Teaching Manual Spanish personal income TAX: Practical Application Fiscal Year 2023

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Presentation

The Personal Income Tax (IRPF, *Impuesto sobre la Renta de las Personas Físicas)* is a fiscal instrument that forms part of the Spanish tax system. It is a periodic, progressive, direct and personal tax levied on the income of natural persons, depending on their personal and family circumstances. It is regulated by Law 35/2006, of November 28, on Personal Income Tax, and Royal Decree 439/2007, of March 30, which approves the Personal Income Tax Regulation. In addition, other applicable regulations must be considered, such as Royal Decree 1461/2018, of December 21, which modifies the Personal Income Tax Regulation, Royal Decree-Law 27/2018, of December 28, which adopts certain measures relating to tax and cadastral matters, and Order HFP/1172/2022, of November 29, by which the objective estimation method of the Personal Income Tax and the special simplified regime of the Value Added Tax are developed for the year 2023.

This teaching manual is intended as a useful instrument for students of Public Sector Economics to gain a basic theoretical and practical understanding of Spanish personal income taxation. To this end, numerous practical examples are included to enable the application of this tax and clarify both common issues and more complex ones. The answers to the exercises refer to the 2023 tax period, applying the regulations in force in this period and introducing any modifications to the regulations. In the different sections of this manual, partial exercises are provided, including the applicable regulations underpinning the study of the theoretical concepts, as well as explanatory notes which help students understand the solutions to the exercises. In addition, at the end of each exercise there are some notes on the Spanish Personal Income Tax that give a quick overview of the tax to facilitate understanding, as well as a glossary of concepts to clarify the most relevant terms.

This manual in English is based on the teaching material in Spanish used by the teachers of the subject, including further explanations of specific points for foreign students when necessary. Firstly, and after this presentation, there is the introduction, the theoretical chapter, which leads into the second chapter, about income from work. The following sections (chapters 3 and 4) are about income from capital and income from economic activities. All of them are explained using elaborate exercises. At the end of the manual, two diagrams of the tax are attached, with a list of the references used to develop them.

I. Introduction

The Spanish Personal Income Tax (IRPF) is regulated by Law 35/2006, of November 28, on Personal Income Tax, and Royal Decree 439/2007, of March 30, which approves the Personal Income Tax Regulation. In addition, other applicable regulations must be considered, such as Royal Decree 1461/2018, of December 21, which modifies the Personal Income Tax Regulation, Royal Decree-Law 27/2018, of December 28, which adopts certain measures relating to tax and cadastral matters, and Order HFP/1172/2022, of November 29, by which the objective estimation method of the Personal Income Tax and the special simplified regime of the Value Added Tax are developed for the year 2023. It is a periodic, progressive, direct and personal tax levied on the income of natural persons, depending on their personal and family circumstances.

1.1. Concept and Nature

The Personal Income Tax (IRPF) is defined as a personal and direct tax that, in accordance with the principles of equality, generality and progressiveness, is levied on the income of natural persons depending on their personal and family circumstances.

It has the following characteristics:

a. It is a direct tax. It taxes a direct or immediate manifestation of wealth: the income of individuals at the time it flows to them.
b. It is a personal tax. The taxable event is related to a specific person.
c. It is a subjective tax. To calculate the tax owed, the personal and family circumstances of the taxpayer are taken into account.
d. It is a periodic tax. The taxable event continuously reoccurs.
e. It is a progressive tax. The tax rate applied increases as the tax base on which the tax is levied increases.

The tax is levied on the amount of income that the taxpayer can use after meeting his/her needs and the needs of those who depend on him/her.

1.2. Scope of Application

Regarding the scope of application, the Personal Income Tax is applied throughout the Spanish territory, without prejudice to:

a. The regional tax regimes of the Basque Country and the Community of Navarra.
b. Specific provisions in the regulations for the Canary Islands, Ceuta and Melilla.
c. The provisions of the International Treaties and Conventions that have become part of the domestic legal system.

1.3. Taxable Event

The taxable event is the receipt of income by the taxpayer. The following items make up the taxpayer's income:

a. Earnings from work.
b. Capital income.
c. Income from economic activities.
d. Capital gains and losses.
e. Income imputations.

1.4. Tax Liability

There are two different classes of taxpayers. In this regard, the Personal Income Tax Law only regulates the tax liability of Spanish residents, leaving the regulation of the taxation of non-residents to a specific law that regulates the income of non-residents (IRNR).

1.4.1. Tax Liability of Residents in Spain

The Personal Income Tax Law considers the individual as a taxpayer. The following are thus liable to pay the Personal Income Tax:

1. Natural persons who have their habitual residence in the Spanish territory. The taxpayer has his/her habitual residence in the Spanish territory when any of the following circumstances occurs:

   a. He/she remains in Spain for more than one hundred and eighty-three days during the calendar year.
   b. The core of his/her economic activities or interests is in Spain, directly or indirectly. It will be presumed, unless proven otherwise, that a taxpayer's habitual residence is in Spain when, in accordance with the previous criteria, he/she is not legally separated from his/her spouse and has minor children who depend on him/her and who habitually reside in Spain.
2. Individuals whose habitual residence is abroad due to any of the following circumstances:
   a. People of Spanish nationality, not legally separated from their spouse and with minor children who have their habitual residence abroad, due to their status as:
   b. Members of Spanish diplomatic missions.
   c. Members of the Spanish consular offices.
   d. Holders of an official position or employment of the Spanish State as members of the delegations and permanent representations accredited before international organizations or that are part of delegations or missions of observers abroad.
   e. Active employees who hold an official position or employment abroad.

   By way of reciprocity, foreign nationals who have their habitual residence in Spain will not be considered taxpayers when this circumstance is a consequence of any of the previous assumptions (members of diplomatic missions, consular offices, officials).
3. Natural persons of Spanish nationality who prove their new tax residence in a country or territory classified by regulation as a tax haven. This rule will be applied in the tax period in which the change of residence takes place and during the following four tax periods.

   The fundamental consequence of a natural person being a taxpayer is that they are subject to the Personal Income Tax for their worldwide income, that is, regardless of where the taxpayer's residence may be.

1.4.2. Tax Liability of Non-residents on Spanish-Source Income

Non-resident individuals and entities are liable to pay an independent tax levied on their income obtained within Spanish territory. In this section we cover the tax liability of non-resident individuals.

The following persons are considered taxpayers for non-resident income tax:

a. Individuals who are non resident within the Spanish territory who obtain income therein.
b. Individuals who are residents in Spain as members of diplomatic and consular missions, foreign officials, etc.

Non-resident natural persons will be subject to the tax exclusively for the income obtained in Spanish territory. For these purposes, the following is considered income obtained in Spanish territory: income derived from economic operations carried out through a permanent establishment located in Spanish territory, income from economic activities obtained without the mediation of a permanent establishment, income from work provided in Spanish territory, income derived from real estate and capital gains.

1.4.3. Individual and Joint Taxation

a) *Individual taxation*

The Personal Income Tax individualizes income by taxing the economic capacity of each natural person (taxpayer) independently of the other natural persons with whom they live. The income is understood to be obtained by the taxpayers according to the origin or source thereof, regardless of the economic regime of the marriage, where applicable. The individualization rules according to the sources of income are the following:

- Earnings from work will be attributed exclusively to whoever has generated the right to receive them. However, pensions and benefits from pension plans and insurance contracts will be attributed to the natural persons in whose name they are.
- Capital returns will be attributed to taxpayers who are holders of the equity elements that generate said returns.
- The income from economic activities will be attributed to those who carry out regular, personal and direct management of the means of production and human resources involved in the activities on their own account. Those who appear as holders of economic activities are presumed as such.
- Capital gains and losses will be attributed to taxpayers who are owners of the assets and rights from which they come.

b) *Joint taxation*

Joint taxation is an optional tax regime. People who are part of any of the following types of family unit can pay joint taxes:

1. The family unit comprising spouses who are not legally separated and, where applicable:
   - Minor children, with the exception of those who, with the consent of their parents, live independently.
   - Legally disabled children of legal age subject to parental authority.
2. 2. In cases of legal separation, or when there is no marriage, the family unit formed by the father or the mother and all the children who live with one or the other and who meet the aforementioned requirements.

No one can be part of two familiar units at the same time.

The determination of the members of the family unit is based on the situation on 31st December of each year, except in the case of a death of a member of the family unit during the year, in which case, the remaining members of the family unit may opt for joint taxation.

In joint taxation, the general tax rules on how to determine the income of the taxpayers, the tax base and the amount of tax owed are applicable. The amounts and quantitative limits established for the purposes of individual taxation are the same for joint taxation, and do not increase depending on the number of members of the family unit.

1.4.4. Obligation to file a Tax Return

Taxpayers who obtain income exclusively from the following sources are not required to file a tax return:

a. Earnings from work, up to a limit of 22,000 euros of annual gross income in individual or joint taxation, when they come from a single payer or from more than one payer if the amounts received from the second and subsequent ones do not together exceed 1,500 euros of annual gross income. This limit is 15,000 euros for taxpayers who receive income from more than one payer and for those who receive compensatory pensions from the spouse or annuities for alimony not fixed by court decision, and when the payer should not withhold taxes or a fixed rate of withholding is applied to full earnings from work.
b. Income from movable capital and capital gains subject to withholding or payment on account, with a joint limit of 1,600 euros annual gross income.
c. Imputed real estate income, income from movable capital not subject to withholding derived from treasury bills, subsidies for the acquisition of officially protected housing and capital gains from public aid, which do not exceed the joint limit of 1,000 euros/year.

d. Income from work, capital, economic activities and capital gains with the joint limit of 1,000 euros and capital losses of less than 500 euros.

Taxpayers who have the right to a deduction for investment in their habitual residence or due to international double taxation laws, or who make contributions to pension plans or social welfare mutual insurance fund that reduce their tax base, always have to file a tax return when exercising these rights.

1.4.5. Exemptions

Article 7 of the Personal Income Tax Law (LIRPF by its initials in Spanish) contains a list of the cases in which income is exempt from personal income tax, without prejudice to other specific cases of exemption listed in the other articles. In accordance with the aforementioned article, some of the sources that are exempt, in some cases with limits, are as follows:

- Public benefits for acts of terrorism.
- Legally awarded compensation for civil liability for physical or mental damage to people.
- Compensation for dismissal or termination—the mandatory amount according to labour regulations. (There are limits).
- Benefits for absolute permanent disability or severe disability accredited by Social Security.
- Public scholarships to study regulated studies (with certain limits), for research, and for financial aid to high-level athletes, also with limits for the latter.
- Child support payments established by virtue of a court decision.
- Literary, artistic, or scientific awards.
- The total of unemployment benefits received in a single payment when certain requirements are met (creation of an entity, incorporation as a partner or self-employed).
- Government maternity or paternity allowances.
- From financial year 2023 on, prize money equal to or less than 40,000 euros. Any prize money more than 40,000 euros will be subject to taxation, at the rate of 20%.

1.4.6. Tax Period and Payment of Tax. Time Period Allocation

The tax period is the calendar year. The tax will accrue on 31st December of each year. The tax period will be less than the calendar year when the death of the taxpayer occurs on a