Comparing Taxes Around Europe

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Anyone who tries to make a comparison of the main taxes on businesses and individuals around Europe will find that it is an extremely difficult thing to achieve. Quite apart from the obvious language barriers, there are also the difficulties posed by the sheer multiplicity of tax regulations, as well as the growing influence of EU Directives.

Nevertheless, a comparative analysis of corporate taxes, parent company treatment, salary and social security, expatriate tax, and VAT position across the region can be extremely beneficial and demonstrate useful year-to-year and country-to-country trends. Such comparisons can also highlight tax planning opportunities and pitfalls. Furthermore, it is important to consider both EU and non-EU countries when seeking to engage in cross-border activities.

Highlights

From a corporate tax perspective, Bulgaria, Malta, Cyprus and the Isle of Man (zero tax) appear to be perfect places to run a business. Actively doing business through an Ireland or Liechtenstein company is also very attractive, and some South- and Eastern-European countries such as Croatia and Hungary have become increasingly competitive in this respect.

From the point of view of parent company location, most jurisdictions apply a full dividend income and capital gains exemption system, and a non-resident taxpayer will gain most benefit, from a tax point of view, by using parent companies located in Cyprus, Liechtenstein and Malta.

In relation to personal tax matters, Liechtenstein leaves the greatest amount of money in the pocket of the employee (89.7%) and Belgium the least (48.63%). There is a similarly large dichotomy in respect of the additional cost of employment borne by the employer, with Liechtenstein at 11% and Belgium at 35%. However, the country that has the highest cost to the employer is France at 43%, but it does leave over 75% of gross salary in the hands of the employee.

There is a continuing lack of uniformity in the administration of VAT within the EU, in spite of the efforts of the European Commission to harmonize the tax. So, any business interested in starting up in another country should never assume that the VAT system is the same as it is at home.

Corporate Taxes

When looking at corporate taxes, it is important to look beyond the headline rate and consider the effective rate payable after add-backs and adjustments. The figures quoted below are therefore based on a model profit and loss account for a standard trading company with pre-tax accounting profit of €1,000,000.

Although there appears to be a general trend towards reducing corporate tax rates, many countries, such as Austria, Cyprus and France, have kept the same nominal rate for the last five years.

A comparison of the effective rates shows a slightly different picture but the overall trend is also downwards.

In most cases, where add backs and adjustments are taken into account to arrive at an effective tax rate in order to make a proper comparison, these adjustments lead to an increase in rate, as can be seen from the effective rates for Ukraine (68.9% higher), Poland (71.3% higher) and Romania (92.5% higher).

Readers may not be surprised to learn that the UK, in respect of both nominal rate and effective rate, is at the higher end of the spectrum coming in at position 26 for nominal rate and position 28 for effective rate out of a total of 31 countries considered.

This contrasts sharply with the UK's near neighbor, the Republic of Ireland, which comes in 4th place for nominal rate and 5th place for effective rate. The UK compares better with France, which is at position 29 for nominal rate and position 30 for effective rate. Germany fares slightly better as it is 27th for nominal rate, but does better on effective rate finishing 23rd.

A number of comparisons can be made in relation to dividends to show the percentage of after tax profit that is receivable by the shareholders, including those resident in countries covered by a double tax treaty:

- Individual shareholders resident in the same country as the paying company.
- Individual shareholders resident in treaty countries.
- Individual shareholders resident in non-treaty countries.
- Company shareholder resident in the EU.
- Company shareholder resident in a non-EU treaty country.
- Company shareholder resident in a non-treaty country.

The territory that comes out best in almost all of these

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situations is Malta, which allows most shareholders to claim a 6/7th tax refund that is normally paid within six weeks of payment of the company's tax bill.

This means that a Maltese resident individual receives 60.58% of the company's after tax profit. For all other categories of shareholder, this percentage increases to 93.2%, making it extremely attractive for investors.

Bulgaria also performs well, as a Bulgarian resident individual receives 85.5% of after tax profit, as do both individual and corporate shareholders in non-treaty countries. The other three categories of shareholder do even better at 90%.

Gibraltar is a surprisingly poor performer across the board coming in on or slightly below the 50% mark. It is in good company: France, Belgium and Italy also fail to reach 50%.

Other issues to consider include the tax treatment of bad debts where most countries do not allow general provisions but do allow specific provisions. Pension contributions are also disallowed in some countries such as Denmark and France. Luxembourg and the Czech Republic disallow non-executive directors' fees and Germany allows only a 50% deduction. Most countries allow depreciation for company cars, with Croatia being the most generous at 40%.

Parent Company Jurisdictions

When looking for the ideal place to site a parent company, it is important to consider the conditions in each country for the exemption of dividends and capital gains in order to identify the most useful and flexible jurisdiction. Again it is important to have a standard basis from which to make comparisons, so the figures in this section are based on a standard profit and loss account and balance sheet and subsidiaries in France, Germany, USA and Switzerland.

Most parent company jurisdictions apply a full dividend income exemption system for dividends received from foreign subsidiaries. A notable exception is the UK, where dividend income is fully taxed (but subject to a tax credit for withholding tax).

In fact most parent company jurisdictions in Europe apply a full dividend income and capital gains exemption. So from a tax perspective and particularly with regard to a low tax burden and a short-term realization of dividends, a non-resident shareholder will gain most benefit from a parent company in Cyprus, Liechtenstein or Malta.

However, to gain maximum benefit from the potential tax savings a combination of parent companies in different jurisdictions may be necessary.

Salary Taxes, Social Security and Expatriate Taxation

A comparison of how much of an employee's salary is left after income tax and social security contributions produces some interesting results but it is also important to look at the employer's social security contributions in order to understand the costs of employment from the employers' perspective.

The only way to achieve this is to use standard data, so the figures in this section are based on the tax position of a married individual with two children, gross annual salary of €100,000, a company car costing €40,000 (when new) and paying mortgage interest of €7,500 per annum.

Clearly, in order to make a proper comparison, it is essential to take account of both tax and social security contributions for both the employee and the employer, as the rates in each country and the relative split between the two varies so widely.

This shows that Liechtenstein leaves the greatest amount of money in the hands of the employee and Belgium the least. However, the additional cost of employment borne by the employer is highest in France at 43% but over 76% of gross salary is left in the hands of the employee.

Looking at both aspects together can be crucial when looking at doing business in another country.

It is interesting to note that when compared with the rest of Europe, the UK does not fare well from the perspective of the employee, but does considerably better as far as employers are concerned.

There is also an increasing trend towards recognizing environmental issues in the tax system by, for example, applying reduced tax rates to environmentally friendly company cars. The Netherlands, for example, gives a reduction from 20% to 14% for use of an environmentally friendly vehicle.

VAT

The final key area of taxation to look at is VAT and, in particular, the way in which it is administered in each country.

The EU average rate as of January 1, 2009 was 19.5%. So, the decision by the UK to reduce its standard rate to 15% puts it at the lower end of the scale and contrasts starkly with the rest of the EU, where many countries have increased their VAT rate. Even when the UK rate reverts to 17½% on January 1, 2010, it will still be lower than the EU average, suggesting that predictions of an increase in the UK rate may not be far wide of the mark.

Another key difference is the UK's VAT registration threshold of £68,000 (approximately €80,000) which is one of the highest in Europe followed by France at €76,300 and Ireland at €75,000. High thresholds such as these are clearly anomalous, with 27 out of the 34 countries surveyed having a threshold of less than €40,000. In fact there are several countries, such as the Netherlands and Italy, that have no threshold at all, so anyone making supplies of goods or services by way of business has an immediate obligation to register for VAT.

It is also clear that although VAT is supposed to operate in a consistent manner within the EU there are wide variations in the way in which the tax is administered. For example, only half of the countries surveyed operate any sort of VAT grouping facility. There are also wide variations in the time limits allowed for issue of VAT invoices. Some countries such as Austria, Denmark, Finland, France and Sweden require invoices to be issued immediately, whereas Germany allows 180 days. So the key message to any business looking to set up in another country is to take local advice and do so at an early stage. ❑