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**Introduction**

Companies within the European Union are becoming increasingly more mobile. The attractiveness of a country as a business location serves as the main evaluation factor. This mobility can be explained by the provision in the EC Treaty for the creation of one internal market: free movement of persons, services, goods, capital, payments and citizens. The free movement of persons can be divided into the free movement of employees and the right of establishment.

Although harmonisation of direct taxes is still a topic of much debate in the European Union, such harmonisation is still limited today. Each member state still has the authority to design its own tax system. However, in seeking to meet the aforementioned principles on free movement, the jurisprudence of the European Court of Justice increasingly infringes on the authority of these member states.

To distinguish themselves yet further from other member states in the European Union and to make themselves more attractive for foreign investors and multinationals, many member states of the European Union attempt to adopt more favourable tax measures. This newsletter provides information on a number of attractive tax measures to facilitate companies in their search for suitable business locations.

## 1 Netherlands

### 1.1 Rate reductions

In seeking to make itself more attractive than other member states in terms of business location or to keep better pace with the present tax rates in the European Union, the Netherlands since 1 January 2008 has applied a general rate reduction in corporate taxes. Profits of up to € 40,000 will be taxed at a rate of 20%, while for profits between € 40,000 and € 200,000 a rate of 23% will apply. And a top income tax bracket of 25.5% will be applied to taxable incomes exceeding € 200,000.

To level the field between corporate tax and income tax, the so-called SME profit exemption has been simultaneously introduced for tax-paying entrepreneurs. 10% of their income from dividends and business profits will not be taxed. This tax discount effectively reduces the maximum tax burden from maximum 52% to less than 47%, subject to the entrepreneur meeting the hour requirement. This means that the measure only applies to entrepreneurs who devote no less than 1225 hours to their company.

To bear the costs of these rate reductions a number of base-broadening measures were introduced on 1 January 2007 and 2008. The depreciation and appraisal rules and loss deduction options were adjusted accordingly.

Commercial buildings may be written off up to only 100% of market value. Depreciation on buildings will be restricted to the assessed value, the so-called WOZ value (Valuation of Immovable Property Act), which will be determined by the local municipality annually based on the assessed value over the previous two years. Depreciation will be restricted to 50% of the assessed value, only if more than 30% of the building is used for the company's own business. If more than 70% of a building is given in use to third parties, the assessed value is equal to the WOZ value. Up to 10% may be annually written off the offered price as Goodwill. This used to be 20%. Annually, no more than 20% of the offered value may be written off from other business assets, provided they have no residual value.

Unlike in the past where a company could decide to take the profit when work was completed, the new rules for 2007 indicate that the profit must be taken during the work in progress. In conclusion, the acquisition costs of intangible assets, with the exception of goodwill, should be written off in one go, as should deduction of development costs from profits. An exception also applies to taxpayers subject to the so-called patent box, but more on that later.

Prior to 2007 losses could be carried back and retroactively deducted from the profits of the three previous years and carried forward with all future profits. As of 2007, the carryover loss deduction in income tax and corporate tax can be carried forward 9 years. The carryback loss deduction in corporate tax will be restricted to 1 year while the 3-year term for income tax will remain in effect.

A so-called significant interest loss (a loss that has occurred upon sale of a block of shares that represented more than 5% of the nominal share capital) can be carried back up to 1 year only.

### 1.2 Patent box and Group interest box

As of 1 January 2007 the Netherlands has created the patent box to encourage income derived from self-developed intangible assets. Thus developed assets are liable to an effective tax rate of 10% over the income generated by these assets and may be included in the patent box provided the profits exceed the development costs. The patent box applies exclusively to corporate taxpayers with self-developed intangible assets which are patented in the Netherlands or abroad, albeit according to Dutch standards. The patent box does not apply to trademarks, logos and innovative software. In conclusion, the facility applies to a maximum of four times the development costs of the intangible asset. The European Commission has in the meantime decided that no state aid will be available for the patent box. As of 1 January 2008 the patent box is extended for intangible assets which are not patented but are developed from an S&D-project and wherefore an S&D-declaration must be given by Senternovem.

The European Commission has yet to decide whether state aid will be provided for the group interest box, as such this facility has yet to be adopted.

The group interest box is created for inter-company financing. In this box the balance of the interest proceeds and interest costs of the inter-company (being 50% or more interest in the company) financing will effectively be taxed at a reduced corporate income tax rate of 5%. The maximum tax to be levied at the 5% rate is limited to a percentage of the average fiscal equity of the company. The purpose of this regulation is to keep capital inside, and attract foreign capital to, the Netherlands.

### **1.3 Changes in the participation exemption**

The participation exemption is a facility in the Dutch corporate tax system that ensures that profits derived from a participation are exempted from corporate tax. The Parent/Subsidiary Directive aside, under Dutch legislation a participation is in place if the company shareholder owns at least 5% of the shares in the subsidiary.

One of the most significant changes in international terms is that Dutch and foreign participations will generally receive equal tax treatment. To prevent profits derived from participation exemption from going to low-tax countries, the term low-tax investment participation has been adopted. Shares in such a participation will not be liable to participation exemption. Low taxed means that the corporate tax is less than 10% of the profit determined in accordance with Dutch fiscal standards. An investment company is a company whose assets consist of more than 50% of portfolio investments.

Furthermore, the liquidation loss legislation applies equally to domestic and foreign participations.

## 2 Belgium

### 2.1 Notional interest deduction

Belgium has an effective corporate tax rate of 33.99% currently in place. Comparisons drawn among the member states of the European Union show that Belgium holds **the fourth highest** nominal corporate tax rate. Only Malta, Italy, France and Germany have a higher tax rate, at which point it bears mentioning that Germany and France are presently in the process of considering tax cuts. The mean nominal rate in Europe is 24.1%.

In order to stay in line, Belgium in 2006 introduced the tax facility notional interest deduction. The additional purpose of this tax facility is to provide an attractive tax incentive for companies that reinforce their capital structure through equity financing. After all, until recently one could only deduct interest-bearing debts from generated profits; today this also applies to the adjusted equity capital. The introduction of the tax deduction for risk capital has caused the corporate tax rate to effectively drop to an average of 25 – 27%, whereby companies with high equity capital hardly pay any taxes today.

Thanks to the introduction of the notional interest deduction foreign investments in Belgium generate the best revenue. Careful, proactive planning is therefore essential. When, for instance, a Belgian holding has the option to draw a dividend from a Belgian as well as from a foreign subsidiary, it preferably draws the dividend from the foreign subsidiary. After all, the Belgian subsidiary sees that a dividend will cause its equity capital to fall, as will its notional interest deduction.

### 2.2 Other measures and developments

Miscellaneous:

- It will be possible to tax abnormal profits once on behalf of the receiving company and once on behalf of the issuing company as a result of transfer pricing adjustments (economic double taxation). The term abnormal profit refers to a lack of economic basis for a specific activity.

- Excess profits arising from sale of commercial vehicles for private use and goods transportation are exempted from taxation under certain conditions, if the capital generated is reinvested in other commercial vehicles that meet specific ecological standards and are used to perform commercial activities.
- Excess profits arising from shares that generate incomes subject to the DBI deduction (participation exemption) are exempted from corporate tax. Alienation costs should also be taken into account as of 2006. The DBI deduction is aimed at the participation exemption.
- Corporate tax will no longer be levied on grants to companies (expansion support, export grants, agricultural grants).
- Companies that enter into an agreement for the production of a recognised audio-visual work can, thanks to the tax shelter, benefit from an exemption of their taxable profit to the amount of 150% of the invested amount. This amount may be partially made up of loans. The European Commission has approved the extension to 2009 of this tax benefit regime in support of the audiovisual sector.
- The deductibility of operating costs for company vehicles will henceforth be applied as a function of the CO2 emission of the vehicle.
- The government is fostering technical innovation in companies by encouraging R&D activities pertaining to patent development and by promoting patent ownership and the granting of associated exploitation rights. To that end, it has brought in an 80% tax reduction on revenue from patents.
- Legal bodies may annually deduct from their taxable basis an amount equivalent to a percentage of the adjusted equity capital. The term for the tax facility comes from the English term notional interest, which basically means imaginary interest. With this measure, the Belgian government is aiming to kill two birds with one stone: attract foreign investors and immediately reduce the burdens for Belgian companies.

- The percentage for 2007 will be 4.281% for companies with maximum 50 employees, € 7.3 million in annual turnover and a balance total of € 3.65. Only 1 requirement can be waived. Failure to meet these requirements will cause the rate to fall to 3.781%. The deduction can be carried over into the profit of the next 7 years. The adjustment applied to the equity capital covers, among other things, the value of shares of participations in other companies, the net asset value of non-resident shareholders in countries with double tax treaties and the net asset value of foreign real estate in countries with double tax treaties.
- The government wants to encourage companies to withdraw the tax-free reserves built up in the past and subject them to a reduced tax rate. The rate for 2007 is 16.5%, falling further to 10% if the withdrawn reserves are used for new investments. In tangible or intangible assets.

## **3 Germany**

### **3.1 Rate reductions**

In Germany legislation has recently passed a tax reform which in principle provides for significant cuts in tax rates on the one hand. The total tax rate will come down from presently approx. 39% to less than 30%. On the other hand the tax basis has been broadened thus compensating some of the tax cuts. The reform will take effect as of 2008.

### **3.2 Tax liability in general**

An incorporated company is subject to taxes on income in Germany under the following conditions:

Unlimited tax liability is given for corporations that either are resident in Germany or whose managerial headquarter is located in Germany. Companies that are neither resident nor have their headquarters in Germany are subject to taxation with respect to their income derived from German sources (limited tax liability).

Taxes on income are the corporate tax and the local trade tax. The corporate tax rate at present (up to 2007) is 25%. Following the tax reform passed recently by the German legislation the corporate tax rate will come down to 15% as of 2008. In addition to the corporate tax a solidarity surcharge of 5.5% of the corporate tax is levied.

The trade tax is levied by the local authorities who also determine the tax rate. On an average the tax rate at present amounts to approx. 18-19%. The present rulings provide that the trade tax is tax deductible. So it reduces its own tax basis as well as the basis for the corporate tax. With the tax reform the rate will come down to approx. 14-15%. On the other hand the trade tax will no longer be tax deductible.

For investment companies it is of particular interest that in principle the income from real estate property is not subject to the local trade tax provided that the activity of the company is considered an investment activity and not a trade activity. An investment activity is given if property is being bought for long term investment purposes and not with the intention to be sold in the near future. Further, the income from the property has to be limited to rental income and other income directly related to the lease contracts. The income must not include revenues generated from additional services rendered to the tenants like cleaning and technical services. Such services are considered being commercial and would entail trade tax liability. For that reason it is recommended that such services are outsourced to managing agents.

### **3.3 Tax basis**

Taxable profits are in principle determined on the basis of the statutory accounts which have to be prepared in accordance with German GAAP as stipulated in the commercial code. German GAAP in principle reflect the rulings of the 4<sup>th</sup> European Directive. International Accounting standards are not applicable yet for statutory accounts and for that matter not relevant for tax purposes.

The tax laws however provide for some rulings limiting the tax deductibility of certain expenses. So taxable profits may differ from the profits as reflected in the statutory accounts. In connection with the significant cuts in the tax rates the tax basis will be further broadened in particular by further limitations on the deductibility of certain expenses.

### **3.4 Limited deductibility of interest expenses**

Under the present rulings interest expenses on third party loans are fully tax deductible. As of 2008, the deductibility of interest rates will be limited. The following rules will apply:

Annual interest expenses of up to € 1.0 Mio. are fully tax deductible. If total interest expenses exceed € 1.0 Mio the deductibility of the expenses will be limited to 30% of the Earnings before Interest, Tax and Depreciation (EBITDA).

Concerning the deductibility of interest expenses on shareholder loans (thin capitalisation) the following remarks can be made.

The thin capitalisation rules in Germany (already applicable under the present rulings) provide, that interest expenses on shareholder loans given to an incorporated company can be tax deducted if the total interest expenses does not exceed 250.000 € p.a.

If the interest expenses on the shareholder loans exceed 250,000 € p.a , the total expenses are only tax deductible as far as the loan does not exceed 1.5 times the amount of the owner's equity (safe haven). If for example the equity equals to the share capital of 25,000 € (the minimum share capital for the GmbH, the limited liability company) the shareholder loan to be remunerated must not exceed (25,000 x 1.5 =) 37,500 €.

The interest expenses on third party loans underlie the thin capitalisation rules, if the loan contract provides recourse to the shareholders of the company. Theoretically the rules apply "for loans taken up by the company from ... a third party with recourse to the shareholder or to his related party". Contrary to this wording the tax administration outlines in two circulars that it only applies the thin cap rules for third party loans in cases of back-to-back financing.

#### *Depreciation expenses*

In connection with the tax reform the diminishing balance method for the determination of depreciation expenses is no longer applicable.

#### *Withholding Tax*

National tax law provides that private corporations are not required to withhold taxes on interest payments.

Concerning dividends the general rule provides withholding taxes on dividend payments. However, double taxation treaties provide in general a limitation of the withholding tax. The Parent-subsidiary Directive rules that no withholding taxes are levied at all on dividends paid within the European Union.

## 4 France

The new President of the French Republic, elected in 2007, is convinced that the tax burden weighing on French taxpayers and businesses is too high and is harming the country's competitiveness. Therefore, he has vowed to continue and to accelerate the decrease of the taxation level that had been hesitantly started a few years ago.

This has led, over the last few months, to the passing of several laws aimed at strengthening France's competitiveness, in particular in order to attract investors, whether they are natural or legal persons.

### 4.1 Measures favouring entrepreneurs and natural persons

#### Lowering of the tax shield to 50% of aggregate income

Thanks to the tax shield, the most heavily taxed taxpayers have their tax burden capped at 50% of their income (and not 60% as was the case earlier). In total, the amount paid in respect of the personal income tax (IR), wealth tax (ISF), land tax and habitation tax on the primary residence, and the CSG and CRDS levies (social contributions) may not exceed 50% of the taxpayer's income. The lowering of the tax shield to 50% will be applicable from 2008.

#### Exempt status of overtime

As regards employees of the private sector, the overtime (and additional time under part-time work arrangements) worked since 1 October 2007 shall be exempt from corporate income tax.

In addition, the overtime worked by employees is also exempt from social security contributions. As regards enterprises, an all-in contribution reduction equal to € 0.50 or € 1.50 shall be applied to each hour of overtime, depending on whether the enterprise has more or fewer than 20 employees. The provisions of the Act also contain a mechanism applicable to public sector workers.

#### Wealth tax: investment in SMEs

Article 6 of the Act on Labour, Employment and Purchasing Power makes it possible to deduct, from the wealth tax (ISF), up to a maximum equal to €50,000, 75% of investments made in SMEs or in institutions serving the general interest. This deduction is slightly less when the investments are made through certain mutual funds.

These three measures concerning the tax shield, the exempt overtime and the ISF reduction are included in the 10 steps contained in the Act of 21 August 2007 on Labour, Employment and Purchasing Power.

### 4.2 Measures in favour of companies – New tax rules applicable to securities held in connection with long-term interests

For many years, the tax rules applicable to holding companies and, more specifically, to securities held in connection with a long-term interest have acted as a brake on the development of the said companies and on the corresponding investments because of the existence of a highly competitive European environment.

Over the last 3 years, major reforms have been made in order to make France more attractive.

#### New rules for the taxation of capital gains on securities held in connection with long-term interest: taxation rate = 0%

This mechanism, which is applicable from 1 January 2007, is more effective than an outright tax exemption of capital gains and has highly relevant advantages. This new scheme makes it possible to deduct for tax purposes substantially all of the securities' acquisition expenses and the financial expenses related to the acquisition of securities held in connection with a long-term interest.

This scheme also authorises the distribution of dividends under standard conditions, without any advance dividend tax.

#### Parent-Subsidiary Dividends: no double taxation

At the same time, the parent-subsidiary rules allow for the distribution of dividends with virtually no taxation for the beneficiary company. The coexistence of these two systems now allows for many optimisation schemes, whether nationally or at European level, with France thus becoming a very attractive country for holding companies.



#### Implementation of the rules

However, several limitations have been created by the legislature in order to (i) exclude companies primarily engaged in immovable property operations, whose capital gains are taxed at a rate of 15%; and (ii) impose a minimum holding period of 2 years. It is also useful to indicate that this 15% tax applies to securities whose cost is at least equal to € 22.8M, and that represent less than 5% of the capital.

In other words, the shares whose cost is lower than the above limit and which account for more than 5% of the capital qualify for the application of these preferential rules.



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