



11 Raven Wharf, Lafone Street, London, SE1 2LR Tel: +44 (0)20 7403 5959 Fax: +44 (0)20 7403 3111
Email: gba@greenback-alan.co.uk Web: www.greenback-alan.co.uk

Published in The Daily NNA, UK & EU and Germany July 2007

Changes in European Corporate Taxation.

In contrast with indirect taxes (VAT etc) the European Treaty does not call for direct taxes (corporation & income taxes) to be harmonised. However, increasingly the decisions of the European Court of Justice (ECJ), particularly in relation to corporation tax, have focused more attention on the conflict between Member States and a trading entity's right to freedom of establishment and movement of capital under the treaty. The decisions of the ECJ have encouraged Member States to amend their own legislation to prevent perceived discrimination against these fundamental rights.

Against this background cross EU border mergers are becoming more common place and increase pressure on governments to make their tax systems more efficient both in terms of the tax base and compliance system. Tax efficiency is a clear encouragement to international businesses to locate in a jurisdiction.

Across the EU corporation tax rates are falling as there is fierce competition between Member States to attract more inward investment. For example some Member States in the former Eastern Block such as Slovakia are introducing a flat rate tax system; others for example, Ireland and Cyprus have taken the more traditional route of lower headline corporate tax rates of 12% and 10% respectively.

Recently both the UK and German Governments have announced their intentions to reduce headline rates of taxation and thereby effectively acknowledging the need to increase their international tax competitiveness. In the UK the Chancellor of the Exchequer has announced that the UK mainstream corporation tax will be reduced from 30% to 28% from April 2008. In Germany even more dramatic changes are proposed. Last month the Corporation Tax Reform Bill was enacted which, among other changes, reduced the headline rate to 15%. It should be noted that this is not the whole picture in that German resident companies are also required to pay a trade tax which will vary between 7% - 17% and a solidarity surcharge of 5.5%. Thus the rate effective on average is being reduced to a fraction under 30% against current rates of about 40%. As with the UK the changes are being delayed so that the new rules will be effective from 1 January 2008.

It does not follow that a reduction in tax rates means that a government's requirement for tax revenues will fall. If anything the converse is true. As a result the rate reductions in both countries are being financed by changes elsewhere, for example in Germany changes to the tax base may mean that some companies will actually be worse off under the new system. Further details of these changes are given in the table. Nonetheless the changes do represent a significant change in

The above is only a summary and is not intended to be relied upon as constituting tax advice. No liability can be accepted by the author or Greenback Alan LLP for an act, or omission to act, based on this article.



11 Raven Wharf, Lafone Street, London, SE1 2LR Tel: +44 (0)20 7403 5959 Fax: +44 (0)20 7403 3111
Email: gba@greenback-alan.co.uk Web: www.greenback-alan.co.uk

**Published in The Daily NNA, UK & EU and Germany
July 2007**

policy for the German Government. In the past their policy, in common with other high tax countries such as France, has been to push for more harmonisation across Europe to maintain higher levels of taxation. Perhaps they have now recognised that the headline corporate tax rates are a crucial factor in an international business' perception of a country's business environment. Although this is a somewhat superficial approach there is some empirical evidence that this is indeed the first step taken before a more detailed examination of all factors including investment incentives and transfer pricing policies etc are explored in detail.

In conclusion it does seem that we are moving to an era of lower headline corporate tax rates across the EU, although in our view, this will not necessarily lead to a reduction in the tax burden placed on businesses. Will the competition for investment between member states lead to an effective harmonisation of corporate tax rates across Europe? Ultimately only time will tell but logically in the longer term this must be the conclusion.

Table
Summary of The German Corporate Tax Reform Bill.
<ul style="list-style-type: none">• With effect from 1 January 2008 the effective combined rate of corporation tax will be reduced to just under 30%. <p>To fund this rate cut the tax treatment of the following expenses shall be changed so that:</p> <ul style="list-style-type: none">• Trade tax shall no longer be a tax deductible business expense.• Thin capitalisation rules are to be changed so that interest expenses will only be allowable to an equivalent of 30 % of the company's profits. Excess interest expenditure may be carried forward against future profits. This Interest Bar is only applicable to group companies and when the interest cost exceeds 1million euros.• Similar rules may apply to license fees, royalty payments etc.