The Personal Income Tax applied in the Member States of European Union. The Case of Spain.

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ABSTRACT

In the Communication on "Tax policy in the European Union - Priorities for the years ahead" (COM/2001/260 of 23 May 2001), the Commission reiterated its belief that there is **no need for an across the board harmonisation of Member States' direct tax systems**. For tax policy, the Communication established, as a main priority, the need to address the concerns of individuals and businesses operating within the Internal Market by **focusing on the elimination of tax obstacles to all forms of cross-border economic activity**, in addition to continuing the fight against harmful tax competition. This approach was confirmed in the Communication "The contribution of taxation and customs policies to the Lisbon strategy" (COM/2005/532 of 25 October 2005) (European Commission, 2006).

The Spanish Law No 35/2006, 28 th November of Personal Income Tax, reformed that tax. The long-term capital gains will be taxed at 18% (before 15%) ;the tax scale will be comprised of only 3 or 4 brackets (before 5) and the top marginal rate (before 45%) will be reduced; and some tax credits and allowances (acquisition of permanent home and contributions to pension funds for example) were readjusted in order to make them more accessible to low-income earners.

The present paper makes a brief approach to the harmonisation in the European Union, explains the reform of the Spanish Personal Income Tax, introduces new figures and formulas never seen before at book of taxes, analyses the concept of the Spanish Personal Income Tax, studies the elements of this tax as the beneficiary, taxable person, territoriality, basis of assessment, exemptions**,** explains the basic mechanism of the tax, deductions**,** the taxable base, the tax rates, collections and examples. This paper is the result of three researches that the authors are carrying out at The Institute for Fiscal Studies, Ministry of Economy and Finance, University of CEU San Pablo, Madrid and University of Oviedo Spain from 2006 to 2008.

THE HARMONISATION OF PERSONAL INCOME TAXES IN THE EUROPEAN UNION

In the Communication on "Tax policy in the European Union - Priorities for the years ahead" (COM/2001/260 of 23 May 2001), the Commission reiterated its belief that there is **no need for an across the board harmonisation of Member States' direct tax systems**. For tax policy, the Communication established, as a main priority, the need to address the concerns of individuals and businesses operating within the Internal Market by **focusing on the elimination of tax obstacles to all forms of cross-border economic activity**, in addition to continuing the fight against harmful tax competition. This approach was confirmed in the Communication "The contribution of taxation and customs policies to the Lisbon strategy" (COM/2005/532 of 25 October 2005) (European Commission, 2006)

As far as **direct taxes** are concerned, Article 94 provides for the Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, to adopt provisions for the approximation of such laws, regulations or administrative provisions of the Member States that directly affect the establishment or functioning of the common market. Some recommendations and legislation have been adopted in the personal tax, company tax and capital duty areas.

As a general principle, the European Commission believes that **taxes on personal income are a matter for the Member States** to determine. At the same time, in some cases, the Commission acknowledges that **co-ordination at EU level is necessary** to safeguard the application of the Treaty freedoms and to eliminate tax obstacles to crossborder activities. There is also a need to co-ordinate personal income taxes to prevent double taxation, or unintentional non-taxation in cross-border situations, or to tackle cross-border tax evasion.

The **European Court of Justice** has consistently held that, in the absence of harmonisation, taxes on personal income fall within the competence of the Member States but they must respect the fundamental EC

Treaty principles on the four freedoms (free movement of workers, services and capital, and the freedom of establishment). In particular, there must be no discrimination on the basis of nationality.

The Communication on the **taxation of pensions** of April 2001 (COM/2001/214) is one of the first examples of the Commission's new approach of achieving a co-ordinated response from Member States to important case-law of the European Court of Justice and eliminating tax obstacles to the Internal Market. The Communication stresses that Member States are free to choose their pension systems as long as they respect the four freedoms of the EC Treaty.

Respect for the Treaty freedoms is equally important in the area of **migrant and cross-border workers**, where the European Court of Justice has already given a number of rulings on the taxation of persons earning income in Member States other than where they live.

Double taxation agreements form an integral part of Member States' tax rules, and the personal tax rules included in these agreements must remain within the boundaries set by the EC Treaty, just like any other national laws.

Finally, the need to avoid distortions to the movement of capital and the need to ensure effective taxation of interest payments received by individuals in Member States other than the Member State of residence have led to the adoption of a **Directive on the taxation of savings income** in the form of interest payments. This Directive enables such interest payments to be made subject to effective taxation in accordance with the laws of the Member State of residence. On 1 July 2005, the provisions of the Directive started to be applied by all 25 Member States. The same measures in the Directive have also been applied, from the same date, in 10 dependent or associated territories through the implementation of bilateral agreements signed by each of the Member States with these jurisdictions; and equivalent measures are applied in five European third countries, including Switzerland.

Spanish action in the area of Personal Income Tax has its legal basis in **the Law No 35/2006, 28 th November of Personal Income Tax, and the modification of Wealth Tax and Corporation Tax and the Royal Decree No 439/2007, 30th March, approving the Regulation on Personal Income Tax**

THE CONCEPT OF PERSONAL INCOME TAX

Direct and Personal Tax on income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends). Income taxes can be levied on both individuals (personal income taxes) and businesses (business and corporate income taxes).

Taxable income includes: earnings from employment, earnings from self-employment, most pensions income (State, company and personal pensions), interest on most savings, income from shares (dividends), rental income, income paid to you from a trust

BENEFICIARY

The central government and certain autonomous communities: Basque Country and Navarre. In accordance with Organic Law No 8 of 22 September 1980 modified by Organic Law No 7/2001 of 27 December 2001 on the financing of the autonomous communities, and the rules on the transfer of taxes from the central government, part of the revenue accrues to the autonomous communities (European Commission, 2002).

TAX PAYABLE BY

- Natural persons who are normally resident on Spanish territory.
- Natural persons who are normally resident abroad:

1. Staff of diplomatic or consular offices, persons occupying an official Spanish government post or position, or active public servants.
2. Natural persons of Spanish nationality who state that their new residence for tax purposes is in a country or territory legally classified as a ‘tax haven’. This rule applies in the tax period during which the change of residence is effected and during the next four tax periods.

EXEMPTIONS

- Exceptional public indemnities for acts of terrorism.
- Aid of any sort granted to people infected with HIV, as laid down by Royal Decree-Law No 9 of 28 May 1993.
- Pensions paid to persons wounded or disabled during or as a result of the Civil War 1936/1939, either under the State system for pensioners or the special legislation drawn up for this purpose.
- Civil liability compensation for personal moral damages, at the rate laid down by law or judicial decision.

- Redundancy or severance payments for workers, at the compulsory rate laid down in the Workers' Statute, in its implementing rules or, where appropriate, in the rules governing the enforcement of awards. However, payments established by agreement, pact or contract are not included.
- Social security benefits or benefits paid by other bodies as a result of permanent total disability or complete invalidity. Also benefits paid to professionals not covered by the special social security system for self-employed workers by mutual provident societies that act as alternatives to the abovementioned special social security system, provided that the benefits are granted in identical situations to those laid down under the social security system for permanent total disability or complete invalidity.
- Permanent disability or invalidity pensions under the system for pensioners, provided that the injury or illness that caused the disability renders the beneficiary of the pension unfit for any profession or occupation.
- Child allowances as provided for in Chapter IX of Title II of the revised text of the General Law on Social Security, approved by Legislative Royal Decree No 1 of 20 June 1994.
- Sums received by State-run homes for the disabled or the elderly (over 65 years of age).
- Public scholarships for all levels and grades of the education system, up to and including a bachelor's degree or equivalent.
- Annual maintenance allowances received by parents as a result of judicial decision.
- Major literary, artistic and scientific prizes, under the conditions laid down by law.
- Economic assistance given to top athletes participating in training programmes drawn up by the Sports Council with the Spanish Sports Federations or the Spanish Olympic Committee, under the conditions laid down by law.
- Unemployment benefits granted by the relevant management organ in the form of a single payment provided for by Royal Decree No 1044 of 19 June 1985 governing unemployment benefits in the form of a single payment of up to € 12,020.24, provided that the quantities received are intended for the purposes and in the circumstances provided for in the said decree.
- Prizes in national lotteries and those organised by the Autonomous Communities, the Spanish Red Cross or the national organisation for the blind.
- Special bonuses paid by the Spanish government for participation in international peacekeeping or humanitarian missions, under the terms laid down by law.
- Earnings for work carried out abroad with an upper limit of € 60,100, provided that a similar or identical tax has effectively been paid abroad at the rate and under the conditions laid down by law.
- Compensation payments made by the Public Administration caused by the malfunction of the public services.
- Amounts perceived for burial/funeral expenses subject to a certain ceiling.
- Economic aids laid down in Article 2 of Law No 14/2002.
- Public compensations accrued in case of freedom deprivation in jail as laid down in Law No 46/1977.
- Dividends perceived up to a maximum amount of € 1,500 per year.

THE BASIC MECHANISM FOR SPANISH PERSONAL INCOME TAX

Figure 1. The basic mechanism for Spanish Personal IncomeTax (Fernández de Soto Blass, 2007).

- Income from employment (salaries); - Income from real states capital (rental); - Income from business (self-employment); - Capital gains and losses; - Imputed income as laid down by law. - Income from tax transparency	- Income from movable assets or movable capital (interest and dividends); - Capital gains and losses;
=GENERAL TAXABLE BASE	**= SAVING TAXABLE BASE**
- Reductions for contributions into Personal Pension Plans or provident Mutual Societies	
= NET GENERAL TAXABLE BASE	**=NET SAVING TAXABLE BASE**
- Personal and Family Minimum	
= STATE AND AUTONOMOUS TAX RATES	**= STATE AND AUTONOMOUS TAX RATES**

= STATE GROSS AMOUNT DUE	= AUTONOMOUS GROSS AMOUNT DUE
- GENERAL DEDUCTIONS (67 %) Deductions for business activities Deduction for gifts. Deductions for investment and expenditure on goods of cultural interest. Deductions for investment on purchase home (10,05 %)	**- GENERAL DEDUCTIONS (33%)** Deductions for business activities Deduction for gifts. Deductions for investment and expenditure on goods of cultural interest. Deductions for investment on purchase home (4,95 %)
- DEDUCTIONS FOR INTERNATIONAL DOUBLE TAXATION **- PREVIOUS PAYMENTS** Deduction for tax purposes Payment in instalments **- DEDUCTIONS FOR MATERNITY** -	
= TOTAL NET AMOUNT DUE (TAX DEBT)	

BASIS OF ASSESSMENT

The amount of the taxpayer's disposable income, i.e. income less the personal and family minimum This includes all income, capital gains and losses and imputed income as laid down by Law No 40/1998, irrespective of where it was generated or the residence for the payement (Fernández de Soto Blass , M. L, 2004).

The taxpayer's income consists of:

- Income from employment;
- Income from real states capital;
- Income from movable assets or movable capital
- Income from business;
- Capital gains and losses;
- Imputed income as laid down by law.
- Income from tax transparency

1. Income is qualified and quantified according to its origin.
2. Net income is the income liable less deductible expenses.

NET INCOME = INCOME LIABLE -DEDUCTIBLE ESPENSES [1]

3. Capital losses and gains are determined by the difference between asset transfer and purchase prices.

CAPITAL GAINS AND LOSSES = ASSET TRANSFER – PURCHASES PRICES

4. The corresponding net income reductions are applied, as appropriate, to each source of income.
5. The different types of income are pooled and offset according to their origin, and are classified in general income and saving income.

~ General income are the taxpayer's income, excluding saving income, and imputed income as laid down by the law

~ Saving income are dividends, interests, insurance investments and capital gains and losses from the disposal of assets

[1] The formulas of the paper are created by the author. You can see them in the book: :Fernández de Soto Blass M. L. (2007): Teoría y Práctica. Tributos Españoles, Dykinson, Madrid.

6. The net general taxable base is obtained by making reductions from the general taxable basis for contributions to pension plans or provident mutual societies,.

NET GENERAL TAXABLE BASE = GENERAL TAXABLE BASE – REDUCTIONS FOR CONTRIBUTIONS TO PENSION PLANS OR PROVIDENT MUTUAL SOCIETIES

7.The general taxable base, that is subject to progressive, State and autonomous or complementary tax rates, is made up of all the taxpayer's income excluding income from capital and the capital gains and losses referred to in the next paragraph, and consists of: (a) the balance resulting from unlimited pooling and offsetting of income and imputed income to which Title VII and Article 78 of Law No 40/1998 refer and (b) the positive balance resulting in each tax period from pooling and offsetting capital gains and losses, solely against one another, excluding those referred to in the following paragraph.

8.The saving taxable base is made up of the positive balance resulting in each tax period from pooling and off-setting, solely against one another, the income from capital the capital gains and losses arising from the transfer of asset elements or improvements realised thereby, more than one year prior to the date of transfer or subscription rights corresponding to the securities purchased, again more than one year previously. Proportional, State, autonomous or complementary rates apply.

9.The personal and family minimum to which the taxpayer is legally entitled, according to his personal and family situation are applied the state and autonomous rates to calculate the general taxable base.. The general taxable base, which cannot, however, end up being negative. Any surplus is applied to reduce the saving the taxable base, which cannot end up negative either.

RATE

The rates given in the tables below are applied to the net general taxable basis. This is obtained by making deductions from the general taxable basis for contributions to pension plans or provident mutual societies and for compensatory pensions to the spouse and maintenance payments, with the exception of those for the taxpayer's children, both paid as a result of a court order.

(a) General or State Rates:

Net taxable basis - Up to €:	Gross amount due - €	Remainder net taxable basis - Up to €:	Rate applicable - %
0	0	17,707,20	15.66
17,707.20	2,772.95	15,300,00	18.27
33,007.20	5,568.26	20,400,00	24.14
53,407.20	10,492.82	and above	27.13

GENERAL TAXABLE BASE X STATE TAX RATES = GROSS AMOUNT DUE 1 A

(b) Autonomous community and complementary rates: these are the rates adopted by the autonomous community in accordance with Law No 21/2001 of 27 December 2001. If the autonomous community has not adopted the abovementioned scale, the following complementary rate will apply:

Net taxable basis - Up to €:	Gross amount due - €	Remainder net taxable basis - Up to €:	Rate applicable - %
0	0	17,707.20	8.34
17,707.20	1,476.78	15,300.00	9.73
33,007.20	2,965.47	20,400.00	12.86
53,407.20	5,588.91	and above	15.87

GENERAL TAXABLE BASE X AUTONOMOUS TAX RATES = GROSS AMOUNT DUE 1B

The following rates apply to the saving net taxable basis:

The personal and family minimum to which the taxpayer is legally entitled, according to his personal and family situation are applied the state and autonomous rates to calculate the general taxable base . The general taxable base, which cannot, however, end up being negative. Any surplus is applied to reduce the saving the taxable base, which cannot end up negative either.

THE PERSONAL AND FAMILY MINIMUM X STATE TAX RATES = GROSS AMOUNT DUE 2A

THE PERSONAL AND FAMILY MINIMUM X AUTONOMOUS TAX RATES = GROSS AMOUNT DUE 2B

GROSS AMOUNT DUE 1 A - GROSS AMOUNT DUE 2 A = STATE GENERAL GROSS AMOUNT DUE

GROSS AMOUNT DUE 1 B - GROSS AMOUNT DUE 2B = AUTONOMOUS GENERAL GROSS AMOUNT DUE

(a) Central government rate: 11,1%.
(b) Autonomous community or complementary rate: 6.99%.

SAVING TAXABLE BASE X STATE TAX RATE (11,1 %) = STATE SAVING GROSS AMOUNT DUE

SAVING TAXABLE BASE X AUTONOMOUS TAX RATE (6,99 %) = AUTONOMOUS SAVING GROSS AMOUNT DUE

DEDUCTIONS

The law on income tax provides for certain deductions:
1.From the gross amount due to the central government, defined as the sum of the quantities obtained from applying the general and the saving tax rate to the general and saving net taxable bases respectively. The gross amount due to the central government is reduced by the deduction below mentioned in (a) and the 67 % of the total amounts claimed in (b), (c), (d) and (e):

(a)Deduction for investment in the habitual place of residence. Generally speaking, 10.05 % of the quantities paid in the period covered by the purchase or repair of the dwelling that constitutes or will constitute the taxpayer's habitual residence. The annual maximum basis of this deduction is € 9,015 and consists of the amounts paid for the purchase or repair of the dwelling and the amortisation, interest and other expenses connected with outside funding. This deduction can also be applied to the amounts that are deposited with credit institutions, in accounts that meet the requirements laid down by law as regards opening an account and withdrawing funds, and provided that they are intended for the initial purchase or repair of the habitual residence, with an annual limit, together with that provided for in the previous paragraph, of € 9,015. This deduction can also be applied for the investment expenses incurred in the repairs carried out for the dwelling adaptation to the handicapped personal needs, with an annual maximum basis of € 12,020. In this case, the deduction percentage will be 13.4%.
(b)Deductions for business activities. Persons liable for income tax who are engaged in business activities are entitled to the business investment incentives established or to be established in the rules on corporation tax, with the same deduction percentages and ceilings.
(c)Deduction for gifts. Taxpayers may apply:
- the deductions provided for in Law No 49 of 4 November 2002 on foundations and tax incentives for private participation in activities of general interest;
- 10 % of the sums donated to legally recognised foundations which are answerable to the corresponding government authority, and to associations for public utility not included in the previous indent.

(d)Deductions for income from Ceuta and Melilla (provinces).
(e)Deductions for investment and expenditure on goods of cultural interest.
(f)Deductions for company-saving account.

2.From the gross amount due to the Autonomous Communities or on a complementary basis, defined as the sum of the quantities obtained from applying the autonomous or complementary rate and the special rate to the general and special taxable bases respectively. They are as follows:
(a)The Autonomous Communities slice of the deduction for investment in the habitual place of residence defined as the result of the application of the rates legally adopted by the Autonomous Communities to the same base of

deduction as mentioned above in 1. (a). If the Autonomous Community had not issued these rates the following ones will be applied: generally speaking, 4.95 %, and in the case of investment expenses incurred in the repairs carried out for the dwelling adaptation to the handicapped personal needs, 6.6%.

(b)33% of the total amount of the deductions provided for in Article 68 of Law No 40/1998, with the limits and requirements as regards assets provided for in Articles 69 and 70 thereof.

(c)The amount of the deductions established by the autonomous community in the exercise of the powers laid down in Law No 21 of 27 December 2001 on the transfer of taxes from the central government to the Autonomous Communities and additional tax measures.

The net amount due to the central government, the Autonomous Communities or on a complementary basis is obtained by applying these deductions. The following deductions are allowed from the total net amount due:

3.Deductions for international double taxation:

(a)Generally speaking, when the taxpayer's income includes capital income or gains generated and taxed abroad, the lesser of the following amounts is deducted:

- the amount effectively paid abroad in the form of a personal tax on the said capital income or gain;
- the result of applying the tax rate to the part of the net basis taxed abroad.

(b)Relief for double international taxation by entities that are subject to controlled foreign corporation clauses, when income is included in the taxable basis.

(c)Relief for double international taxation by taxpayers when income is attributed to the transfer of rights of personal portrayal.

4.Deduction for maternity: deduction for women with children younger than 3 years that work by their own on other people's account, given discharge in the corresponding regime of the Social Security and coexist with the children when each child does not obtain any income over € 8,000. In case of adopted or welcomed children, working women may claim for the deduction up to three year later of the adoption/welcome registration in the Civil Registry. When there is no registration need, the deduction may be claimed as of the date of the judicial or administrative resolution. The deduction may rises up to € 1,200 per year per child under 3 years.

JOINT TAXATION

Persons who form any of the following types of family unit may file joint tax returns:

1.Spouses who are not legally separated and, where relevant: (a) under-age children, with the exception of those who with their parents' consent, live independently from them, (b) adult handicapped children who are legally subject to extended or reinstated parental authority.

2.In cases of legal separation, or where there is no matrimonial link, a family unit formed by the father or the mother and all the children that live with either parent and that meet the requirements laid down in (1) above.

No one may form part of two family units at the same time. The members of the family unit are determined on the basis of the situation prevailing at 31 December. Opting for joint taxation is not binding for successive periods. It must include all members of the family unit. If one of them files an individual return, the others must too. The decision to opt for joint taxation during an assessment period cannot be altered subsequently, once the statutory deadline for filing a tax return has elapsed. Joint taxation is governed by the general tax rules on calculating the taxpayer's income, the gross and net taxable bases and the tax debt, and by the following special rules:

3.The amount and limits for individual taxation also apply to joint taxation. They may not be increased or multiplied according to the number of family members. However:

- The maximum limit for deductions from taxable income laid down in articles 52, 53 and 54 of Law 35/2006 (contribution to pension funds, mutual societies and any others) apply individually to each member of household.
- Taxpayer allowance will be € 5,050 regardless the number of household members. Disability allowances are claimed according to personal circumstances of spouses belonging to the family unit.
- In the first type of family unit, before deductions laid down in articles 52, 53 and 54, the taxable base will be reduced in € 3,400 per year. In the second type of family unit, the amount will be € 2,150 per year.
- In no case may the personal allowance be applied to children, without prejudice to the amount resulting from the family allowance.

4.In joint taxation, it is possible, subject to general tax rules, to offset capital losses and net negative tax bases that were not offset by members of the household in previous tax periods in which they filed individual tax returns. The same elements determined in joint taxation may only be offset, in the case of subsequent individual taxation, by taxpayers that meet the rules on individualisation of income contained in this law.

5.Income of any type obtained by natural persons in a family unit that have opted for joint taxation is taxed cumulatively.

6.All the members of the household remain jointly and severally subject to the tax, without prejudice to the right to divide up the tax debt among them, according to each one's share of taxable income.

TAX DUE DATE AND COLLECTION

The tax due date will be the 31th December of each day

Taxpayers must submit a return for this tax. However, taxpayers whose income comes exclusively from the following sources do not have to file a return:

- Earned income, with a gross annual limit of € 22,000 euros in individual or joint taxation;
- Income from movable assets and capital gains subject to withholding tax or advance payments, with an annual limit of € 1,600;
- Imputed real estate income from urban real estate other than the habitual residence.
- Income from Treasury Bills (not withheld at source) and Grants for the acquisition of subsidised housing, with an annual limit of € 1,000.
- In any case, those taxpayers with a joint income up to € 1,000 exclusively coming from employment, capital, professional activities and capital gains do not have to file a tax return.

The limit for earned income is € 10,000 for taxpayers who receive earnings from more than one payer and who collect compensatory pensions from their spouse or non-exempt maintenance payments.

Taxpayers who are entitled to relief for investment in housing, double international taxation or contribute to pension plans or provident mutual societies that reduce the taxable base, are obliged to submit a return.

CONCLUSIONS

In the Communication on "Tax policy in the European Union - Priorities for the years ahead" (COM/2001/260 of 23 May 2001), the Commission reiterated its belief that there is **no need for an across the board harmonisation of Member States' direct tax systems**. For tax policy, the Communication established, as a main priority, the need to address the concerns of individuals and businesses operating within the Internal Market by **focusing on the elimination of tax obstacles to all forms of cross-border economic activity**, in addition to continuing the fight against harmful tax competition. This approach was confirmed in the Communication "The contribution of taxation and customs policies to the Lisbon strategy" (COM/2005/532 of 25 October 2005).

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