

“Incorporating or non incorporating, that is the question”

Company vs self-employed

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Tax Partner

TAX
PARTNERS

General overview

- Direct taxes:
 - Personal Income Tax (“PIT”)
 - Non Residents Income Tax
 - Corporation Income Tax (“CIT”)
 - Inheritance and Gifts Tax
 - Net Wealth Tax and Property Tax
- Indirect Taxes
 - VAT
 - Transfer Tax

Personal Income Tax (“PIT”)

- **The Spanish Personal Income Tax** taxes all earnings of:
 - Individuals
 - Resident in Spain
 - Nonresident individuals are taxed under the Nonresidents Income Tax.
- A tax payer is resident in Spain if:
 - 183 days rule
 - The center of his vital interest is located in Spain.
- During one single fiscal year a tax payer cannot be resident and nonresident at the same time.
 - Tax planning opportunities

PIT Overview

- The sources of earnings are classified in two categories:
- General taxable base (“GTB”):
 - Employment income
 - **Self-employment income**
- Unearned income:
 - Savings and other investment income, such interest, dividends and capital gains.
- Both baskets are completely isolated: no compensations allowed between both

Self employed income

- General principle: CIT rules, income less expenses
- Capital gains are never considered business income
- Spouse salary:
 - Only if registered within the SS as worker
 - Market value as benchmark
- Use of assets owned by spouse or minor children
 - Deduction of the rent agreed or market value
 - In case of common ownership no deduction allowed (50 %)
- The 5 % forfeit expense

The simplified system

- Taxable profit determined on prefixed items
- Only for certain activities (non professional)
- Limits based on:
 - Turnover
 - Employees
- Example: restaurant
 - Principal: 16,175 €
 - Employee: 3,603 €
 - Table: 220 €
 - Kw 126 €

PIT tax rates

Hasta	Cuota	Resto	%
-	-	12.450	20%
12.450	2.490	7.750	25%
20.200	4.428	13.800	31%
34.000	8.706	26.000	39%
60.000	18.846	Onwards	47%

Corporation Income Tax (“CIT”)

- Applicable to:
 - Legal persons
 - Resident in Spain
- Taxable base: profit or loss for the year
- No baskets
- Tax rates
 - 25 %
 - Startups: 15 % for the first 2 profitable years

Conclusions

- The taxable profit would be the same in PIT or CIT
- Since the tax rates of CIT are lower, incorporating seems the best choice UNLESS the simplified system applies to the business activity
- How the partners will pay their bills ?
 - Tax deferral until the company distributes a dividend
- What if the partners work for the company?
 - The arm's length principle
 - Safe harbor rules for professional services

Safe harbor rule

- Professional companies: 75 % of income derives from professional activities
- Overall partner's compensation must be at least 75 % of the profit
- Minimum salary of each partner:
 - If the company has employees: average salary (1) * 1,5
 - If no employees: 31,950 € per year (2016)
- The tax deferral would only be for the profit left after the minimum salary has been withdrawn

(1) Employees performing similar functions

Example:

- A company with two partners is engaged in design of web pages. The 2016 data are:
 - Web designer employee salary : 20,000
 - Profit for the year (before computing the partners salary): 90,000
- Determine the minimum salary for the partners:
 - 75 % of the profit is: $90,000 * 75 \% = 67,500$
 - $1,5 * \text{average salary: } 20,000 * 1,5 = 30,000$
- Each partner should have a salary of, at least, 33,750 €
- The final profit of the company would be: 22,500 (90,000 – 67,500)
- Partners may waive the safe harbor rule



Final thoughts

- The choice should not always be driven by tax factors
- The personal liability for the business debts should be a major concern
- A company not always isolates the personal assets from the risk of the business