Short Considerations on Tax Competition for SMEs

Florin Tudor [1]

[1] *"Dunărea de Jos" University Galați, ftudor@ugal.ro*

Abstract. Tax competition is particularly evident with regard to attracting foreign direct investment, portfolio investment to finance investment, higher skilled jobs, etc. Taxpayers may choose thus the tax for those residences that offer a combination of public goods and taxes that satisfy the highest preferences. Starting from the main rules in the field of taxation, our study aims to identify those opportunities that can benefit SMEs on a background of fierce tax competition fierce competition in EU.

Keywords: tax harmonization, unfair competition, good governance, subsidies, public policy.

1 Introduction

EC Treaty contains a number of basic rules, among which: the interdiction to apply to the imported products indirect taxes higher than those applied to similar domestic products, prohibition to grant to the exported products to the territory of any Member State, any repayment of internal taxation that exceeds the internal taxation imposed on them whether directly or indirectly.

Harmonization is permissible based only on the unanimous decision of Member States, of the indirect taxes, to the extent that such harmonization is necessary for the functioning of the internal market. Although there is no express provision for the harmonization of direct taxes, this decision may be taken under Article 94, that the Council may adopt directives for the harmonization of rules of the Member States that have a direct bearing on the common market.

There are also several articles in the EC Treaty containing provisions which are relevant to taxation, such as: a) an explicit prohibition of discrimination by virtue of nationality (Article 12), b) a prohibition, except in those limited circumstances provided regarding the state aid (art. 87).

2. The ECJ stated practice regarding in Harmonization of rules in matters of taxation

It is considered that tax harmonization within the EU is hampered by two obstacles that amplify each other: the unanimity rule for decisions in matters of taxation, as the absence of a convergence of views on the limits to this approach . There is, therefore, people who believe that such a right is related to the national sovereignty and cannot be legitimately exercised by bodies, such as the Community.

In a common commercial policy the gradual transition to a common currency within the EU and the limitations on the use of budgetary lever Stability and Growth Pact, tax remains the only major tool of economic policy under the control of the Member States mainly used to promote specific objectives and to meet the local community priorities requested and to shelter the domestic producers or certain areas from unfair competition of interests groups. The most relevant example concerns the taxation of transnational corporations; the evidence is represented by the extensive network of bilateral double taxation treaties in which engaged all EU countries .

According to the decisions stated by the European Court of Justice (ECJ), the simple differences between the domestic tax systems, tax bases and tax rates is not, in itself, restriction or discrimination. In other words, fundamental freedoms cannot be used as a pretext for a complete harmonization of national tax systems. The decision, on introduction certain types of taxes, the tax rates and tax base structure, is related to the national sovereignty, as long as there's no guarantee that citizens of other Member States which are in similar circumstances are treated similarly, and the market access is not restricted disproportionately. Therefore, "there is no right to be subjected to the same level of taxation across the EU".

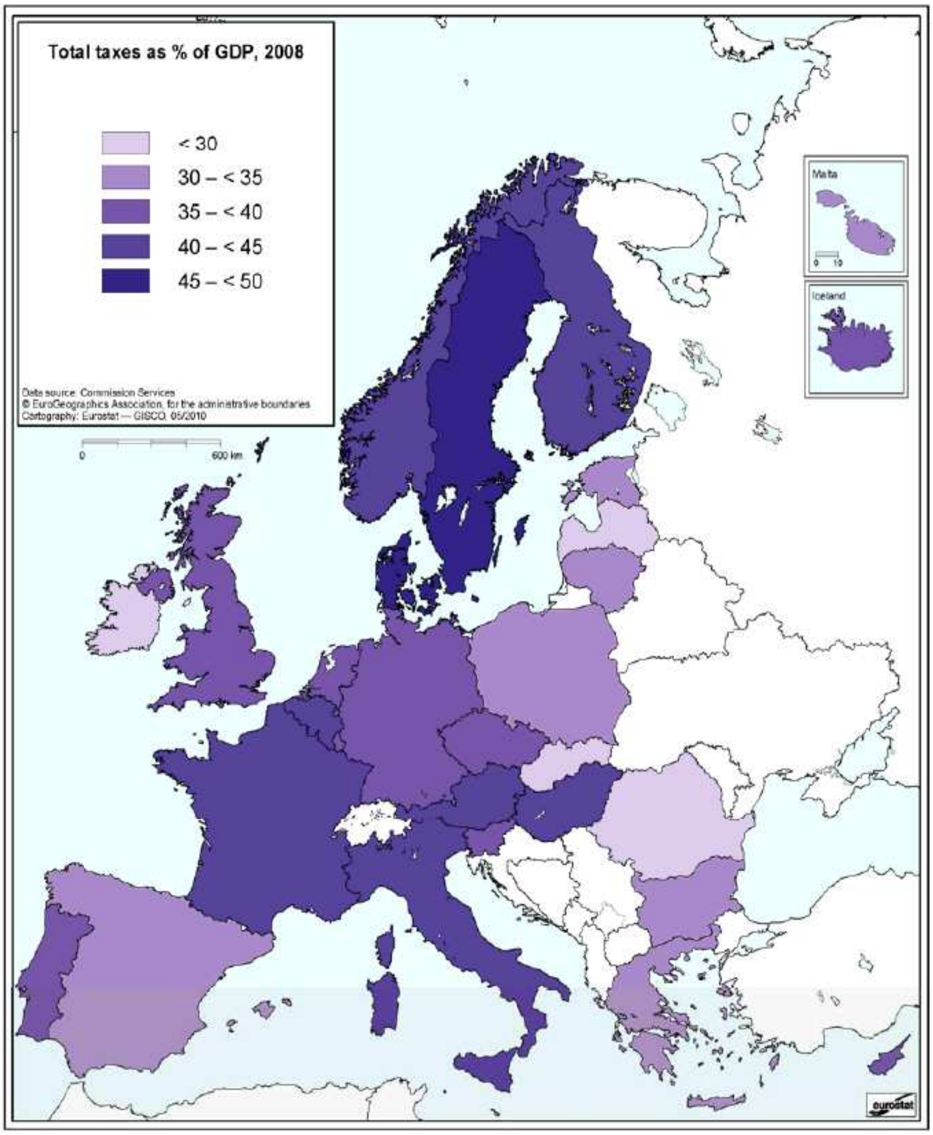
3 Levels of taxation in the EU

The correct functioning of the single internal market requires no distorted conditions of competition within it, meaning that decisions related to movement of people and capital (Such as location, form and funding of investments) are not influenced by the applicable tax regimes, known as the goal of tax neutrality.

There are substantial differences in the total tax burden not only between the old and the new Member States but also amongst the latter.

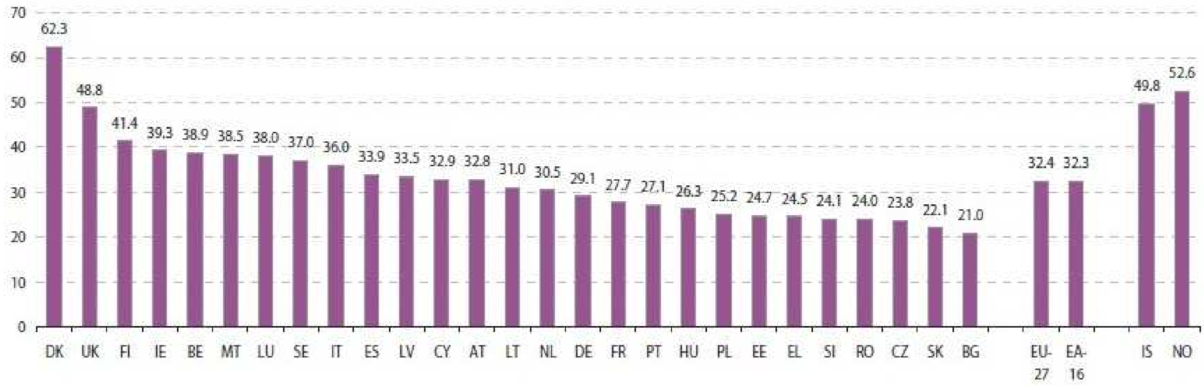
As can be seen in Figure 1, there are two groups of high-tax countries, the Nordic countries (i.e. Denmark, Sweden and Finland), and a cluster of five Member States towards the center of the EU, namely Belgium, Austria Italy, France and Hungary, all of which had a tax ratio in excess of 40 % in 2008. The first consists of three countries Hungary, Cyprus, and Slovenia) with tax levels level exceeding the EU-27 average (37.0 %) and the remaining new Member States with lower tax ratios: from the Czech Republic (36.1 %, less than one percentage point below the average) to Romania (28.0 %, i.e. 9.0 percentage points below the average).

Figure 1 Distribution of total tax burden



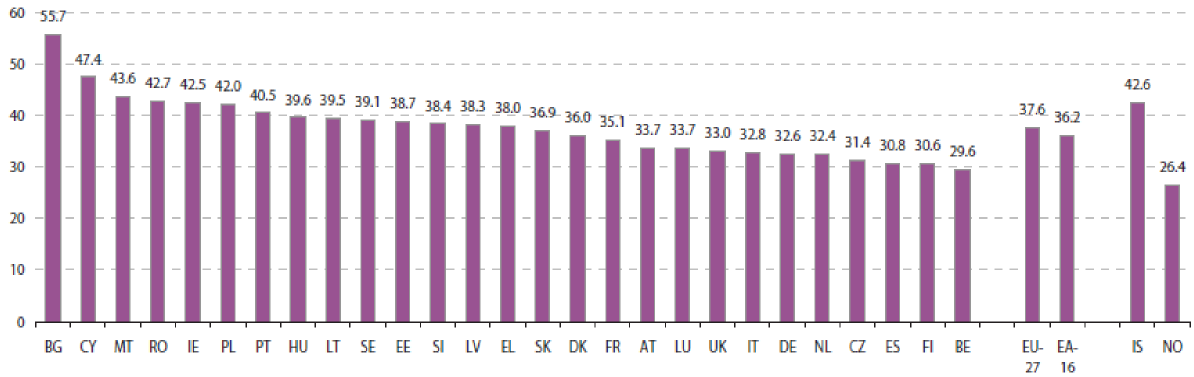
In general, new Member States often have a structure different from the old Member States as regards the major types of taxes. Thus, most old Member States raise roughly equal shares of revenues from direct taxes, indirect taxes, and social contributions, the new Member states frequently display a substantially lower share of direct taxes in the total. The lowest percentage of revenue from direct taxes is made in Bulgaria (only 21.0% of total), Slovakia (22.1%) and Czech Republic (23.8%); in Poland the share of direct taxes shrank by one third between 1995 and 2004 but has increased again since then and currently stands at 25.2 %. Reduced share of revenue from direct taxation in these countries can be explained by the fact that the new Member States have moderate rates of taxes levied on income tax and personal income.

Figure 1 - Revenue from direct taxes



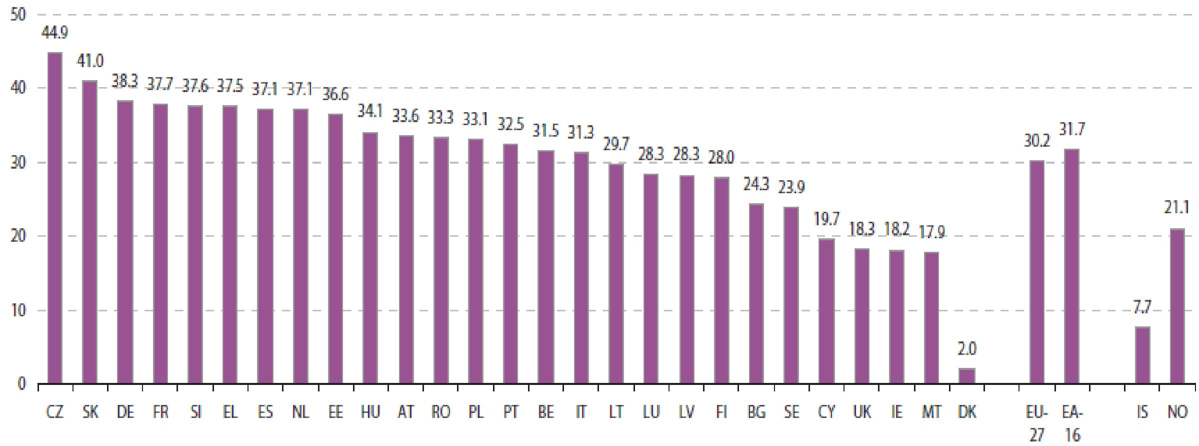
Source: European Commission: Taxation Trends in the European Union 2010

Figure 2 - Revenue from indirect taxes



Source: European Commission: Taxation Trends in the European Union 2010

Figure 3: Revenue from security contributions



Source: European Commission: Taxation Trends in the European Union 2010

Since the end of the 1990s there has been a strong trend towards lower corporate tax rates. Overall all Member States except Malta, Hungary and Finland show lower statutory rates in 2010 than in 1995. The downward trend is on-going: in seven countries rate cuts were introduced in the last two years: Czech Republic, Greece, Luxembourg, Hungary, Slovenia, Sweden and United Kingdom. The average corporate tax rate in the EU-27 has now fallen to 23.2 %, while in the euro area, comprising mostly old Member States, the average is around two and a half percentage points higher.

Table 1: Income tax rate

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Difference 1995-2010	2000-2010
BE	40.2	40.2	40.2	40.2	40.2	40.2	40.2	40.2	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	-6.2	-6.2
BG	40.0	40.0	40.2	37.0	34.3	32.5	28.0	23.5	23.5	19.5	15.0	15.0	10.0	10.0	10.0	10.0	-30.0	-22.5
CZ	41.0	39.0	39.0	35.0	35.0	31.0	31.0	31.0	31.0	28.0	26.0	24.0	24.0	21.0	20.0	19.0	-22.0	-12.0
DK	34.0	34.0	34.0	34.0	32.0	32.0	30.0	30.0	30.0	30.0	28.0	28.0	25.0	25.0	25.0	25.0	-9.0	-7.0
DE	56.8	56.7	56.7	56.0	51.6	51.6	38.3	38.3	39.6	38.3	38.7	38.7	38.7	29.8	29.8	29.8	-27.0	-21.8
EE	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	24.0	23.0	22.0	21.0	21.0	21.0	-5.0	-5.0
IE	40.0	38.0	36.0	32.0	28.0	24.0	20.0	16.0	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	-27.5	-11.5
EL	40.0	40.0	40.0	40.0	40.0	40.0	37.5	35.0	35.0	35.0	32.0	29.0	25.0	25.0	25.0	24.0	-16.0	-16.0
ES	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	32.5	30.0	30.0	30.0	-5.0	-5.0
FR	36.7	36.7	41.7	41.7	40.0	37.8	36.4	35.4	35.4	35.4	35.0	34.4	34.4	34.4	34.4	34.4	-2.3	-3.4
IT	52.2	53.2	53.2	41.3	41.3	41.3	40.3	40.3	38.3	37.3	37.3	37.3	37.3	31.4	31.4	31.4	-20.8	-9.9
CY	25.0	25.0	25.0	25.0	25.0	29.0	28.0	28.0	15.0	15.0	10.0	10.0	10.0	10.0	10.0	10.0	-15.0	-19.0
LV	25.0	25.0	25.0	25.0	25.0	25.0	25.0	22.0	19.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	-10.0	-10.0
LT	29.0	29.0	29.0	29.0	29.0	24.0	24.0	15.0	15.0	15.0	15.0	19.0	18.0	15.0	20.0	15.0	-14.0	-9.0
LU	40.9	40.9	39.3	37.5	37.5	37.5	37.5	30.4	30.4	30.4	30.4	29.6	29.6	29.6	28.6	28.6	-12.3	-8.9
HU	19.6	19.6	19.6	19.6	19.6	19.6	19.6	19.6	19.6	17.6	17.5	17.5	21.3	21.3	21.3	20.6	1.0	1.0
MT	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	0.0	0.0
NL	35.0	35.0	35.0	35.0	35.0	35.0	35.0	34.5	34.5	34.5	31.5	29.6	25.5	25.5	25.5	25.5	-9.5	-9.5
AT	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	25.0	25.0	25.0	25.0	25.0	25.0	-9.0	-9.0
PL	40.0	40.0	38.0	36.0	34.0	30.0	28.0	28.0	27.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	-21.0	-11.0
PT	39.6	39.6	39.6	37.4	37.4	35.2	35.2	33.0	33.0	27.5	27.5	27.5	26.5	26.5	26.5	26.5	-13.1	-8.7
RO	38.0	38.0	38.0	38.0	38.0	25.0	25.0	25.0	25.0	25.0	16.0	16.0	16.0	16.0	16.0	16.0	-22.0	-9.0
SI	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	23.0	22.0	21.0	20.0	-5.0	-5.0
SK	40.0	40.0	40.0	40.0	40.0	29.0	29.0	25.0	25.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	-21.0	-10.0
FI	25.0	28.0	28.0	28.0	28.0	29.0	29.0	29.0	29.0	29.0	26.0	26.0	26.0	26.0	26.0	26.0	1.0	-3.0
SE	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	26.3	26.3	-1.7	-1.7
UK	33.0	33.0	31.0	31.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	28.0	28.0	-5.0	-2.0
EU-27	35.3	35.3	35.2	34.1	33.5	31.9	30.7	29.3	28.3	27.0	25.5	25.3	24.5	23.6	23.5	23.2	-12.1	-8.7
EU-25	35.0	35.0	34.9	33.9	33.3	32.2	31.1	29.7	28.7	27.4	26.3	26.0	25.5	24.4	24.4	24.0	-11.0	-8.1
EA-16	37.5	37.6	37.7	36.4	35.8	34.9	33.5	32.1	30.7	29.8	28.4	28.0	27.1	26.0	25.9	25.7	-11.8	-9.2

Source: European Commission: Taxation Trends in the European Union 2010

4. Brief comparative analysis of the competition rules applicable to the tax in the EU and Romania

Tax competition is particularly evident on the drawing: direct foreign investment, seen as increasingly important for generating employment in EU countries (See Table No. 3); mobile financial capital (portfolio investment), useful to finance investment, strengthening financial markets and obtaining comparative advantages in providing financial services; intra-firm financial flows, which can be channelled into their jurisdictions by attracting those tax corporate functions used for international transfers of profits; higher skilled labour.

Table 2: The investment in the EU

geo\time	2001	2002	2003	2004	2005	2006	2007	2008	2009
EU (27 countries)	17,9	17,3	17,1	17,2	17,7	18,2	18,7	18,4	:
EU (25 countries)	17,9	17,3	17,1	17,2	17,7	18,2	18,6	18,3	:
EU (15 countries)	17,8	17,3	17	17,2	17,7	18,2	18,6	18,2	16,1
Euro area (16 countries)	18,5	17,9	17,6	17,8	18,2	18,9	19,3	19	:
Euro area (15 countries)	18,5	17,8	17,6	17,8	18,2	18,9	19,2	19	:
Belgium	19,1	17,4	17,2	18,2	18,9	19,3	20,1	20,7	19,4
Bulgaria	14,9	15,2	16,1	17,2	22,3	23,6	23,4	28	19,5
Czech Republic	24,5	23,6	22,1	21	20	19,7	20,5	19	17,2
Denmark	17,9	17,8	17,7	17,4	17,7	19,7	19,9	19	16,2
Germany	18,3	16,7	16,3	16,1	16	16,8	17,3	17,5	16
Estonia	22,3	24,4	27,2	27,1	28,1	31,3	29,3	23,3	16,5
Ireland	18,1	17,3	18,8	20,9	23,1	23,2	21,8	16,9	10,7
Greece	18,1	19,1	19,8	18,5	17,1	18,1	18,1	16,4	14,3
Spain	22,7	22,7	23,6	24,7	25,8	26,9	26,6	24,7	19,6
France	16,5	15,8	15,8	16,2	16,7	17,5	18,2	18,5	17,2
Italy	18	19,2	17,9	18,1	18,4	18,8	18,9	18,5	16,5
Cyprus	11,7	12,9	11,8	12,1	13,9	15,4	17,1	20,4	:
Latvia	23,8	22,5	22	24,4	27,5	28	28	24,5	17,1
Lithuania	18	17,4	18,1	18,8	19,3	21	23,1	20,5	13,2
Luxembourg	18,3	17,7	17,6	17,3	16	15,6	17,4	17,1	13,8
Hungary	19,3	18,2	18,7	18,9	19,1	17,4	17,8	18,5	17,8
Malta	17	12	14,9	15,3	15,4	17,1	18,1	14,4	12,5
Netherlands	17,9	16,4	15,9	15,6	15,6	16,4	16,7	17,1	15,2
Austria	22,1	20,4	21,3	20,8	20,5	20,1	20,4	21	20
Poland	17,3	15,3	14,9	14,7	14,8	15,7	17,4	17,7	16
Portugal	23,2	22,2	20,5	20,1	20	20	19,9	19,9	17
Romania	17,8	17,9	18	18,7	19,9	20,5	24,5	26,3	20,3
Slovenia	21,2	19,9	20,6	21,5	22,3	22,9	23,5	24,4	19,4
Slovakia	26,4	25,1	22,9	22,2	24,9	24,7	24,5	22,8	18,3
Finland	17,7	16	16,2	16,5	17,6	17,7	18,9	19	16,7
Sweden	15	14,3	13,9	14,1	14,9	15,7	16,5	16,8	14,3
United Kingdom	15,3	15,2	14,8	14,9	16	15,3	15,9	14,4	12
Iceland	17,1	14,3	16,3	19,7	25,3	30,1	24,3	19,9	10,3
Liechtenstein	:	:	:	:	:	:	:	:	:
Norway	15,5	15,1	14,3	15,1	16,1	16,8	19	18,6	17,8
Switzerland	19,4	18,8	18,1	18,4	19	19,3	19,6	19,3	18,2

Source: Eurostat

After some recent opinions, tax competition is likely to generate significant positive effects. First, it reduces the vulnerability to exploitation of taxpayers exercised over by the state. Also, tax competition may stimulate growth of budgetary efficiency, as determined to offer the best services at lowest cost to the taxpayer. Not in the least, tax competition can stimulate economic activity by releasing the investments from the tax burden.

Briefly presented, negative consequences may produce a suboptimal level of public goods. Thus, as tax competition intensifies, it is increasingly difficult to be taxed at levels that taxpayers cover the marginal cost of providing public goods. Also, tax competition can have influence on the decisions regarding the investment location; as well it can have influence on the shift of the tax burden on less mobile tax bases, with negative social effects.

Small enterprises are the backbone of the European economy. They are a key source of jobs and a breeding ground for business ideas. Europe's efforts to usher in the new economy will succeed only if small businesses will be considered a priority.

At Lisbon has been set the goal for the European Union to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, more and better jobs and greater social cohesion. Small enterprises must be considered as a main driver for innovation, employment as well as social and local integration in Europe. Therefore, in our opinion, the best possible environment for small business and entrepreneurship needs to be created .

Share of SMEs in total number of companies in Romania is about the European Union average, and given the large number of companies closed in the last period of economic crisis.

Romanian SMEs appear to play a lesser role in the local economy than that held by their counterparts in other EU countries on average. This is true both in terms of their contribution to employment (63.6% vs. 67.4% in the EU), but especially in terms of their contribution to value added (42.2%), which is significantly lower than the European average (57.9%). As shown in the figures in the table below, this situation is due in large part, to the group of microenterprises, which generally have lower performance compared with their counterparts in Europe.

Table 3: SMEs in Romania: the basic figures, non-financial business economy, 2008 Estimates:

	Business			Workforce			Value added		
	Romania		UE-27	Romania		UE-27	Romania		UE-27
	Number	Percentage	Percentage	Number	Percentage	Percentage	Billion €	Percentage	Percentage
Microenterprise	389 389	88,1 %	91,8%	876 357	21,2%	29,7%	11	12,1 %	21,0%
Small enterprise	41 500	9,4%	6,9%	821 061	19,8%	20,7%	12	14,1 %	18,9%
Medium enterprise	9 174	2,1 %	1,1%	935 751	22,6%	17,0%	14	15,9%	18,0%
SMEs	**440 063**	**99,6%**	**99,8%**	**2 633 169**	**63,6%**	**67,4%**	**37**	**42,2%**	**57,9%**
Large enterprise	1 802	0,4%	0,2%	1 509 794	36,4%	32,6%	51	57,8%	42,1%
Total	441 865	100.0%	100,0%	4 142 963	100.0%	100,0%	88	100,0%	100,0%

Source: SBA Factsheet for Romania, 2009

The Lisbon Agenda set out a series of tax provisions that will support SMEs, namely the exemption of certain categories of taxes, or subsidies for research and development tax credits.

Each country has introduced various mechanisms to support SMEs. France, for example, has introduced policies to support certain categories of activities considered to be innovative, such as: tax exemption during the first three years of work if there is profit; application of a tax rate of up to 50% over the next two years; exemption from social security contributions for a period of 8 years for highly skilled labour.

In general, at the level of EU has been operated the income tax reduction or the application of more favourable tax rates for SMEs. Analysts have pointed out that SMEs contribute 70% -90% in total GDP, providing the first opportunity of many jobs.

For example, in 2006, Austria has reduced the tax income from 34% in 2003 to 25% in 2006, with reference to lower tax rates in Poland and Czech Republic. This was offset in part by broadening the tax base.

Most recent studies have revealed the following division:

- States with low fiscal pressure applied to SMEs (UK, Netherlands 9.7%, Denmark 4.6%);

- States with an average tax burden for SMEs (Germany 13.3%, Belgium 13.3%, Spain 14.1%, Austria 12.2%);
- States with high tax burden applied to SME (Sweden 17.8%, France 17.8% Italy 15.2%).

Table 4: Tax rate for SME

Country	Tax rate
Spain	30% if the profit is less than EUR 90 152 EURO 5% if the profit exceeds the sum of 90 152 EURO
Estonia	0% for reinvested profit 28.27% for net profit distributed
France	15% if the profit is less than EUR 38 120 EURO
Portugal	20% for a period of three years while the turnover is less than EUR 149.639 EURO
Romania	3% of annual turnover (2009)

Source : Instrastat

In Romania, SMEs are a very important segment in terms of:

- 70% contribution to GDP;
- insurance aprox.60% of the total active population;
- contribution by 60% to income tax;
- assisting the export in proportion of 50%.

To encourage the SME sector in Romania have been implemented policies involving tax deductibility of interest on loans, a choice between paying income tax (16%) or income tax (2.5% annual turnover). This tax rate increased from 1.5% in 2004 to 2.5% in 2006 and 3% in 2009 and 2010 to rise to the common tax rate of 16%.

Increased number of SMEs has a positive impact on the business environment by reducing unemployment and increasing productivity. It is necessary that the tax authorities to adopt policies to encourage this sector further, taking into account their essential role in economic development.

National bankruptcy laws should be assessed in the light of good practice . New regulations at national and Community level should be screened to assess their impact on small enterprises and entrepreneurs. Wherever possible, national and EC rules should be simplified. Governments should adopt user-friendly administrative documents. Small enterprises could be exempted from certain regulatory obligations. In this context, the Commission could simplify competition legislation to reduce the burden of compliance for small business.

Also, tax systems should be adjusted to reward success, to encourage the creation of new businesses, to encourage small business expansion and job creation, and facilitate the establishment and succession in small businesses.

Member States should apply best practice to taxation and to personal performance incentives.

In order to improve access of small enterprises to financial services, the following measures will be taken:

- Identify and remove barriers to the creation of a pan-European capital market and to the implementation of the Financial Services Action Plan and the Risk Capital Action Plan;
- Improve the relationship between the banking system and small enterprises by creating appropriate access conditions to credit and to venture capital;

- Improve the access to the structural funds and welcome initiatives by the European Investment Bank to increase funding available to start-ups and high-technology enterprises, including equity instruments.

5. References

Jean-Philippe Chetcuti: The Process of Corporate Tax Harmonisation in the EC, 2001, p.2-2/8
Reuven S.Avi-Yonah, International Tax as International Law, Cambridge University Press, 2007, p. 184 şi urm.
Wolfgang Schon: Tax competition in Europe – the legal perspective, EC Tax Review 2000-2, p.99
EUROPEAN CODE OF BEST PRACTICES FACILITATING ACCESS BY SMES TO PUBLIC PROCUREMENT CONTRACTS, COMMISSION STAFF WORKING DOCUMENT, Brussels, 25.6.2008, SEC(2008) 2193
EU SMEs and subcontracting, Final report, 2009
State aid: Commission prolongs crisis framework with stricter conditions, IP/10/1636, Brussels, 1st December 2010
COMMISSION RECOMMENDATION of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (notified under document number C(2003) 1422), (Text with EEA relevance), (2003/361/EC)
European SMEs under Pressure, ANNUAL REPORTONEU SMALL AND MEDIUM – SIZED ENTERPRISES 2009
Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme […], Impact Assessment {COM(2005) 702 final}, COMMISSION STAFF WORKING DOCUMENT Annex to the COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE ECONOMIC AND SOCIAL COMMITTEE, SEC(2005) 1785, Brussels, 23.12.2005
Tax harmonization trends in the European Union. Challenges for Romania, European Institute of Romania Project SPOS 2007 - Strategy and Policy Studies, Study no. 5
European Economic and Social Committee opinion on the impact of territoriality of tax legislation on industrial change (2008 / C 120/14)
Promoting good governance in tax matters, Communication of the Commission to the Council, the European Parliament and the Economic and Social Committee, Brussels, 28.4.2009, Com (2009) 201 Final
Council Directive 77/799/EEC - 19 December 1977, as amended in 21 April 2004 by Directive 2004/56/EC.
Council Directive 2008/55/EC - 26 May 2008
Council Directive 2003/48/EC - 3 June 2003
European Commission, Small Business Act for Romania, 2009
http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/index_en.htm
http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm#code_conduct