxpayer. A recipient who is a resident of Spain is liable to the tax with regard to property located or rights which could be exercised in Spain or abroad which are acquired through gratuitous transfer, either as an inter vivos gift or through a mortis causa transfer. Non-resident recipients are subject to this tax exclusively with regard to assets located in Spain or rights which may be exercised in Spain.

IGT in Spain is regulated at both state level and the autonomous regional level. In relation to mortis causa transfers, the applicable law will be the law of the autonomous region where the deceased had his habitual residence at the time of death. If the deceased was not tax-resident in Spain, the state legislation would be applicable.

With respect to inter vivos gifts, the applicable legislation would depend on the tax residence of the beneficiary. If the donee is resident in Spain, the legislation of the autonomous region where the donee has his habitual residence will prevail. However, there is a specific rule if the assets transferred consist of real estate located in Spain. In such a case, the applicable law would be that of the autonomous region in which the property is situated, but if the real estate is situated abroad, the state law would apply. If the donee is not resident in Spain, state law would be applicable (regardless of the nature of the Spanish assets or rights donated).

The taxable base of the recipients (heirs, legatees or donees) will be the net value of the assets received. Burdens and encumbrances imposed directly on the asset which effectively reduce its value or capital (pension, annuities, etc), duly documented debts (mortgages, pledges, local taxes) and certain expenditures (medical costs, burial expenses, etc) would be deductible.

Under the state law and most of the autonomous regulations, the applicable tax rates for determining the final tax liability for IGT are progressive, ranging from 7.65% up to 34% (in cases where the taxable base exceeds €797,555.08) multiplied by certain fixed surcharges which vary from 1 to 2.4. These surcharges are calculated by reference to the recipient's net wealth in Spain and his relationship with the deceased or donor. For gifts, the previous net worth of the beneficiary is not taken into account. For mortis causa transfers, an allowance on the taxable amount, which refers to the degree of family kinship between the acquirer and the deceased considering the age of the beneficiary, will be applied. Spanish-resident taxpayers may be entitled to a tax credit for foreign taxes paid abroad.

In addition, in certain cases autonomous regional regulations have established an allowance of up to 100% of the IGT due.

## CONCLUSION

The Spanish legal system, as Spain is a civil law country, does not recognise the institution of trusts or a difference between formal and economic ownership. In addition, Spain has not ratified the Hague Convention. Therefore, the only existing guidelines on the Spanish treatment of foreign trusts can be found in a few judgments, tax rulings and in academic literature.

Under Spanish civil law, trusts cannot be established in Spain, but there are other civil institutions such as executorships or the *fideicomisary* substitution which could have similar effects and could be used to understand the potential effects that

foreign trusts could have in Spain. However, those institutions do not allow the constitution of a separate fund and do not differentiate between legal and economic ownership.

From a Spanish tax point of view, trusts should be disregarded; transactions carried out through trusts should be considered as transactions made directly between settlors and beneficiaries, even in cases where trustees have discretionary powers to allocate or distribute the assets held by trusts to beneficiaries.

Therefore, any transfers made by settlors to trusts would be considered as not having been carried out, so no tax liabilities in Spain would be levied on the establishment of a trust or subsequent transfers to trusts. As settlors are considered the owners of assets held by trusts, all income obtained by trusts would be attributed directly to the settlors and taxed accordingly. Spanish residents would be taxed under the PIT regulations and non-residents would be taxed on their Spanish-source income under non-resident income tax (NRIT) rules.

Any transfers made from trusts to beneficiaries would be treated as if the transfers had been made directly between settlors and beneficiaries. Depending on the nature of these transfers, they would be taxed as inter vivos gifts or as mortis causa transfers under the IGT rules. IGT duty would depend, in most cases, on the kinship relationship between transferors and the acquirers (ie settlors and beneficiaries), recipients' (ie beneficiaries) previous net wealth and the applicable law (state law or the law of the autonomous regions), which could make IGT duty vary substantially. Once ownership of assets passes from settlors to beneficiaries, beneficiaries would be then subject to taxation on all the income and capital gains derived by the trust under the PIT or the NRIT rules.

Settlors (while considered the owners of the assets held by the trust) or beneficiaries (when the effective transfer is considered to be made, for example, upon a settlor's death) would be subject to wealth tax in respect of the assets held by the trust. Spanish tax resident individuals are subject to wealth tax on the net value of their worldwide assets and rights and non-residents are only taxed in respect of assets and rights located or to be exercised in Spain.

Tax rulings issued by the Spanish tax authorities could be questionable in many circumstances, since they over-simplify greatly the issues arising from the establishment and maintenance of a trust, but they provide guidance on how the use of trusts would be analysed by the Spanish tax authorities. A case-by-case analysis would always be needed to determine the tax implications of foreign trusts in Spain.

*Guillermo Vidal Wagner*  
*Partner Cuatrecasas, Gonçalves Pereira*  
*Mónica García-Perrote Forn*  
*Associate Cuatrecasas, Gonçalves Pereira*  
*Paseo de Gracia, 111*  
*08008 Barcelona*  
*Spain*