Doing Business
in Spain

KRESTON
IBERAUDIT

Setting up your Business in Spain

Issues to consider.

Spain is one of the most attractive destinations for foreign investment, offering access to the market of the EMEA region and Latin America. According to the OECD FDI Regulatory Restrictiveness Index, Spain ranks 9th most open country to international investment. The highly qualified population and a decline in labor costs, together with state-of-the-art infrastructure, make Spain well placed for the future growth of economy, especially as an international center for innovation.

However, there are several issues which you must consider when you are looking to set up your business in Spain.

At Kreston Iberaudit, we have a team of qualified and committed professionals who will always accompany and advise you.

We can advise and help you in different areas such as:

- Administrative services
- Accounting outsourcing
- Consolidation
- Controlling & Reporting
- Due Diligence
- Financial consulting
- Holding Companies regime or Specific locations
- HR/ Payroll outsourcing
- M&A & Transactions services
- Legal advice & law firm (labour, commercial, tax law)
- Transfer pricing
- Tax consulting
- Tax Regime for expatriate personnel employees,

- …

This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company No limited liability or ring-fencing of the Spanish operations.
- If have a permanent establishment in Spain, then profits from this PE are liable to Spanish Corporation tax.
- Must file parent company accounts, prepared under Spanish Company Law, at Companies House for public inspection, even if these are not made publicly available overseas.

Limited Company:

- Provides limited liability and ring-fencing to Spanish operations.
- Gives a perception of a local business, with longevity.
- Corporation tax to be paid on company profits.
- Companies, must have their annual financial statements audited when two of the below conditions are met for two consecutive years:

	March 31st
Company Turnover, exceed	5,700,000.00 €
Company Balance Sheet total assets, exceed.	2,850,000.00 €
Company average number of employees, exceed.	50

Limited Liability Partnership:

- Members (partners) have limited liability.
- Profits are allocated to members who then pay Income Tax on these profits personally.
- The tax residence of the member, and where the profits in the LLP originated will determinein what jurisdiction and how these profits are taxed.

How much Corporation Tax will the business pay?

Current General Corporation Tax rates in Spain is: **25%.**

For financial years starting in January 2023, the special rate of 23% may be applicable if the net turnover is less than EUR 1 million.

A lower tax rate is applicable for newly-formed companies, which applies to the first two years in whichit obtains a taxable profit: The rate is 15%.

(NB: rates are for the tax year started in January 2023)

Payment of Company Tax:

The company tax return must be filed within 6 months and 25 days after end of the accounting period.

Payment by instalments of company tax is in April, October and December. Generally, each instalment is 18% of the previous year's company tax liability.

A separate method of calculation, 24% on the result of the current year, applies to large companies whose turnover in the previous year exceeds a set limit (10 Eur Million). Same method, but with a different applicable rate of 17%, may be applied for small companies that have voluntarily opted for this system.

Calculation of taxable income:

The starting point is net profit per accounts, calculated in accordance with the General Accounting Plan. However, the accounting result must be adjusted by applying the tax principles established inthe legislation of the tax. In general, the expenses relating to business activity are deductible if they are properly accounted for and justified, and if the timing of recognition rules have been fulfilled.

There is no distinction between long-term and short-term gains.

Minimum tax rate:

Since 2022, Spain has incorporated a general minimum tax rate of the 15% on the taxable base, before applying some deductions and tax allowances regulated in the Law. This tax rate applies to entities to which the general rate of 25% applies, with certain specialities for special activities.

Tax losses: can be carried forward indefinitely. However, there are specific quantitative limitations forthe offsetting of these tax losses, companies whose turnover of the previous year was under 20Eur Million: Tax losses may be offset up to 70% of the positive tax base prior to offset, although offset is permitted up to 1 Eur Million in any event.

Financial expenses:

Thin - capitalization rules are not applicable. Nevertheless, interests derived from participative loans are considered non-deductible. Moreover, interest payments are deductible with the limit of 30% of the Operating Profits when interest amount exceeds 1M Eur.

Disallowable expenses:

Penalties and fines. Corporation tax payments. Gifts and donations (exception applicable forNon-Profit recognized entities).

Group relief:

A consolidated tax return may be filed if an election is made before start of tax year. Resident companies with a common resident or non-resident Ultimate Holding Company areincluded in the same tax group.

There must be a 75% direct or indirect ownership for whole of both the current and prior tax year.

R+D Tax credits:

This tax credits may be available at a rate of 25% (in certain cases 42%) of the R+D expenses and investments incurred in the tax period. The activity must be carried out in Spain or EU economicarea. Additional tax credits can apply in some circumstances and advice should be obtained.

It is recognized a tax credit for 12% of the expenses incurred in the tax period on Technological Innovation (T.I).

Mentioned R+D and T.I Tax Credits are limited to 25% of the gross tax payable (the limit will be raisedto 50% when R+ D and T. I expenditure and investment in the tax period exceed 10% of the gross taxpayable). However, any excess can be carried forward for use in the following 18 years.

In case of insufficient tax payable, before applying the afore mentioned R+D and T.I tax credits, it isestablished the possibility to request the payment of the tax credits from the tax authorities through the tax return in cash. In order to apply mentioned mechanism, specific requirements must be met, and advice should be obtained.

What if we use Spain to set up our holding company?

The Spanish tax legislation means that it is a very attractive place to set up a holding company.

Highlight tax impact of disposals of group companies.

Comment on treatment of dividends paid and received including the impact of withholding tax.

Additionally, Main Tax Benefits of Spanish Holding Company are:

- 95% exemption for dividends and capital gains realized on the disposal of shares (participationof at least 5% and minimum 10% of Corporate Tax applicable to the subsidiary);
- Absence of withholding tax on distribution of non-Spanish source dividends exempted (ETVEs companies);
- Full deductibility of interest payments (fulfilling certain requirements);
- No capital duty on the issue of share capital for entities established in certain provinces, and on share-for-share contributions;
- 95% Exemption of overseas branch income (provided similar tax paid abroad and minimum 10% tax rate); This limit (5% non-exempt) will NOT apply to companies that have net revenue of less than EUR 40 million and that are not part of a business group, for a period limited to three years, when obtained from a subsidiary, whether or not a resident in Spain, constituted after 1st January

2022.

Special Tax Regime of the Balearic Islands

The Special Tax Regime of the Balearic Islands was established in 2023. Its main objective is to reduce the negative effects on the competitiveness of companies derived from the insularity of companies with activity in the Balearic Islands. In terms of corporate income tax, this regime allows a significant reduction in corporate income tax for the part of the profit obtained from establishments located in the Balearic Islands.

Basis of reduction=reserve for endowed investments in the Balearic Islands (RIB):

The limit of the base, and therefore the maximum reduction applicable, is 90% of the undistributed profit generated in the Balearic Islands, provided that the following conditions are met:

A) Materialise the RIB applied in corporate taxation acquiring assets located or received in Balearic Islands, and on the job creation related with these assets

B) Set aside a reserve for this amount and maintain it for as long as the assets to be realised are to be held (between 5 and 10 years),

Profits must derive from economic activities carried out from permanent establishments located in the Balearic Islands.

Duration of the special regime:

In principle, the special regime has been approved for a period of 5 years, starting in 2023, and would therefore end in 2028.

Maximum amount

The effect on tax liability, as well as with other de minimis aid, may not exceed the limit established by the EU (€300,000 during the year of application and the 2 previous years).

Therefore, given that the tax rate is 25%, the taxable base eligible for reduction is 1,200,000 euros, and the saving in tax liability would be 300,000 euros, over a period of 3 years.

What if we make cross-border transactions between group companies?

Spain follows internationally recognised Transfer Pricing (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been betweencompletely independent parties.

The Spanish transfer pricing legislation is based on the OECD transfer pricing guidelines and the workof the European Union Joint Transfer Pricing Forum. Although pan-European comparable should be acceptable, in practice the Spanish tax authorities have expressed a strong preference for the use of local comparable whenever possible.

Management fees are deductible if they're at arm's length, and the service yields or may yield a profit to the company receiving the services. This benefit must be proved and documented, together with the substance and reality of the services.

Taxpayers must provide information regarding related party transactions in a specific informativetax return.

Taxpayers should update their transfer pricing documentation on a yearly basis, including all relevant changes in the conditions of their commercial and financial relations in light of the pertinent documentation requirements.

Deadline to submit documentation: The tax authorities may request documentation at any timeafter the taxpayer files the annual corporate income tax return.

From a strategic perspective, it is preferable to prepare documentation in Spanish. If the documentation is needed as evidence (especially in court), it should be translated into Spanish.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods.
- Provision of management services.
- Property rental charges.
- Transfer of intangible assets i.e. trademarks, patents.
- Sharing of knowledge, expertise, business contacts etc.
- Provision of financial support i.e. inter-group loans and charging a "market" interest on loans.

A business will need to prepare a Transfer Pricing Report proving the arm's length basis of transactions. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length basis.

A taxpayer may conclude an advance pricing agreement (APA) with the tax authorities thatentitles the company to use its proposed method of valuing transactions for four fiscal years.

The above explained Transfer Pricing Report will not be compulsory in the following circumstances:

- entities that belong to the same Spanish Tax Consolidated group for the operations performed within the Spanish group.
- intra-group transactions realized with the same related party with a total volume of less than €250.000 This threshold does not apply for transactions involving intangible assets, transfers of real state, transfers of shares, and entities located in tax havens.

Small-size companies can apply abridged Transfer Pricing Documentation regime.

However even if an entity is exempt from the Spanish transfer pricing regime it may fall under the scrutiny of the other international tax jurisdictions where it transacts. There mayalso be other tax regulations which ensure transactions are undertaken at a commercial value.

What Employment Taxes and Social Security will need to be paid?

If an individual is resident in Spain, then they are subject to Spanish tax laws.

Taxpayers considered resident in Spain are liable for Spanish tax on their worldwide income.

An individual is considered resident in Spain for tax purposes if:

(1) he is present in Spain for more than 183 days in a calendar year: or

(2) Spain is the taxpayer's main center or business base or the place where his professional activities or economic interests are located, either directly or indirectly; or

(3) the taxpayer's spouse and dependent children habitually reside in Spain.

We would advise any new entrant to Spain or person who spends time working in Spain to takeprofessional advice to determine whether they are Spanish tax resident.

Current Personal Income Tax rates in Spain are:

State tax

From (Euros)	To (Euros)	State tax %
0	12,450	9.50%
12,450	20,200	12.00%
20,200	35,200	15.00%
35,200	60,000	18.50%
60,000	300,000	22.50%
300,000	+	24.50%

Regional tax

From (Euros)	To (Euros)	Regional tax %
0	12,450	8.50%
12,450.00	17,707.20	10.70%
17,707.20	33,007.20	12.80%
33,007.20	53,407.20	17.40%
53,407.20	+	20.50%

(NB: rates are for the tax year started in January 2022. Regional tax rates vary between the different regions of Spain (Comunidades Autonomas). The above rates are valid for the region of Madrid. In the rest of the regions the rates for the top tax bands are higher, rising to 48% (regional + state tax) for the very top band.

Capital Gains Tax Rates

Residents

From (Euros)	To (Euros)	State tax %
0	6,000	19.00%
6,000	50,000	21.00%
50,000	200,000	23.00%
200,000	300,000	26.00%
300,000	+	28%

Non-residents

	State tax %
Residents in the EU, Iceland and Norway:	19.00%
Other taxpayers:	24.00%

The personal income tax legislation contains a regime that is very attractive for expatriated staff of multinational companies. An individual who is assigned to work and live in Spain may opt to be taxed as a non-resident for the first six years of the assignment. Under such an agreement, the individual is taxed at a flat rate of 24 % on the gross amount of the income. To qualify for the benefits of the mentioned non-resident taxation regime, the individual must; (1) not have been a tax resident in Spain for the previous 10 years; (2) work in Spain for a Spanish tax resident company or a PE of a non-resident company; (3) not derive tax-exempt income in Spain under the Spanish non-resident income tax law; and (4) not derive more than €600,000 of personal employment income.

Employers and employees also have to pay Spanish social security, which is called *Seguridad Social*:

Current Social Security rates are:

Percentage of gross pay check			
Reason for contribution	**Employer**	**Employee**	**Total**

Standard	23.60%	4.70%	28.30%
Unemployment*	5.50%	1.55%	7.05%
Other**	0.8%	0.10%	0.9%

*These percentages may be slightly different depending on your work contract.

**Salary guarantees in case of bankruptcy; professional studies; additional amount based on the employee's professional classification.2022´

NB: (rates are for the tax year started in January 2022).

Whereas the amount paid by the employee is included in the gross paycheck; the employer contribution is not. So, the employer can calculate the total cost of an employee as the gross paycheck + 29.9% (assuming a simple pay slip where the base amount for social security is equal to the gross paycheck).

It is the employers' legal responsibility to pay over employee's tax and social security deductions to the Spanish tax authorities.

Spain has a Reciprocal Agreement with the USA, EU countries and many others whereby when an overseas national of those countries is seconded to Spain for a defined period of time and continues to pay social security in their home country, then the employer and employee are exempt from paying Spanish social security.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 21%. If a business makes taxable supplies, then it MUST be registered for VAT.

There are three types of supply:

- Taxable – must charge VAT on supplies, can reclaim input VAT
- Exempt – cannot charge VAT nor reclaim input VAT
- Outside the scope – not in the Spanish VAT system

The supply of most types of goods and services in Spain would be classed as Taxable supplies.

However, when these supplies are made to companies which are outside of the Spanish advice needs to be sought as to what rate of VAT, if any, to use.

If a Spanish entity sells goods or provides services to its non-EU parent then there is no VAT chargeable on this overseas supply, however on the basis that the supply would be VAT able if made in the UK then the entity will be able to reclaim all its input VAT.

Vat taxable entrepreneurs are obliged to submit quarterly VAT returns if annual turnover is less than € 6,010,121.00 or monthly statements if annual turnover is higher than € 6,010,121.00. The presentation of the declaration must be obligatorily by electronic means, for which a digital certificate is required.

Since 1st of July 2017, it has entered in force a new reporting obligation (SII) for companies whose turnover is higher than € 6,010,121.00. These companies are obliged to provide VAT books corresponding to issued and received invoices, electronically through electronic office of the Spanish Tax Authorities. The deadline for the submission of the information is 4 calendar days since the date of the issuance for invoices issued and 4 calendar days since the date of the registration for invoices

received.

Can we provide Share option plans to our staff?

Many companies see Share Option plans as being an important way of attracting, motivating and retaining key staff.

Spain has a number of "approved" share option plans which give tax benefits to employees and employers alike and it is often possible to adapt an overseas stock option plan to fit into one of these "approved" plans.

However, this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in Spain.

How else can we compensate our employees?

Spain has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Spanish businesses to their workforce.

Flexible benefit packages are also gaining in popularity, giving employees options on how they wish to "spend" their benefits allowance; which can range from "purchasing" additional holiday entitlement to obtaining full family medical cover.