Comparison of the corporate tax regimes in the eu member states

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COMPARISON OF THE CORPORATE TAX REGIMES IN THE EU MEMBER STATES

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Summary:

The main objective of this paper is to provide the comparison of the corporate tax systems in the new EU member states, which mostly influence the effective tax burden of theirs, and through it also the decisions of the potential investor to invest at some member state. It concerns about all the corporations income tax systems, which have the greatest effect upon it. They are compared mutual here from the point of view of theirs structures, tax rates and some weighty factors influencing the tax base.

Anotace:

Hlavním cílem tohoto článku je poskytnout srovnání daňových systémů právnických osob (korporací) v nových členských státech EU, které nejvíce ovlivňují jejich efektivní daňové zatížení a tím i rozhodování potenciálních investorů investovat v některém členském státě. Týká se to především korporátních systémů daně z příjmů, které na to mají největší vliv. Ty jsou zde vzájemně porovnávány z hlediska jejich struktury, daňových sazeb a některých důležitých faktorů ovlivňujících daňový základ.

1. Taxation of Corporation Income

In general, the taxation of income of corporations in the new member states follows international standards (mostly GAAP) as a starting point, and then modified by each new member state to a different extent. Corporation that are resident in one of the new member states are subject to corporate income tax on their worldwide income. Corporate residence depends on the fiscal domicile or the place of management. The corporation tax liability is determined according to **the corporation tax system, the tax rate and the tax base.**

1.1 Tax Systems

Regarding the extent of integration of the corporation income tax into the personal income tax of the individual shareholder, study [4] distinguishes three main categories: **the classical system, double taxation avoiding systems and double taxation reducing systems** (see Fig. 1)

The classical system results in the double taxation of dividends by imposing both corporation tax and personal income tax. Within EU, the classical system is currently applied only in Ireland. It is not in effect in any of the new member states.

Double taxation avoiding systems, by contrast, ensure that profits are taxed only once – either at the corporate level or at the shareholder level.

- Malta is the only new member state that applies a full imputation system (beside Finland and France as the current member states). Dividends received by individual shareholders are grossed-up by the underlying corporation tax and taxed progressively. At the same time, the corporation tax is credited against the personal income tax. As a result, there is full relief from corporation tax on distributed profits, and dividends are subject only to personal income tax.
- Latvia (beside Greece) eliminates double taxation thorough a system of dividend exemption at the shareholder level. Profits are subject only to corporation tax.

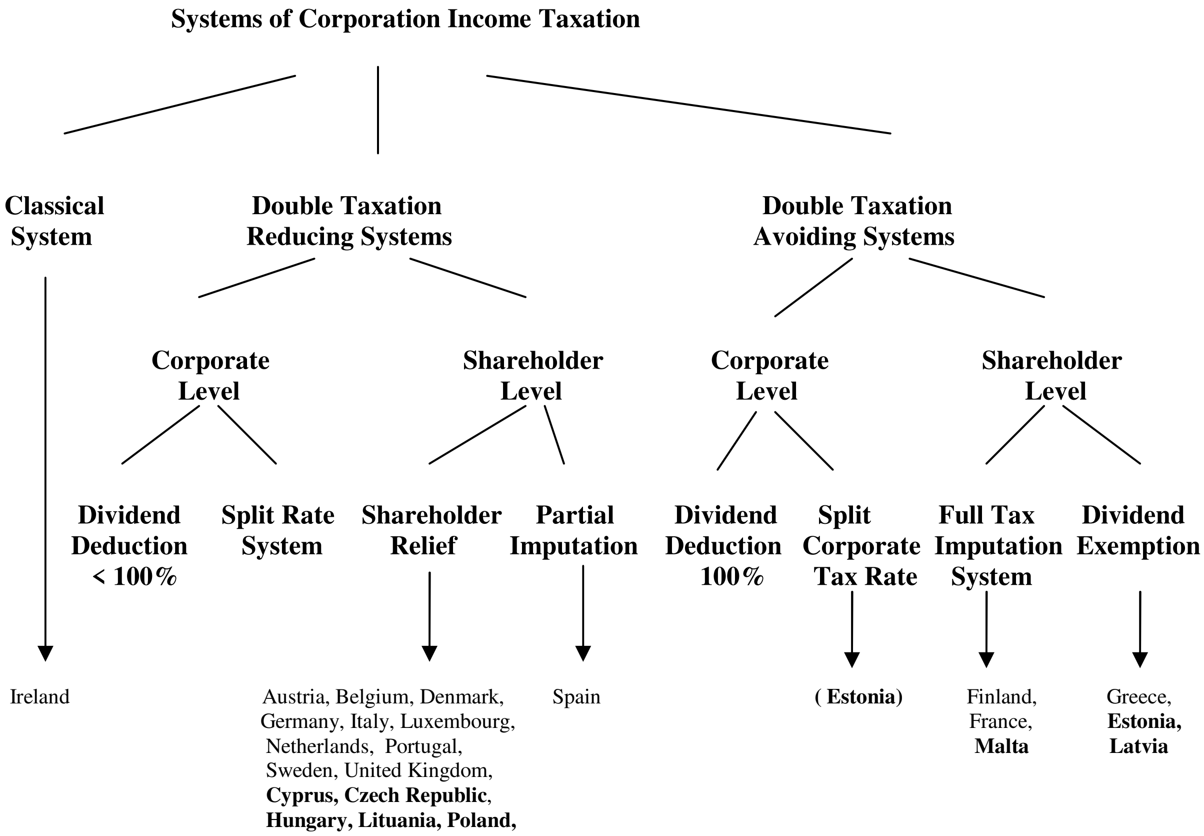
Consequently, the corporation tax rate determines the tax burden of both retained and distributed profits.

- Estonia combines elements of a split-rate system with a system of dividend exemption. At the corporate level, retained earnings are tax-exempt, and distributed profits are taxed at a rate of 26 %. At the shareholder level, dividends are exempt from personal income tax, as it is the case in Latvia.

Double taxation reducing systems granting only partial relief from double taxation on dividends are operate at most of the new member states, as well as at the majority of the current member states:

- In Cyprus, the Czech Republic, Lithuania and Poland, a final witholding tax of 15% is imposed on distributed profits. The finale witholding tax of 15 % represents a preferential treatment because it corresponds to the lowest personal income tax rate. In the Czech Republic, double taxation is relieved not only at the shareholder level, but also at the company level. The distributing corporation may credit 50 % of the witholding tax levied on distributed profits against its corporation income tax liability.
- In Hungary, dividends are subject to a final witholding tax of 20%, which is also a preferential treatment because the tax rate of the first tax bracket is set at 20 %.
- In the Slovak Republic a 15 % final witholding tax on dividends was imposed.
- In Slovenia, 40 % of dividends received are deductible from the personal income tax base. Consequently only 60 % of the dividends is subject to income tax.

Figure 1: Systems of Corporate Income Taxation in the New and Current Member States



Slovak Republic, Slovenia

1.2 Tax rates

As regards the **corporate income tax rates**, the new member states, on average, offer lower statutory tax rates, compared to the current EU-15 member states. In the year 2004 the statutory tax rates were: in Cyprus, Lithuania and Latvia – 15 %, in Hungary – 17,7 %, in the Slovak Republic and Poland – 19 %, in Slovenia – 25 %, in Estonia – 26 %, in the Czech Republic – 28 %, and the highest tax rate had Malta – 35 %. The average rate 21,5 % was considerably lower than the current average tax rate of the EU-15 member states, which was 31,4 %. However, the spread between the statutory corporate income tax rates in the new member states was relative large for amounted to 20 percentage points.

1.3 Tax bases

Taxable income is determined according to the accrual principle. Generally, financial accounting profits form the starting point for the tax base. All new member states adjust financial accounting profits for tax purposes to a different extent to obtain the corporation tax base. Several differences exist with respect to individual elements of taxable income. The most important rules – most of which are taken into account in the calculation of effective tax burden - are explained below:

1.3.1 Depreciation of the Fixed Assets in consequence of amortisation

Buildings - may be depreciated for tax purposes in all new member states. The useful life ranges from 20 to 45 years. The declining-balance method is in use in Latvia and Lithuania. In the Czech and the Slovak Republics, companies may use a special accelerated depreciation method based on coefficients. In Malta, an initial allowance of 10 % in addition to the annual rate of 2 % is allowed. In Estonia the depreciation of buildings practices according to the rules of financial accounting (IFRS).

Other tangible Fixed Assets - such as plants, machinery and office equipment are depreciated in all new member states. In the Czech and Slovak Republics, Latvia, Lithuania and Poland, companies may use the declining-balance method. In the Czech and Slovak Republics, the amount of depreciation is determined by an accelerated depreciation method, which is based on coefficients. Companies located in the Czech Republic benefit from a first year deduction of 10 % in addition to the annual allowances for the acquisition of new machinery. Cyprus, Hungary, Malta and Slovenia restrict depreciation to the straight-line method. Useful life is 4 years in Slovenia, 5 years in Malta, 6 years in Czech and Slovak Republics and 10 years in Cyprus. Tangible fixed assets in Hungary and Poland are amortised at a rate of 14 % and in Latvia and Lithuania at a rate of 40 %.

Intangibles - (e.g. brands, patents, expertise) that have been acquired against payment must be capitalised and amortised over their useful economic life (Cyprus, the Czech Republic, Hungary, and Malta), or the amortisation method stated in the tax law must be applied. The useful life specified in the tax law varies from 3 years in Poland over 5 years in Latvia, the Slovak Republic and Slovenia to 12,5 years in the Czech Republic, Cyprus and Hungary. In Lithuania, intangibles are treated most favourably because they are amortised at a rate of 66.67 % using the declining-balance method. In Estonia the intangibles are amortised for tax purposes also according to the rules of financial accounting.

1.3.2 Inventories

Inventories are valued at production cost. In Cyprus, Lithuania and Malta, the first-in, first-out (FIFO) method is compulsory. In the Czech and Slovak Republics and Latvia, the weighted-average cost method is an option. Hungary, Poland and Slovenia permit the last-in, first-out (LIFO) method.

1.3.3 Provisions

Due to the diversity of the tax treatment of provisions, it is not possible to provide a comprehensive overview. Rather, the focus is on provisions for bad debts or uncertain liabilities. In all new member states, provisions for contingent (uncertain) liabilities are not deductible for tax purposes. Furthermore, in Cyprus, Hungary, Latvia, Malta and Slovenia, provisions for bad debts are prohibited. Only companies in the Czech and Slovak Republics, Lithuania and Poland are entitled to deduct provisions for bad debts if certain prerequisites are fulfilled. In Latvia, only financial institution are entitled to account for such a provision.

1.3.4 Tax Treatment of Losses

With regard to the tax treatment of loses, none of the new member states allow a carry-back of losses. However, all of the countries grant a loss carry-forward. In seven countries (Hungary, Latvia, Lithuania, Poland, the Czech and Slovak Republics and Slovenia), the loss carry-forward is limited to five consecutive years. Only Cyprus and Malta allow an unlimited loss carry-forward. In Poland, the amount of a loss carried forward to be set off from taxable profits in each year is limited to 50 % of the loss. The Slovak Republic has also implemented some restrictions. Hungary offers an unrestricted carry-forward for start-up losses (start-up period max. 4 tax years). Estonia has a unique tax system. As retained profits are here tax-exempt, taxable income therefore equals the amount of distributed profits to the shareholders and the amount considered as hidden profit distribution. Since retained profits are not taxed, there is no need to implement special provisions for the treatment of losses.

2 Additional Company Taxes

Corporations may be subject to additional taxes on business profits or on business assets other then corporation income tax. In general, the most important additional taxes are **real estate tax, property tax and local business tax.**

Real estate tax is levied in all new member states except Estonia, Malta and Slovenia. The tax base covers land and buildings. The taxable value is derived from either market prices, lower standard tax values or the area of land (square meters). Therefore, the taxable value may be completely different in different countries even thought the tax base covers the same items. Although the amount of real estate tax varies from country to country, real estate tax has no significant impact on the effective tax burden of companies, since the tax rates are relatively low.

A property or net wealth tax on business assets is not levied in any of the new member states. This reflects the situation in the EU-15 member states.

An additional **local business tax** for companies is levied in Hungary only. The tax base comprises the net sales revenues including interest income. The cost of goods sold, cost of services (subcontractor fees) and the cost of material are deductible. The local authorities set the tax rate. The maximum rate for the local business tax, however, may not exceed 2 %. The local business tax is deductible for corporate income tax.

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