

# Entry into force of Madrid's new regional tax incentive for foreign taxpayers

## Tax Alert



November 2024

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## Approval of a regional personal income tax credit of 20% for investments in securities by foreigners acquiring tax residence in Madrid.

Law 4/2024 of 20 November 2024, amending the revised wording of Madrid's regional legislation on devolved taxes, approved by Legislative Decree 1/2010 of 21 October 2010, to establish a personal income tax ("PIT") credit for new investments by foreign taxpayers, has now been published in the Official Gazette of the Region of Madrid ("BOCM").

This significant regional PIT credit was first proposed in 2023. However, insufficient support for it during the government's previous term of office meant that it never saw the light.

In July 2024, the Madrid Assembly published the Draft Law on this tax credit, the structure and content of which have remain unchanged throughout the legislative process. The Law ultimately approved therefore includes no amendments with respect to the initial text of the 2024 Draft Law.

This new Law, which was published in the BOCM on 28 November 2024, provides for its retroactive entry into force as of 1 January 2024 and application to all transactions carried out as of that date.

The main objective of this Law is to attract new investors, thereby fostering the generation of employment, the creation of new companies and the growth of those already operating.

The main features of the new tax credit are as follows: Since the content of the **Draft Law** and **Law 4/2024** is practically identical (with the exception of certain technical corrections), this alert is an **update** of that released previously, and includes details of the final steps of the Law's approval and publication in the BOCM.

### Who is eligible for the tax credit?

Natural persons not resident in Spain who relocate to the Region of Madrid and become personal income taxpayers, provided they have not **been tax resident in Spain during the five years preceding** the year in which the change of residence takes place.

Note that such persons must continue to hold personal income taxpayer status in the Region of Madrid until the final year of the six-year mandatory investment period.

### PIT credit rate and eligible investments

The PIT credit will amount to **20%** of the acquisition value, including the related expenses and taxes and excluding interest, of any of the following assets:

- a. Securities representing the assignment to third parties of equity traded on organised markets or otherwise.
- b. Securities representing holdings in the equity of Spanish or foreign entities, traded on organised markets or otherwise.

Where the relevant investments are in unlisted securities representing a holding in the equity of any kind of entity, eligibility for the tax credit will be subject to three requirements:

- ✓ The entity in question must not be incorporated or domiciled in a tax haven.
- ✓ The direct or indirect holding of the taxpayer, combined with any such stake as may be held in the same entity by their spouse or individuals to whom they are directly or indirectly related, by consanguinity or affinity, up to and including the second degree, **may not exceed 40%** of the capital or voting rights of the entity on any day of the six calendar-year period for which the investment must be held.
- ✓ The taxpayer must not exercise executive or management duties at, or have an employment relationship with, the entity in which the investment is held.

## Deadline for investment

Investments consisting of **securities representing the assignment to third parties of equity issued by Spanish entities, or securities representing a holding in the equity of Spanish entities** may be made in any of the following three years:

- in the year preceding that in which tax residence in Madrid is acquired;
- in the year in which tax residence in Madrid is acquired; or
- in the year following that in which tax residence in Madrid is acquired.

In the case of **eligible investments other than those listed above**, the investment may be made:

- in the year in which tax residence in Madrid is acquired; or
- in the following year.

## Minimum investment period

The taxpayer must maintain the qualifying investment for a minimum period of six years.

However, this minimum investment period requirement will not be deemed breached where an investment is disposed of and the proceeds are fully reinvested in any eligible assets within one month.

## When is the tax credit to be taken?

Generally speaking, the tax credit may be taken in the year in which the investment is made or, where the taxpayer in question has insufficient tax payable in that year to use it, within the five years immediately following it.

In the specific case of investments in securities representing the assignment to third parties of equity issued by Spanish entities, or securities representing a holding in the equity of Spanish entities made in the year preceding that in which personal income taxpayer status in Spain is acquired, the tax credit may be taken in the year in which tax residence is acquired or within the five years immediately following it.

Any other regional tax credits to which the taxpayer may be entitled will be applied before this new credit is taken.

## Can entitlement to the tax credit be lost?

Yes. Entitlement to the tax credit will be forfeited in the event of loss of tax residence in Madrid during the six-

year minimum investment period, and in the event of breach of the obligation to maintain the investment (i.e. if the assets - the securities referred to above - are transferred before the above period elapses without the requisite full reinvestment).

## Is it incompatible with other tax credits?

The new tax credit envisaged in the Draft Law is incompatible -in respect of the same investment- with regional tax credits for the acquisition of shares or holdings in new or recently created entities, or for investments in companies listed on the Alternative Stock Market.

## And with the inbound expatriates regime?

It is incompatible with the inbound expatriates regime as the tax credit is not envisaged in such scheme. Application of the special inbound expatriates regime involves calculating the taxpayer's PIT liability in line with the provisions set forth in the revised Non-Resident Income Tax Law, the assessment structure of which does not factor in regional tax credits for the purpose of determining the tax due.

## Practical implications

As stated previously, application of the tax credit calls for a detailed analysis of each particular case, as whether or not a given investment may be optimised depends on the specific circumstances of each investor and the taxpayer's expected income throughout the entire period in which it may potentially apply (the year of the investment and the following five years in the event of insufficient gross tax payable). Thus, when deciding how much to invest, taxpayers should take into consideration not only the income earned in the year of the investment, but also that which will be earned in subsequent years, to assess whether they have a sufficient amount of gross tax payable to be able to take advantage of the credit.

Subject to individual analysis, this tax credit may prove more beneficial for high-income taxpayers with sufficient personal income tax liability to avail themselves of it.

Nonetheless, the impact of the investment on wealth tax and the tax on large fortunes in the Region of Madrid should also be considered.

For a non-resident who is thinking of coming to Spain, and specifically to Madrid, it is important to analyse the implications of both the inbound expatriates regime (assuming they meet the relevant requirements) and the ordinary regime, in order to ascertain whether or not they should apply the tax credit for investment in Madrid.

One potentially significant difference? between the two is as follows:

- Under the inbound expatriates regime, wealth tax and/or the tax on large fortunes is only paid on assets or rights located, exercisable or enforceable in Spain, and tax is only levied on Spanish-source income, deemed to include all earned income and income from economic activities officially classed as entrepreneurial activities, and not on other income not received in Spain (foreign-source dividends, capital gains, rent, etc.).
- If the taxpayer does not opt for the inbound expatriates regime, and therefore opts for the general regime for residents in Spain, potentially taking advantage of the Madrid tax credit, as an ordinary resident they must, in principle (except where there are double taxation treaties in place) declare their worldwide wealth and income and report their assets located abroad (using tax form 720) if the minimum threshold (€50,000 for each group of assets) is exceeded for such purpose.

It is therefore very important for those who are considering setting up in Spain and, specifically, in the Region of Madrid, to analyse their specific circumstances in order to determine how they will be taxed.

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