

HOW TO IMPLEMENT YOUR COMPANY IN SPAIN?

Companies based outside Spain can **develop their activity in our country by adopting one of the following alternatives:**

- by establishing a permanent address,
- by establishing a registered branch,
- by incorporating in Spain a company (limited company, etc).

It must be highlighted that while a **branch** is defined by a physical feature (independent facilities) and a legal feature (certain independence in the management regarding the main entity), **permanent establishments** are not identified by their legal features, yet by physical characteristics: facilities, office or location where commercial transactions usually take place in a country where the entity does not reside.

Permanent establishment.

A key feature of the Permanent Establishment (PE) is the **lack of** a legal personality apart from that corresponding to the central house. For identifying a PE, we must verify whether there is or not a Double Taxation Treaty between Spain and the country of residence of the foreign investor.

- ✓ If there is a Double Taxation Treaty between Spain and the country of residence of the taxpayer, the PE must comply with the applicable regulations.
- ✓ If there is no applicable Double Taxation Treaty, special attention must be paid to the limitations of the PE set by the Spanish regulation, which state that non-residing people (either physical people or entities) execute transactions within the Spanish territory by a PE when:
 - by under any title, it counts, either continually or occasionally, on facilities and working sites where to execute its business activity; or
 - it acts in Spain through an authorised agent who, on behalf of the non-residing person or entity, executes these powers and faculties.



The following are considered to be PE:

- registered offices, branches, factories, stores, shops or other establishments;
- mines, oil and gas wells or pits;
- agricultural farming, mixed farming or any other farms or windings;
- construction works, facilities or assemblies of at least six months.
- **the representation office** in Spain of a foreign company which acts as coordination, support and control of the activities executed by the central house.
- A **branch** is always a PE for tax purposes, yet not from a legal point of view. Branches must be registered in the Spanish Register of Companies.

Regarding tax purposes, the PE is subject to the same formal, registry, accounting and taxation (profit tax, VAT, etc) obligations of a Spanish residing company. With the exception of special features regarding the deduction of expenses (mainly those related to the central house: payments of the PE to the central house regarding canons, technical assistance, use of goods and rights).

According to tax purposes, two different PE can be distinguished:

- ✓ Those whose transactions do not complete the commercial cycle: this is, they work for the central house to which they belong to and who completes the commercial cycle.
- ✓ Those with a limited activity length: this is, they execute in Spain certain activities for a limited period of time or at a particular moment. Such activities are construction works, facilities or assemblies for periods of time over 6 months; temporary or seasonal activities; natural resources winding.

From the different listed possibilities, the incorporation of a company is the most valued option, in comparison with the other

options. Why?: a **company** has legal personality, limited liability and is independent and self-managed. Nor the PE, neither the branch.

I. INCORPORATION OF A LIMITED LIABILITY COMPANY.

In Spain the incorporation of a company can adopt many forms: Public limited liability Company (S.A. standing for *Sociedad Anónima*) private limited liability company (S.L. standing for *sociedad Limitada*), Commandite Company, Collective company, etc. It is also possible by transferring to Spain a European public limited liability company, yet in most cases, companies are incorporated as Private Limited Liability Companies. Some reasons which justify this option are as follows:

- ✓ Less required capital,
- ✓ More flexible articles of association,
- ✓ Less performance and management requirements, such as no need of advertising or notifying in advance General Meetings,
- ✓ Contributions in kind not verified by audit.

II. ELEMENTS WHICH INTEGRATE A SPANISH PRIVATE LIMITED COMPANY (S.L.)

To incorporate your Limited Company. it is required the following:

- ✓ **Name**: business or trade name of the company formed by the name of the founders or a combination of words or numbers. It must be approved by the Central Register of Companies.
- ✓ **Object of the company: or list of business lines or activities of the Company.**

- ✓ **Registered** office: or main place of business management and control in Spain. It must be a fixed location since its modification may imply modifying the articles of association of the company with higher costs. The registered office must not be confused with the residence for tax purposes or with the working site address.
- ✓ **Share** capital: There share capital is €3,000 which must be paid at the incorporation of the company into an account under the name of the company. It is divided into numbered shares property of the owners.
- ✓ Shareholders: Owners of the share capital. They can be a person or a corporation. Regulations provide that a sole person can form a single member company.
- ✓ **Board of Directors.** It can be of different types:
 - Sole administrator
 - Joint and severally administrator: Several administrators properly granted with the necessary powers and faculties for its social management.
 - Joint administrators: several administrators who act jointly (at least two of them).
 - Board of Administrators: A minimum of three members who will act not jointly, yet as a body in the management (prior agreement adopted in a previous meeting).

Both people and corporations can act as administrators, but in this case, a person must be appointed as common representative.

- ✓ Demanded majority for the adoption of agreements (respecting legal minimums established according the type of agreement),
- ✓ **Notice of a meeting,**
- ✓ **Transmission of equity shares.**

III. THE COST OF INCORPORATING A LIMITED COMPANY

Incorporating a S.L. in Spain for a minimum capital (€3,000) implies the following costs (without VAT):

- ✓ Public Notary (granting public deed)€180
- ✓ Central Register of Companies (certificate of Trade name).....€25
- ✓ Provincial Register of Companies (registry)€120
- ✓ Tax operations (1% share capital)€30



IV. OBLIGATIONS OF A LIMITED COMPANY

Companies (both limited and public limited) are subject to nearly the same labour and trade obligations. S.L are subject to the following obligations:

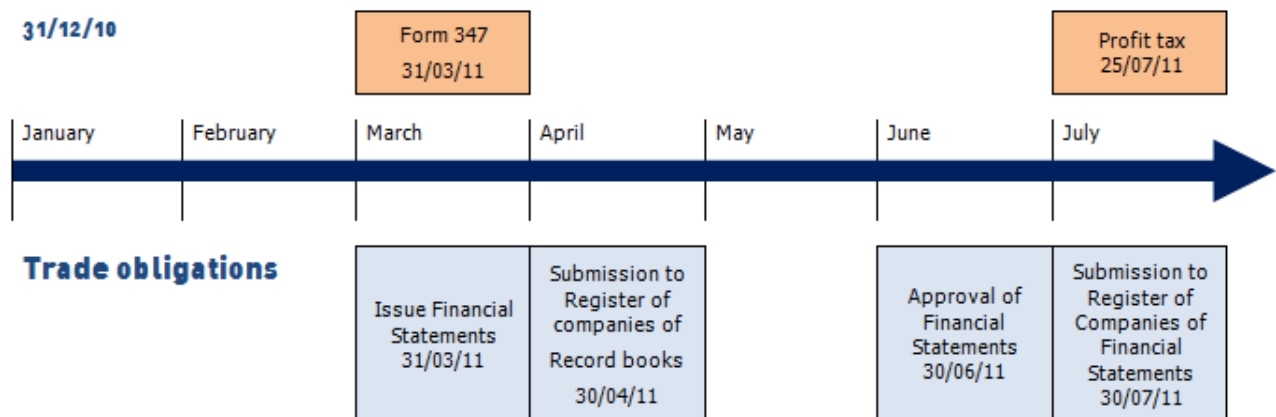
IV. 1. TRADE OBLIGATIONS

- ✓ Founder partners must be in possession of a Tax Identification Number in Spain, known as Número de Identificación de Extranjeros (N.I.E.).
- ✓ Incorporating the company and transmitting shares must be granted by **public deed**

TAX AND TRADE OBLIGATIONS AFTER FISCAL YEAR-END AT 31/12/2010

Tax obligations

31/12/10



- ✓ Legalisation of **commercial books: of minutes, of partners, and if it is a single-member company, of contracts (partner-company)**
- ✓ Regarding Financial Statements (balance sheet, income statement, statement of changes in equity, environment statement, price regulation, and, for certain companies, statement of cash flows, auditors' and directors' report), the company has the following obligations:
 - **Formulation** by the administrative board. Within the first three months after the year-end.
 - **Approval:** by the General Meeting. Within the first six months after the year-end.
 - **Submission to the Register of Companies:** by the administrative board. Within the first month after its approval.
- ✓ Submission to the Register of Companies of the commercial books (balance sheet, income statement, quarter trial balance, accounting book, inventory, capital assets), within the first four months after the year-end.
- ✓ The General Meeting must be convened at least 15 days in advance by registered post with acknowledgement of receipt (according to articles of association).

Schedule of annual and trade tax obligations up to December 31.

IV. 2. LABOUR OBLIGATIONS

The registration of partners and/or administrators of companies within the social security has several problems arising from the difficulty of establishing the nature of the relationship partner-company and defining the activity the first can execute within the board of directors of the company.

Therefore, it is important to take into consideration the criteria established by Act 66/1997 of December 30 and modified by the General Act 50/1998 of December 30 of Administrative Tax Measures and Social Order.

In the event of partners of private and public limited companies, there are several alternatives for its incorporation into the Scheme for the self-employed (without unemployment compensation) or into the General Social Security Scheme.

Breakdown of assumptions and schemes:

PRIVATE AND PUBLIC LIMITED COMPANY	ADMINISTRATOR OR COUNSELLOR	MANAGEMENT FUNCTIONS, PAID TIME OFF AND OWNER OF -25% CAPITAL: GENERAL SCHEME (without unemployment compensation nor Fogasa)	
		NO MANAGEMENT FUNCTIONS, OWNER OF -33% CAPITAL; GENERAL SCHEME	
		NOT PARTNERS: GENERAL SCHEME (without unemployment compensation nor Fogasa)	
	WORKING PARTNERS	CAPITAL +50%: SELF-EMPLOYED SCHEME	
		CAPITAL -50%:	MANAGEMENT FUNCTIONS AND OWNER +25% CAPITAL: SELF-EMPLOYED SCHEME
			NO MANAGEMENT FUNCTIONS, OWNER OF -33% CAPITAL; GENERAL SCHEME
50% CAPITAL FAMILY MEMBERS: SELF-EMPLOYED SCHEME			

- ✓ **Non-working partners:** Partners of companies who do not work at the company and only dividends are not registered in the Social Security Scheme.
- ✓ **Non-partner workers:** Workers none qualified as partners are registered into the General Social Security Scheme.

INCORPORATION OF THE COMPANY (either Public or Private Limited Company) IN THE SOCIAL SECURITY SCHEME.

Businessmen, who employ people registered into the Social Security System, must request to the Social Security General Fund their registration within the scheme.

The registration by request of Tax Identification Code must be prior to the provision of services. Employers must provide, together with the forms of the Social Security General Fund, proof of their incorporation into the Social Security General Scheme (incorporation deed, activity license, VAT number as well as any required documents by the Social Security System)

Once submitted all documents to the social Security System, the employer must inform within the first month of operation, the beginning of the working activity to the

Autonomous Community Authority Body and the Occupational Risks Prevention Plan. The Labour Inspectorate book of the autonomous community must be regularly updated.

The employer must inform, within the established terms for that purpose, the registration and amendment of data of workers.

The employer must register workers with Social Security while providing services and pay the corresponding rates within the established terms.

The obligation to pay the social security starts with the provision of services and lasts while the labour relationship between worker and employer remains into force. It remains even in the event of incapacity for work, risks while pregnancy and breastfeeding, maternity leave or trial period.

The obligation to pay ends when interrupting the provision of services as long as their absence of work is notified within the six days after the end of provision of services.

V.- MAIN TAXES TO WHICH A COMPANY IS SUBJECT TO:

V.1.- PROFIT TAX:

Direct tax which affects companies and entities. Companies residing in Spain are subject to this tax. Companies residing in Spain are those that meet one of the following requirements:

- ✓ Incorporation according to the Spanish regulation.
- ✓ Registered office in Spain.
- ✓ Commercial office in Spain where management and control activities are executed.

A) TAX BASE:

The company pays taxes for the registered earnings (income less expenses registered according to Spanish accounting standards - *Plan General de Contabilidad español*). Yet, due to differences in the consideration of expenses and income by the tax regulation and the accounting standards, accounting earnings must be subject to "extra-accounting adjustments" which may be positive or negative whether they increase or reduce the profit. Positive adjustments as non deductible provisions, non deductible expenses (such as, profit tax, fines and penalties, gifts and concessionality).

Negative adjustments are tax benefits arising from the amortization of assets.

B) TYPE OF TAX RATE:

- ✓ Companies pay taxes for the positive tax base (prior compensation of negative tax bases of the previous 15 years) at a fixed tax rate of 30%.
- ✓ Yet small and medium sized companies, known in Spain as PYMES (and which include those companies with net turnover under eight million Euros), are subject to the following tax rates:
 - ✓ tax base between EUR 0 and EUR 120,202.41 at 25 %.
 - ✓ Remaining tax base **at 30 %**.
 - ✓ **Temporally** (applicable for taxable periods started **in years 2009, 2010 and 2011**), tax rate for **PYMES** is **5%** (from 25% to **20%** (for the first EUR 120,202.41 of the tax base), and from 30% to **25%** (for the remaining quantity)), providing the compliance with the following requirements: Net turnover under 5 million Euros, average staff under 25 workers and creation of new job positions in the stated years in comparison with 2008.

C) TAX INCENTIVES APPLICABLE TO COMPANIES:

As a general rule the tax regulation on Tax Profit includes tax incentives applicable to companies when determining the tax base, prior compliance with the established requirements for its application. As an example, special attention can be paid to the tax rate applied to finance lease or free amortization rate of assets.

Tax incentives for **small and medium sized companies are more:** Free amortization rates for investments in Assets for a value equal or less than EUR 601.01; accelerated amortization for investments in new assets, property, plant and equipment, intangible assets and real estate; provision for insolvency; free amortization for job creation as well as lower tax rates.

C) PROFIT TAX SUBMISSION TERM (form 200):

It must be submitted within the **first twenty-four days to count after the six months after the year-end**. Therefore, if year-end takes place at December 31, Profit Tax must be submitted from July 1 to 25.

V.2.- VALUE ADDED TAX (VAT):

Companies in the development of their activity must pay Value Added Tax (VAT) in the provision of services or products by business or professionals.

As a general rule, all business must charge VAT in the provision of services or products and can deduce VAT in the acquisition of services or products.

Exceptions to this rule are as follows:

1º.- If the company has as main business the export of goods, it does not charge VAT in its sales, yet it can deduct paid VAT.

2º.-The company either buys or sells goods, provides or is offered services by another business or professional with registered office in a country within the European Union. In these four cases (acquisition/provision of goods, acquisition/provision or services) the VAT will be that corresponding to the payee of the transaction. Therefore, businessmen who sell or provide services will not charge VAT, being the businessmen who acquire the good or service those who pay VAT in their country, with the corresponding deduction. These transactions require the compliance with specific VAT obligations.

A) TYPES OF VAT

Since July 1 2010, tax rates are as follows: The general tax rate is **18% and it applies to all goods or services which are not subject to the reduced tax rate 8% or even lower 4%.**

The reduced tax rates 8% applies to: Transport; Hotel industry services; Hairdresser services and housing and repair services, with certain restrictions.

The even more reduced tax rates 4% applies to: Bread, milk, cheese, eggs, non-modified vegetables and fruit; Books, newspapers and non advert magazines; drugs.

B) DEDUCTION OF PAID VAT

For the reduction of paid VAT it is necessary to: Be businessmen or professional; purchased goods and services (for which you pay VAT) are necessary for the business or professional activity (if the applicability of product to the activity is not total, VAT will be proportional to its use); have the corresponding invoice; have purchased the good or service in the last four years.

C) VAT OBLIGATIONS

Companies as well as businessmen or professionals **must issue an invoice for all the services identifying clearly the payees and keep a record of all the invoices paid to their suppliers. In certain cases (for example at retail stores) invoices can be replaced by tickets.**

Differences between charge and paid VAT must be declared and liquidated on a quarterly basis (according to its conditions and terms) through the form 303. The result can be either to pay or to received VAT.

As a general rule, the VAT return is filed on an annual basis, this is, it only takes place in the last quarter/month of the year (to be submitted in January of the following year), yet, in several cases established by the VAT Law, it is possible to request the monthly return of VAT (for example, non-European exporting countries), being required the registration in the VAT monthly return census prior to filing the VAT monthly return.

It is compulsory the **record of the following VAT books:**

- ✓ Registry book of issued invoices.
- ✓ Registry book of received invoices.
- ✓ Registry book of investment goods.
- ✓ Registry book of EC transactions.

V.3.-BUSINESS ACTIVITY TAX (IAE- Impuesto de Actividades Económicas):

The IAE is a local tax which must be paid for executing a business activity in the Spanish territory, regardless it is executed in a registered office or not, usually or hardly ever, by a non-profit or profitable institution, it creates profits or losses.

A business must be registered in as many IAE as different business activities it develops.

A businessman or professional may be exempt of paying IAE, yet companies will only be exempt in the particular cases specified in the regulation.

Exemption situations are as follows:

- ✓ Exemption during the first two years of the business activity.
- ✓ Exemption from the third year of activity, providing the annual turnover of the last year and liquidated at January 1 of each year (IAE accrual date) is under **EUR 1,000,000**. For example, if in year 2008 the turnover recorded for the profit tax exceeded EUR 1,000,000, in year 2010 IAE tax must be paid for each business activity developed by the company in 2010.

V.4.- SUBMISSION OF ANNUAL DECLARATION OF THRID-PARTY TRANSACTIONS (form 347):

Without any doubt, this is the most important declaration for the Administration for taxation control purposes. Through this **informative** (without any cost) **declaration** the company declares the economic transactions executed with a client or supplier within the year to which the declaration refers to and which exceed EUR 3,005,06 annually. In addition to this, it declares the cash collections received from a client for a total amount exceeding EUR 6,000 on an annual basis. This declaration is submitted in March of the following year to which it refers to, regardless the company's closing date of the fiscal year. So *from March 1 2011 to March 31 2011*, form 347 for natural year 2010 must be submitted.

VI.- REGULAR TAXATION OBLIGATIONS OF A COMPANY:

The **annual volume of transactions** which close the annual VAT declaration of the previous year indicates the frequency with which VAT declarations, retentions and progress payments of the profit tax must be submitted by the company throughout the ongoing fiscal year. So:

- ✓ If in the previous year, the volume of transactions exceeded **6,010,121.04**

€/year, the new conditions of **big company** establish the obligations of the company for the ongoing fiscal year, the submission of regular declarations on **monthly basis** (within the first 20 days of the following month to the month which the declaration refers to).

The conditions of big company must be notified by the Treasury through the submission of the census declaration (forms 036 or 037) in January of the billing year).

- ✓ If in the previous year, the volume of operations was equal or lower than **6,010,121.04 €/year**, the company on the ongoing year will submit regular declarations on a **quarterly basis** (within the first 20 days of the first month after the quarter-end).

The most common declarations to which the company is subject to are as follows:

- ✓ **Regular VAT declarations (form 303)** on a quarterly or monthly basis for liquidating the paid or charged VAT deductible in the concerning period. Besides the submission of the annual summary of the VAT (form 390) in January of the following year of the year-end.
- ✓ **Regular declarations of workers' retentions** (% according to the table on employees' progressive remunerations) and **professionals' retentions** (as a general rule 15%; 7% for special cases) on a quarterly basis (form 110) or on a monthly basis (form 111) for paying accrued retentions within the referred period.

Retentions executed to workers and professionals do not imply a tax charge for the company, on the other hand, they are a tax for the physical people (workers and professionals) who the retention is applied to.

Besides, the company must also submit an annual summary of workers' and/or professionals' retentions (form 190) in the first month after the year-end.

- ✓ **Regular declarations of rental retentions (form 115)** on a quarterly and monthly basis for paying the accrued retentions (from 19% from 01-01-2010) obtained as rents for the period. This retention is not a taxable charge for the company, yet for the owner of the rented property. Besides, the submission of the annual summary of rental retentions (form 180) in January of the following year of the year-end.
- ✓ **Progress payment of Profit Tax (form 202):** all companies have to pay within the first 20 days of *April, October and December* the liquidations of the Profit Tax for the ongoing year. The declaration for paying progress payments of the PT is form 202. The **condition of big company** establishes the frequency of progress payments.
- ✓ **Regular informative declaration of VAT from EU transactions (form 349)** on a quarterly or monthly basis (depending on the volume of EU transactions) for declaring the clients and/or suppliers (businessmen / professionals residing in a different country of the European Union) to who you have purchased or sold a good or service. It is an informative declaration which does not imply monetary payment of any kind, neither taxable charge for the company.



VII.- OTHER OBLIGATIONS IN THE EVENT OF FOREIGN INVESTMENT IN A SPANISH COMPANY

It is worth highlighting the obligations which a Spanish company and its branches have with the Foreign Investment Register (subject to the directorate-General of International Trade and Foreign Investment in Spain), and which apply whenever foreign participation in the share capital:

- ✓ Submission of an annual memory on foreign investment in Spanish companies (form D-4), when the mentioned Spanish company has a share capital over **EUR 3,005,060.52** and the **total participation of non residents (both corporations and physical people) is less than 50% of the capital or a foreign partner holds at least 10% of the capital.**
- ✓ The **branches** of foreign companies in Spain must submit an annual memory regardless the total amount of capital of own resources.

With this memory, which must be submitted in the first nine months after the year-end they will declare shareholder and economic data (basically the same as stated on the Profit Tax) of the Spanish company (with foreign participation) at year-end.

- ✓ Submission of the declaration of foreign investment (form D1A) or foreign disinvestment (form D1B) in Spanish companies or branches. With these declarations (to be submitted in the first month after the investment or disinvestment) investors' (disinvestors') data will be notified as well as the corresponding amounts.

These declarations are compulsory when the foreign accumulated investment amounts to **EUR 3,005,060.52.**