

Doing Business in Spain

2010



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1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 80 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Spain has been provided by the office of UHY representatives:

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Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current at August 2010.

We look forward to helping you do business in Spain.



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2. Business environment

The Spanish constitution and government

Under the 1978 Constitution, Spain is a parliamentary monarchy. The King is the head of the state and he monitors the functioning of the democratic institutions in accordance with the Constitution.

The country is governed by a bicameral parliament known as the Cortes. This comprises a congress of deputies (Congreso de los Diputados) elected every four years by universal suffrage and a senate (Senado) of directly elected representatives from the provinces and regions.

Spain is comprised of seventeen autonomous regions, with a total of 50 provinces. The autonomous regions or communities share in the centrally collected tax revenues and directly collect certain taxes that are reserved to them.

The domestic market

Population

There are 46.745 million inhabitants according to the 2010 census. The tax growth rate is 2.93% and more than half of the population lives in the cities.

Area

506,013 sq. km. including the Balearic Islands, Canary Islands and Ceuta and Melilla in North Africa.

Population density

92.40 inhabitants per square kilometre.

Currency

The Euro (1 Euro = USD1.31; 1Euro =£0.82)

Language

Spanish is the official language of the State. In certain autonomous regions it is used jointly with other official languages.

The economy

In 2010, the service sector accounts for 70.06% of Gross Domestic Product (GDP), industry 15.19%, construction 10.36% and agriculture 4.39%. The construction sector is currently suffering because of the global economic

crisis. The vehicle market has also seen a decline as a consequence of the crisis. This market suffered 20% decrease in sales in 2009.

Unemployment

Unemployment is a persistent problem of the economy. However, since 1994 unemployment was dropping on a yearly basis of up to 8.3% in 2006, the lowest rate since 1979. However the current economic turmoil has increased unemployment to a 20% in 2009.

Prices and interest rates

Spanish efforts to meet the Maastricht convergence criteria for the European Monetary Union have resulted in a stabilisation of prices and a decrease in interest rates to historical lows. For the year 2010, the official interest rate has been stated as 4%. The inter-annual inflation rate for March 2009 was -0.1% due to the global economic crisis.

Foreign trade and the balance of payments

While Spain's foreign trade in merchandise shows a consistent deficit, services and transfers produce consistent surpluses. In the last few years Spanish exports have grown at a higher rate than the world trade average and at a higher rate than its imports. There has also been a commercial specialisation in capital intensive activities and in economies of scale, while technologically intensive sectors of the economy continue to show weakness.

Financial institutions

Commercial banks, merchant banks and saving banks are involved in the great majority of financial transactions in all sectors of the economy. Saving banks handle business transactions and are very similar in their operations to the commercial banks but tend to specialise in private savings, personal loans and the financing of house purchases.

Stock market

Stock exchanges in Madrid, Barcelona, Valencia and Bilbao provide markets for government securities, public and corporate bond issues and shares in leading Spanish companies.

3. Foreign investment

Heavy foreign investment has been a feature of the Spanish economic scene for a long time. This has been encouraged by the growth of the economy, the internal market and Spain's progressive attitude to its economic development, and in particular, its membership of the European Union and its determination to meet the Maastricht conditions for joining the single European currency from the outset.

Direct investment may take the form of a Spanish subsidiary company or branch of a foreign company with specific assets assigned to it. The acquisition of an existing Spanish company or participation in one is a common form of investment. The investment may consist of cash, assets or technical assistance.

The purchase of securities through the Spanish stock exchanges as a financial investment is normal where control or participation in the company's management is not the aim. This is, of course, a less permanent form of foreign investment.

Foreign investment in residential coastal area property continues to be a growth area of the economy providing a boost to construction and its dependent industries. This type of investment has the added advantage of creating a base for future vacation and retirement spending.

4. Setting up a Business

There are many ways in which a business may be set up in Spain. Set out below are the most common alternatives.

Sociedad Anónima (SA)

This type of company commonly known as an SA Company is usually used by medium to large corporations; the responsibility of the shareholders is in principle limited to their shareholding in the capital of the company.

The SA Company is required to have a minimum share capital of 60,101.21 Euros of which a minimum of 25% has to be paid upon incorporation. There are higher minimum capital requirements for specific types of SA corporations, such as banks and insurance companies.

The capital of the SA Company may be paid in cash or in-kind (equipment, stock, property, etc.)

The cash contribution to capital must be certified by a bank. An in-kind contribution needs to be independently valued by appointment of the Mercantile Registrar and the directors' report must be approved by the general meeting.

The company may opt for a board of directors or an administrator system made up of a sole or several administrators.

Spanish law does not establish a minimum number of shareholders to be incorporated in a SA. However, sole shareholder companies are subject to a special system of publicity. This exceptional condition has to be registered in the company registry and mentioned on all corporate stationery and legal documents.

The SA Company must be incorporated before a public notary and the minimum requirements include the details of the shareholders, registered office, activity of the company, capital structure, accounting year-end and duration. The deed of incorporation usually includes the minutes of the first meeting of the company, in which the administration of the company is decided upon.

Sociedad Limitada (SL)

This type of company, commonly known as an SL Company, is usually used by small- to medium-sized corporations. The responsibility of the

participants is in principle limited to their participation in the capital of the company.

The SL Company is required to have a minimum capital of 3,006 Euros which has to be paid in full upon incorporation. Spanish law does not establish a minimum number of shareholders to be incorporated in a SL. However, sole shareholder companies are subject to a special system of publicity. This exceptional condition has to be registered in the company registry and mentioned on all corporate stationery and legal documents.

As in the case of SA companies, SL companies must be incorporated before a public notary, and the minimum requirements include the details of the shareholders, registered office, activity of the company, capital structure, accounting year-end and duration. The deed of incorporation usually includes the minutes of the first meeting of the company in which the administration of the company is decided upon.

The capital of the SL Company may be paid in cash or in-kind (equipment, stock, property, etc.) The cash contribution to capital will have to be certified by a bank, but unlike the case of SA companies, the contribution in-kind will not require an independent valuation. The directors' report approved by the General Meeting will be sufficient.

The company may opt for a board of directors or an administration system made up of a sole or several administrators.

Branches

The main difference between a branch and a subsidiary is that a branch is not an independent legal entity from the main company, whilst a subsidiary is legally independent. This means that among other considerations, the accounts of a branch are a part of the accounts of the company, and that a branch does not limit its liability to the assets assigned to the branch, but to all company assets.

In order to incorporate a branch in Spain, legalised translated copies of the company's legal documents are required. Articles of association, appointment of directors and a deed of incorporation of the branch duly notarised with the pertinent stamp duty paid and registered in the company register of the branch.

The Spanish branch of a foreign company is a permanent establishment in Spain for tax purposes and is therefore required to keep accounts in accordance with the Spanish accounting principles and statutory requirements. This includes the obligation to file annual accounts at the

company register and annual corporation tax return for the branch as a permanent establishment in Spain. A characteristic of a branch of a foreign company is that it is able to offset some expenses incurred by the headquarters of the company.

A branch has to include a legalised copy of the company's annual accounts registration in the annual accounts' country of residence; failing this, a legalised copy of the accounts drawn up in accordance with the accounting principles in that country.

These documents do not need to be translated into Spanish. However, the signatures of the directors need to be legalised by a notary and also with the note of the Hague Convention.

Sociedad Colectiva

A Sociedad Colectiva is one of the partnerships in Spain. This type of partnership is rarely used. In a Sociedad Colectiva partners have joint, several and unlimited liability for the debts of the partnership.

This partnership must be incorporated before a public notary and registered in the mercantile register. Once registered, it becomes an independent legal entity, however, the partners have unlimited liability for the actions of the partnership.

Sociedad Comanditaria

A Sociedad Comanditaria is another type of partnership used in Spain. The peculiarity of this partnership is that it has two categories of partners, those with unlimited liability (*Socios Colectivos*) and those with limited liability.

The partners with limited liability are only liable in principle to the extent of their capital contribution.

This partnership must be incorporated before a public notary and registered in the mercantile register. Once it is registered, it becomes an independent legal entity with the two types of partners. The difference between the two types of partners and thus capital must be clearly stated in both the deed of incorporation and in the balance sheet of the partnership.

5. Labour

Employment in Spain is legally regulated through general rules and collective agreements distributed by activities, the principal characteristics of which are summarised in the following paragraphs.

The Social Security system is obligatory in Spain and provides coverage for all situations from work accidents to retirement.

Contracts of employment

Written contracts of employment are obligatory and the employment of people without contracts can result in serious consequences for the employer including, in some cases, heavy fines. Special care should be taken in the employment of foreigners, particularly those from outside the EU, by ensuring that all the documentation is in order prior to signing the contract. Personnel costs are high compared with net take home pay. This is due to compulsory extra pay and high employer contributions to Social Security, therefore total costs can easily be underestimated. In all cases, it is essential to be guided by professionals specialising in this field.

Trial period

Trial periods are periods during which the work relation can be broken without the obligation of paying compensation. Trial periods are normally established in collective agreements. The general regulation establishes them as follows:

- Graduate employees: maximum six months;
- Other employees: maximum two months, three months in companies with less than 25 employees;
- Contract to give experience: one month for graduate employees with a qualification obtained after a three-year degree course and two months for graduate employees

Types of contracts

Employment contracts of unlimited duration are officially encouraged by incentives that may vary between regions, depending on the activity of the company and the situation of the employee. The company can obtain subventions from the Social Security in certain cases.

There are different types of contracts for the different needs of the employer, the most commonly used ones are the following:

- For the duration of a job or service: This type of contract is commonly used in the building trade;

- To deal with an accumulation of orders: The contract can be for a maximum of six months in a 12 month period. This can be modified by a collective agreement;
- To substitute employees who are on temporary leave of absence with the right to return to their jobs;
- To give work experience to qualified persons within five years of finishing their studies who may receive a minimum salary of 60% of that corresponding to their employment category in the first year and of 75% in the second year. The duration of the contract must be between six months and two years;
- Apprenticeship: For unqualified workers over 16 and under 21 years of age (under 25 years of age until 31 December 2011), with a reduction in the working day of approximately 15% and remuneration equal to the national minimum wage adjusted to the actual time worked. The duration of the contract must be between six months and two years.

Social Security

All employees and self-employed persons must be covered by Social Security. All contributions are obligatory but self-employed persons must pay their own contributions.

The employer is responsible for paying the contribution of employees to Social Security, deducting the corresponding quota when paying their salaries. In addition to this amount, one has to add the employer's contribution to the Social Security which is approximately 30% of the employee's gross pay. The sum of both amounts will be included in the official form used by the employer to settle the payment. The deadline is one month after settling the employee's salary.

6. Taxation

Tax authorities

The Spanish government levies taxes on personal income and wealth, company profits, value added, property transfers, inheritance and gifts. Some of these taxes are administered and collected by autonomous regional governments. In addition, local authorities levy taxes on property, capital gains on property, new construction and on business activity. The latter is required only for large companies.

Basis of taxation

Liability to taxation is decided by the residency of companies or individuals, by the location of assets and source of income. Residents of Spain pay tax on their world-wide income, whereas non-residents are generally only subject to tax on Spanish source income.

Foreign income is fully taxable but a credit for foreign tax paid may be given in accordance with double taxation agreements.

An individual is considered a resident for the year if he or she is in Spain for more than 183 days in one calendar year. Individual residents, who change their fiscal residence to tax havens, will be considered fiscal residents for the following four years. Corporations, whose effective head office is in Spain, can be deemed a resident. Non-resident corporations are subject to corporation tax only on income arising from business carried out in Spain. In some director controlled companies, profits may be directly assigned to the shareholders and assessed for individual income tax instead of corporation tax.

The fiscal year of a company cannot exceed 12 months and any reduced period resulting from a change of year-end will be considered as a separate tax year. This may prejudice the carry-forward of tax losses.

Corporation tax

The current general corporate tax rate in Spain is 30% for the year 2010. Exceptionally, companies with a turnover of less than 8 million Euros are taxed at 25% for the first 120,202.41 Euros of profit and at 30% for the rest of the profit. However, there are a number of deductions that can often reduce the overall tax liability. There is a deduction applicable to the profits generated by the sale of fixed assets, providing the proceeds are reinvested. Other tax credits related to the avoidance of double taxation on dividends and capital gains are international double taxation, investment

in assets used to protect the environment, employment of handicapped persons and research and development.

Corporation tax is payable within six months and 25 days following the year-end. However, advance payment is required three times a year at a rate of 18% of the tax paid for the previous year. Optionally, such payments can be based on current year performance. The latter is compulsory for companies with turnover in excess of 6,010,121.04 Euros. In this case, the payment on account is 21% of the profit for the period.

The tax regulations contain numerous provisions for the treatment of transactions with residents and resident entities of tax havens. Tax losses can be carried forward for a maximum of 15 years. Holding companies of foreign investments are not taxed for dividends or other certain incomes received from outside, if the shares have been held for at least one year (see Spanish international holding companies).

Spanish international holding companies

From 1 January 1996, Spain has joined those countries that have already included international holding companies in their tax legislation. Spanish international holding companies are not taxed for dividends or share of profits received from abroad, as long as the shares or participations have been held for at least one year before the dividend is payable and the participation is of at least 5%.

In addition to the above, these companies have many advantages; one of the most important ones is the taxation of the partners or shareholders of the holding company.

The potential sale of the shares of participating companies is not subject to tax in Spanish international holding companies.

Non-resident fiscal representation

Non-residents and companies subject to income or corporation tax must, in certain cases, appoint a fiscal representative. Failure to do so may result in a fine of 2,000 Euros.

Withholdings and prepayments

Non-operating income from interest and dividends is subject to 19%. No exception is made in the case of amounts paid by group companies. Non-operating income for non-residents from rents and royalties is subject to 24% withholding at source.

Non-residents are subjected to a 3% withholding tax on the sale of real estate.

Individual income tax

The new income tax law introduces the concept of total income as the taxable base. There is a general reduction per taxpayer of 5,151 Euros. There are further reductions of 918 Euros if the taxpayer is over 65 and 1,122 Euros if over 75 years of age. Disabled taxpayers will reduce their taxable base between 2,316 Euros and 7,038 Euros depending on the level of incapacity. Further reductions are allowed for dependants.

Salaries, wages, commissions, interest dividends, business profits and capital gains are taxed as income. Taxpayers with wages or salaries less than 22,000 Euros need not make an annual declaration.

The minimum tax rate is 24% and the maximum 43%. Spanish nationals cannot avoid income tax by taking up residence in tax havens, as they will continue to be considered as residents of Spain. Non-residents are taxed under a separate tax law. Benefits in-kind are taxable except for medical insurance and the costs of updating or recycling employees. Deductions are allowed for social security contributions, subscriptions and certain legal costs.

Taxable income is divided into a general part and a saving part for capital gains and losses generated by patrimonial assets, interests, dividends, etc.

The general part of the income is taxed according to the general tariff, while the saving part is taxed at a fixed rate of 19% for the first 6,000 Euros and later is subject to 21%.

General and saving losses can only be offset against general or saving gains, respectively. Losses not offset in the same year being carried forward for four years.

The inflation index will apply in the future only to property transactions.

The deduction from tax payable for the purchase of a main residence is now a total of 15% of the cost of acquisition, up to a limit of 9,015 Euros, deferred in the case of the purchase being financed by a loan.

Capital gains from the sale of the principal residence are tax-exempt, up to a limit, when the proceeds of the sale are reinvested.

Shares held personally at 31 December 1994, in an ordinary company (the tax law does not specify that the shares must be held in a Spanish company), could apply an index adjustment of 14.28% per year, therefore leaving the capital gain subject to no tax after eight years and one day (only for sales made before the 19 January of 2006).

Property owned personally at 31 December 1994 could apply an index adjustment of 11.11% per year, therefore leaving the capital gain subject to no tax after 10 years and one day (only for sales made before 19 January 2006).

Non-residents income tax

Non-resident's income is subject to a flat rate tax of 24%, except dividends, interests and capital gains obtained on the sale of patrimonial assets, where the rate is 19% and income from pensions which are taxed from 8% up to 40%.

Non-resident property owners are subject to income tax of 24% over 2% of the cadastral value (or 1.1 % if the cadastral value has been reviewed). This is considered deemed income and is the object of much debate.

Non-resident companies are subject to corporation tax on 3% of the rateable value of the properties owned by the company. Non-resident companies that are resident in a country which has a double tax Treaty with Spain, with a clause of exchange of information, are exempt on providing certificates to the Spanish Tax Authorities stating that the shareholders are residents in a country with the same conditions.

Value Added Tax

The rules and regulations for Value Added Tax are based on the EU Sixth Directive.

Business transactions are taxed at 16% and certain basic products and services at 7% or 4%. Exports and similar services are not subject to tax. Effective 1 July 2010, rates will increase from 16% up to 18% and from 7% up to 8% respectively.

Tax on property transfer

All transfers of land and buildings, under any title of transfer except succession and donation, are taxed at the rate of 7% of the value, except in the case of first sales from a real estate promoter on which VAT is payable. The rate of VAT in these cases is 7% on houses and 16% on urban land. Transfer of items other than land, buildings and rights over real estate are taxed at 4%. Effective 1 July 2010, rates will increase from 16% up to 18%

and from 7% up to 8% respectively. Public documents that require registration are taxed at 1%.

Tax on capital

A tax of 1% of the capital is levied upon incorporation and on any increase in capital. Mergers and acquisitions are taxed at the same rate, as are reductions in capital and liquidations. Tax on mergers is exempt if based on the EU Directive 90/435.

Inheritance and gift tax

Inheritance and gift tax is only levied on individuals and not on companies. This tax, which increases on a sliding scale, has the peculiarity of taking into account pre-existing wealth and degree of kindred. This means that two brothers inheriting on equal terms will be taxed at different rates based on their previous wealth.

Municipal tax on land transfer

Every time land is transferred, regardless of where it is built on, the municipality levies a tax on the increase in value since the land was last transferred. The applicable tax rates vary according to the municipality.

Municipal tax on properties

An annual tax based on the cadastral value is payable to the municipal authority. Tax rates vary according to the municipality between 0.4% and 1.30% for urban property.

Municipal tax on business activities

An annual tax on business activities is payable to the municipal authorities. Tax payable depends on the type of activity, the category of the street where the business is located and the size of the municipality. This tax will only be applicable to large companies at present time.

7. Accounting & reporting

Since 1990, Spanish domestic law has incorporated the rules and regulations of the EEC Fourth Directive on accounting, reporting requirements of the EEC Seventh Directive on consolidated accounts for groups of companies, and of the EEC Eighth Directive on the control of accounts and external audit.

All businesses are required to keep adequate accounting records in accordance with the Code of Commerce and the Spanish General Accounting Plan. All companies registered in the company registry are obliged to file an annual reporting pack including a balance sheet, profit and loss account, notes to the accounts, statement of changes in the net equity and a director's report.

Effective 1 January 2002, all companies must keep their accounting records in Euros. For companies that are obliged to file full accounts and are therefore subject to an external audit, a copy of the audit report must be included in the reporting pack.

Small companies may file abridged accounts providing they do not exceed the following limits for two consecutive years:

- Total assets 2,850,000 Euros
- Turnover-net 5,700,000 Euros
- Average number of employees 50.

All companies exceeding the above limits are required to file the complete reporting pack and are obliged to have an annual external audit.

Auditing is a legally regulated activity in Spain. The audit law of 1988 restricts the audit of accounts to suitably qualified persons or firms who are inscribed in the Spanish official register of auditors of accounts (ROAC), maintained by the Spanish Institute of Accounting and Auditing (ICAC). Persons or firms who are not so ascribed cannot legally act as independent auditors of accounts in Spain, no matter what other Spanish or foreign qualifications they may have.

Minimum professional indemnity insurance of 300,000 Euros per partner is obligatory by law. Auditors may practice individually, in a partnership or as a corporation, but have unlimited liability in all instances for audits performed.

The statutory corporate records include:

- Incorporation deed
- Memorandum and Articles of Association
- Minutes book (shareholders and directors meeting)
- Register of shares or participations.

Official books of account

The official book of accounts must be legalised by the Mercantile Registry and must be kept together with all the supporting documentation for six years.

8. UHY firms in Spain

UHY Fay & Co has been established since 1983 and specialises in audit, business services & outsourcing, tax & corporate, consulting and labour services.

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