Comparison of Reduced Corporate Tax Rate in the EU

Chang Woon Nam*

Many European countries favour small and medium-sized enterprises (SMEs) by granting them reduced corporate income tax rates (European Commission 2012). There are several reasons for such a type of tax expenditure policy. First of all, the vast majority of firms that operate in Europe are SMEs. Consequently, SMEs' competitiveness significantly affects the competitive position of a country's economy as a whole. Secondly, the concentration of their activities on the domestic market leads to a bounded business vision: combined with the asymmetric information about profit opportunities abroad, this fact limits the diversification of SMEs' investments in an international context. Thirdly, SMEs are generally more responsive to domestic tax incentives than large companies (Coyne 1995), while taxes play a more important role in the cost structure of SMEs as they do not have the

* Ifo Institute.

Table 1

Reduced Corporate Income Tax Rate for SMEs in the EU (2012)

Country	Standard rate	Reduced rate for SMEs	Eligibility criteria for reduced rates / thresholds for lower rates
Belgium	33%		Companies that fulfil a number of conditions related to the activities of the company, the shareholding of the company, the rate of return of distributed profits and the remuneration of their managers benefit from reduced rates
		24.25%	Profits of up to €25,000
		31%	Profits between €25,000 and €90,000
		35.50%	Profits between €90,000 and €322,500
	+ 3% austerity surcharge on income tax rate		
Spain	30%	25%	Companies with a turnover below €10 million. Only on a taxable base up to €300,000[a)]
		20%	In 2009–2012: micro-enterprises with a turnover less than €5 million, employing fewer than 25 employees and maintaining or increasing employment. Only on a taxable base of up to €300,000
France	33.33%	15%	Largely independent businesses with an annual turnover no greater than €7.63 million. Only on the first €38.120 of profit
Luxembourg	21%	20%	Taxable base up to €15,000
	+ 5% solidarity tax		
Netherlands	25%	20%	On the first €200,000 of profits
Latvia	15%	9%	Micro-enterprises with a turnover less than LVL 70,000 (= approx. €100,000), employing up to 5 employees (if turnover above, excess taxed at 20%)
Lithuania	15%	5%	Companies with a taxable profit less than LTL 1 million (= approx. €290,000), employing up to 10 employees
Hungary	19%	10%	On the first HUF 500 million (= approx. €1.64 million) of profits per annum
Romania	16%	3%	Privately-owned companies with a turnover less than €100,000, employing up to 9 employees (optional)
Britain	24%	20%	Companies with profit under GBP 300,000 (= approx. €348,000). Marginal relief is available on profits between GBP 300,000 (= approx. €348,000) and GBP 1.5 million (= approx. €1.74 million)

[a)] As of 2011, companies in Spain that grow above the limits applicable for small companies can benefit from the lower rate for three years after losing their small-business status.

Source: European Commission (2012).

financial and human capacity to developed sophisticated tax avoidance strategies (see also Weichenrieder 2007).

In addition, SMEs have limited access to capital markets, partly because of the perception of higher risk, informational barriers and their involvement in smaller projects, etc. As a result, they have often been unable to obtain long-term finance in the form of term debt and equity, and a larger part of their investments have traditionally been self-financed (see also Nam and Radulescu 2007). Furthermore, the corporate tax system encourages debt financing and discriminates against SMEs, since corporate interest payments are tax deductible. Such a type of tax non-neutrality between the financing methods favours large firms, which have easier access to bank loans (Chen, Lee and Mintz 2002).

Some EU countries including Britain have traditionally had lower tax rates for SMEs, whereas such a corporate tax reduction does not exist at all in countries like Austria, Finland and Germany. As shown in Table 1, ten EU member states currently make use of reduced corporate tax rates to support SMEs. Although it is disputable, those countries that provide fiscal incentives and preferential tax treatment to SMEs claim that they (1) create a large number of jobs and (2) enhance the level of entrepreneurship, which implies flexibility, speed, risk-taking and innovation (Chen, Lee and Mintz 2002).

However, the European Commission (2012) argues that using the tax expenditure system to rectify the aforementioned distortions and SME-specific disadvantages does not the first-best solution (see also de Mooij and Nicodeme 2008). According to Santarelli and Vivarelli (2002), those less-efficient SMEs tend to have a higher expected probability of exiting from the market than larger firms do and therefore it is optimal for them to invest more gradually, since entry and other investment costs made at the setting-up phase are sunk. In this context a government subsidy or a tax expenditure system may reduce differences between the efficient and the inefficient firms, and consequently disturb not only investment decisions, but also market selection, as well as the learning process undergone by entrepreneurs.

References

Chen, D., F.C. Lee and J. Mintz (2002), *Taxation, SMEs and Entrepreneurship,* STI Working Paper 2002/9, OECD.

Coyne, E.J. (1995), *Proposed Analytical Model for FDI Attraction Into Developing Countries,* Essays in International Business 1, The International Business Center, College of Professional Studies, University of the District of Columbia, Washington DC.

De Mooij and G. Nicodeme (2008), "Corporate Tax Policy and Incorporation in the EU", *International Tax and Public Finance* 15, 478–498.

European Commission (2012), *Tax Reforms in EU Member States: Tax Policy Challenges for Economic Growth and Fiscal Sustainability, 2012 Report,* Luxembourg: Office of Official Publications of the European Communities.

Nam, C.W. and D.M. Radulescu (2007), "Effects of Corporate Tax Reforms on SMEs' Investment Decisions under the Particular Consideration of Inflation", *Small Business Economics* 29, 101–118.

Santarelli, E. and M. Vivarelli (2002), "Is Subsidizing Entry an Optimal Policy?", *Industrial and Corporate Change* 11, 39–52.

Weichenrieder, A. (2007), *Survey on the Taxation of Small and Medium-sized Enterprises,* Paris: OECD, http://www.oecd.org/tax/tax-policy/39597756.pdf.