2019 YEAR END BUSINESS TAX PLANNING AND ACCOUNTS REVIEW

As we approach the end of the year our thoughts turn to pleasant things like Christmas and New Year celebrations, family, friends and fun. Perhaps a bit of skiing in Sierra Nevada too.

However, we still have a while to go and this is the time of year when we should also think about the health of our businesses and getting the most out of the tax system.

None of us like unpleasant surprises and it is all too frequent that we come across businesses and individuals who tell us "if only I had done that" when we explain some of the simple steps that could have been taken to fix problems or mitigate tax bills, before it was too late.

The old saying "A stitch in time saves nine" remains as true today as it ever was.

So in this article we examine some simple steps that everyone can take before the end of the year so that we can enter the festive period with that cosy feeling that everything is under control and there will be no nasty surprises in the new year.

Individuals

The personal tax system in Spain is, relatively speaking, simple and reasonable, leaving very few areas where an individual can act to legitimately reduce tax. The most important opportunities relate to the following:

Pension schemes

Foreigners rarely consider investing in Spanish pension schemes mostly because they have little awareness of their existence. Every bank and financial institution in Spain offers such schemes and they are very tax efficient.

Pension scheme payments are deductible

Each year a person can invest up to 8.000 Euros or 30% of their earned income (if less) and get full tax relief at their highest income tax rate. As income tax is up to 48% in Spain this means that almost half of your pension contributions would be paid for by the Government! Excess contributions can be claimed in the following tax years.

Additionally, annual contributions of up to 2.500 Euros may be made to a plan set up by a non working spouse. Disabled persons have very generous contribution limits of up to 24.250 Euros.

The whole point is that when we retire we usually have a much lower level of income and much lower tax rates and that is when we draw down from our pension funds.

The Spanish population makes 90% of their contributions to pension plans during the month of December. They certainly know what's good for them!

Investments in new businesses

30% of new business investments are deductible

Up to 30% of the amounts invested in new business can be claimed up to a maximum of 60.000 Euros. The conditions are:

◊ The company must have been created within the last 3 years.

◊ The company must have a trading activity (not real estate) and have necessary material resources and personnel.

◊ The share capital and reserves of the company must be less than 400.000 Euros.

◊ Shares must be kept for at least 3 years.

Donations

Donations are deductible

Gifts to charitable organisations, public foundations and political organisations give rise to income tax deductions subject to different limits depending on the amounts and types of donations.

Businesses

Companies and the self-employed – planning your expenditure

Most businesses should know by now what level of profit can be anticipated for the year. Perhaps it's obvious but when you are working hard with the stress of running a business you can sometimes not see the wood for the trees.

Plan your expenses to get early tax relief

This is the time of year you should spend some extra time with your accountant/ tax adviser to establish where you are and what taxes you will pay if you 'do nothing'. There is still time to plan your expenditure perhaps bringing forward a project and paying for it a bit earlier than you originally anticipated.

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The banks are making loans reasonably easy these days because they can tap into government guarantees which makes loans to supplement customer cashflow sensible. Interest rates are at an all time low so loans are definitely very affordable.

Beware though, buying equipment, vehicles, etc., will not work quite so well because you can only deduct depreciation allowances from profits, not the cost of the assets. New small businesses can, however, deduct double the normal rates of depreciation.

Corporation tax—payments on account

Normally corporation tax payments due in April, October and December are calculated at 18% of the amount paid on the last filed corporation tax declaration. These are payments on account towards the full year's tax bill.

Election that might reduce corporation tax payments on account

However, if the profit of your business is going to be lower next year you can elect to pay tax on the actual profits of each calendar quarter.

This can be a very important choice for a business that has had a bumper profit year which is not likely to repeat, or if you think that your profits are going to be less next year.

Imagine how unpleasant it would be to finish up overpaying this tax and then having to wait up to 9 months to get it back.

The deadline for this option is 29 February 2020.

Self-employed— Quarterly income tax payments on account

Don't file income tax returns unless you have to

If you are a self employed person and more than 70% of your income in a year has been subject to tax withheld by the payers then you will not have to file quarterly income tax declarations for the following year. The time to check this is before the end of March 2020.

Self-employed— reduced rate withholding tax

Be careful to apply the right income tax rate on invoices

Individuals who register as self-employed are allowed to apply the reduced rate of 7% (instead of 15%) withholding tax on their invoices. The 7% rate applies in the tax year of commencement plus the next two years. You will be fined if you put the wrong withholding tax rate on your invoices. By the way, the newly self employed can claim a 30% general deduction on their profits, as long as they tick the right box on the annual income tax declaration. Don't forget this!

IVA—Intracommunity transactions

The tax form M349 has to be filed if you buy or sell goods or services to other EU states. The question arises as to whether you have to file this every month, quarter, or even just once a year.

Don't file unnecessary intra-community declarations

The obligation is essentially monthly but in the case that:

- In the current and previous 4 quarters intracommunity sales or purchases are less than 50.000 Euros, the declaration can be filed quarterly.
- In the case that annual sales of goods and services total less than 35.000 Euros and the sale of goods alone total less than 15.000 Euros, the declaration can be filed annually at the end of the year.

IVA refunds

You have the right to claim a refund of IVA if the IVA you have paid on your costs exceeds IVA on your sales. This is a very common situation for businesses that export goods and services because they charge no IVA on sales, and also businesses that charge lower rate IVA such as property developers.

Don't allow your IVA repayments to be left unclaimed

This right runs out after four years and there is a strong, and we would say irrational, tendency in Spain not to claim back IVA because this often results in a tax inspection. Consequently we often see that IVA refunds are permanently lost, often with the taxpayer not realising that the tax adviser has made this decision.

First and foremost, to be afraid of a tax inspection means that there is something to hide, whether the bookkeeping is badly done or the paperwork is not in good order. Sometimes, because there are uncertainties about the right IVA treatment of income or expenses. Uncertainties should not exist.

The message here is that it is completely unnecessary to fear the tax system and it makes no sense to give up on a tax refund. If you haven't claimed back IVA, and do check this with your tax adviser, then you need to sort out the problem.

2019 YEAR END BUSINESS TAX PLANNING AND ACCOUNTS REVIEW

IVA monthly filing regime

Speed up your IVA repayments

If your business pays out more IVA on its costs than it charges on its sales then you would reclaim overpaid IVA.

The normal annual regime results in IVA reclaim being significantly delayed because the repayment claim is made in January for the previous calendar year, and the tax office usually delays annual repayment between 3 and 9 months . That's an average typical cash flow delay of between 8 and 20 months .

Instead of this delay you can opt for the monthly IVA filing system. The monthly system speeds up the repayment so that typically it takes an average of 3 months after each month end. This speeds up cash inflow by an average of a year.

This is an important opportunity to improve cash flow. A few examples of the business that benefit are property developers and exporters of goods or services

IVA prorata scheme

Mixed IVA scheme election deadlines

Some business have several sources of income including a mixture of income that is subject to IVA and not subject to IVA. An example is a property business that rents commercial (standard rate IVA) and residential property (Exempt IVA). This causes complications in the way that IVA on expenses can be claimed.

For these kinds of business, IVA on expenses is deductible according to the proportion of income subject to IVA and exempt.

An election can be made to deduct IVA on the basis of expenses that are directly attributable to one source of income or the other. The election has to be made between 1 October and 31 March of the next year. This can reduce tax payable.

IVA and corporation tax —group tax elections

Elections to simplify IVA and corporation tax filings for groups

December is the month when companies which are owned or managed by the same directors/shareholders may file an election to consolidate their tax affairs into a single set of tax declarations.

This type of consolidation works very well because it allows offsetting of profits and losses, surpluses and deficits in tax declarations which can radically improve business cash flow.

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And now to the accounts of the business……..

At this time of the year it is imperative to spend time reviewing your accounts. By now you should have a very good idea of how the year will turn out and you should be spending time with your accountant/tax adviser.

Bookkeeping and accounts can seem a bit impenetrable and it's a fact that some professionals like to make things more complicated than they really are. It really is nothing more than common sense.

Don't ignore the importance of your business accounts

All too often business owners ignore their accounts and just let the professionals get on with it, asking no questions and just assuming that everything is fine. Unfortunately, that's really not good enough. You, the directors, sign the accounts and the tax declarations and that's who the tax office will hold responsible when things go wrong.

Here are some important balances you absolutely should dig into.

Fixed assets:

Imaginary fixed assets

Over the years the business will have purchased various assets, property, vehicles, computers, software, etc. All too often these balances just seem to continue to exist forever even though the vehicle was sold, the computers replaced, etc.

It may seem unbelievable but we have come across more than a few company accounts that still show high value real estate that was sold years ago!

Stock and profit margins from the sale of goods:

If you sell goods, at the end of the year you are meant to make an accurate count of your stock. If you don't do this it will distort your company profits and your profit margins.

Check your reported profit margin

The tax office sent letters to small businesses in early 2019 explaining that they have compiled data with typical gross profit margins and other ratios and warning businesses that they were monitoring profit margins with the intention of carrying out tax inspections.

Basically their letters said "you have been warned" and its best to take this seriously. As a minimum you should ask your accountant to show you how to

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calculate your profit margin statistics to make sure you don't have a potential problem.

Suppliers and customer balances

In the Spanish bookkeeping system, each supplier has a separate account containing all the invoices and payments. Obviously, these balances should make sense.

Make sure that supplier and customer balances are correct

If you, the directors of the company, don't check these balances once a year then you could be missing the fact that expenses invoices haven't been entered into the books, payments have been misallocated, and you could be paying too much tax.

These accounts are the biggest problem for external accountants because they take a lot of work to check. All too often we find that no one has bothered to make sure the balances have anything to do with reality, year after year, which causes a lot of work and real problems.

Bank accounts

Fudged bank balances

As you would expect the balances on these accounts should match the bank statements, all through the year. Beware of the bad practice of making a once a year adjustment to fudge the balance. The counter entry (remember its double entry bookkeeping) is usually the cajón desastres.

Directors/shareholders accounts

Next to the cash accounts (more about these later), these are probably the most abused accounts in Spanish accounting practice. These balances should equal the amount of money lent to the company or taken out of the company as loans.

Directors/share-holders accounts treated as 'dump' accounts

In practice these accounts are often used as 'dump accounts' or in the Spanish vernacular 'cajón desastres'. If the reason for a payment is not known by the bookkeeper then this is one of the accounts used to 'lose' the entry. This creates enormous problems down the line because you will be treated as having taken money from a company, which is regarded as salary or dividend, and you will be subject to income tax and the company to withholding tax.

You absolutely must make sure that these accounts represent reality.

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*What cash account?!**

Cash account

We've kept the best till last. You might well ask "what cash?".

This bad practice ranks right up there with the fudged bank account balances and directors accounts being treated as a dump for unidentified payments. The idea is this: If you can't lose any more payments in the directors accounts, let's pretend that the bank payment was cash withdrawn and put in the petty cash box……..

Year end action for your accounts— in conclusion

Honestly, we are not making up these problems. With new clients we see many of them more often than not. These are your company accounts and your tax declarations, you sign them and you are responsible. We strongly recommend that you spend some time making sure that they make sense.

And have a Merry Christmas!

This article is necessarily brief and does not contain a complete analysis of the matters discussed. Before taking any action, professional written advice should always be obtained.

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