

Tax Collection System

There is often a misconception as people think that taxes in Spain are higher than in other countries as they can pay a lot to the tax authorities on a quarterly basis, even when their business is not doing very well. What many people don't realize is that they are not paying their taxes, but other people's. They are merely collecting tax on behalf of the Government from their suppliers and clients and passing it on. Let's look at some examples:

VAT on Sales

When we make a supply that is subject to VAT, we add VAT to the price agreed with our clients. Therefore, when we receive payment from our clients, we receive our fees and the VAT. This VAT belongs to the tax office and should therefore be passed on at the end of the current reporting period. An example would be as follows:

Sales invoice issued			
	Invoice	Our money	VAT - Tax office money
	€	€	€
Sales	3,000	3,000	
VAT @ 16%	480		480
	<u>3,480</u>	<u>3,000</u>	<u>480</u>

When the sale has been completed, our profit is €3,000:

Profit and loss account	
	€
Sales	3,000
Expenses	
Profit / (Loss)	<u>3,000</u>

However, we have collected from our client our money and the VAT that becomes a creditor to be paid at a later date:

Balance Sheet			
	Profit	Bank	VAT Creditor
	€	€	€
Sales Invoice	3,000	3,480	480
	<u>3,000</u>	<u>3,480</u>	<u>480</u>

VAT on Purchases

When we make a purchase that is subject to VAT, we add VAT to the price agreed with our supplier. Therefore, when we make the payment to our supplier, they receive our fees and the VAT. This VAT suffered should be refunded by the tax office; therefore we can deduct it from any VAT collected through our sales before VAT is passed on at the end of the current reporting period. An example would be as follows:

Purchase invoice - expense			
	Invoice	Our	VAT -
	€	money	Tax office
	€	€	money
	€	€	€
Expenses	200	-200	
VAT @ 16%	32		-32
	<u>232</u>	<u>-200</u>	<u>-32</u>

By making the purchase our profit is reduced by the amount of our cost:

Profit and loss account	
	€
Sales	3,000
Expenses	-200
Profit / (Loss)	<u>2,800</u>

However, we can deduct the VAT paid from our VAT creditor:

Balance Sheet			
	Profit	Bank	VAT
	€	€	Creditor
	€	€	€
Sales	3,000	3,480	480
Expenses	-200	-232	-32
	<u>2,800</u>	<u>3,248</u>	<u>448</u>

IRPF on Purchases

When we make a purchase that is subject to withholding tax (IRPF), we deduct withholding tax from the price agreed with our supplier. This tax is an income tax payment on account for the profits of our supplier. By making this deduction we are merely acting as tax collectors on behalf of the tax office, hence we pay that money at the end of the quarter. An example would look as follows:

Purchase invoice - Rent				
	Invoice	Our	VAT -	IRPF -
	€	money	Tax office	Tax office
	€	€	money	money
	€	€	€	€
Rent	1,000	-1,000		
VAT @ 16%	160		-160	
IRPF @ 18%	-180			180
	<u>980</u>	<u>-1,000</u>	<u>-160</u>	<u>180</u>

Our profit is only affected by the actual cost of the rent:

Profit and loss account	
	€
Sales	3,000
Expenses	-1,200
Profit / (Loss)	<u>1,800</u>

However, we the income tax withheld from our supplier becomes a creditor:

Balance Sheet				
	Profit	Bank	VAT	IRPF
	€	€	Creditor	Creditor
	€	€	€	€
Sales	3,000	3,480	480	
Expenses	-200	-232	-32	0
Rent	-1,000	-980	-160	180
	<u>1,800</u>	<u>2,268</u>	<u>288</u>	<u>180</u>

IRPF on Purchases

There are many transactions where withholding tax should be applied. Two of the most common forms of IRPF deductions are those relating to rental of property as seen in the example above, and those relating to services provided by certain professional sole traders. Let's consider a further example for this type of expense:

Purchase invoice - Professional Services				
	Invoice	Our	VAT -	IRPF -
	€	money	Tax office	Tax office
	€	€	money	money
	€	€	€	€
Services	1,500	-1,500		
VAT @ 16%	240		-240	
IRPF @ 15%	-225			225
	<u>1,515</u>	<u>-1,500</u>	<u>-240</u>	<u>225</u>

Again, for the purposes of our profit calculation VAT and IRPF can be ignored:

Profit and loss account		€
Sales		3,000
Expenses		-2,700
Profit / (Loss)		<u>300</u>

Having considered a few examples that illustrate ordinary business transactions, this example would lead to the following:

- Quarterly tax returns with payment of taxes amounting to €453.
- Reported profit amounting to €300.

Thus the commonly mistaken conclusion of taxes being high in Spain, as many puzzled entrepreneurs wonder how it is possible to pay €453 euros worth of tax when the profit was only €300. The answer to that question can be seen below:

Balance Sheet				
	Profit	Bank	VAT	IRPF
	€	€	Creditor	Creditor
	€	€	€	€
Sales	3,000	3,480	480	0
Expenses	-200	-232	-32	0
Rent	-1,000	-980	-160	180
Services	-1,500	-1,515	-240	225
	<u>300</u>	<u>753</u>	<u>48</u>	<u>405</u>

- The profit was €300 but the actual net cash inflow from operations was €753.
- The excess €453 was collected on behalf of the tax office which of course has to be paid when the period comes to an end.

Of course, in practice, it is never this simple. Businesses can face cash flow shortages for a number of reasons and when the taxes collected are not ring-fenced making the appropriate payments can be very difficult indeed.