PREFERENTIAL CORPORATE INCOME TAX TREATMENT FOR SMES: AN INTERNATIONAL COMPARISON*

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Abstract: The paper analysis all forms of preferential tax treatment (tax rates, all sorts of incentives, simplification measures and reliefs from other taxes that are based on corporate income) of corporate income tax of SMEs as one of the measures to boost the economic growth. The analysis is concentrated on incorporated SMEs, with the objective to give the comparative analysis of OECD/EU/SEE countries, with reference to Slovenia and Croatia.
The main methodology is international comparison, based on different basic and preferential corporate and personal income tax rates (including local taxes and surcharges), as well as additionally calculated overall effective statutory dividend tax rates (overall tax on distributed profits, which comprises corporate income tax and personal tax rates on dividend inclusive different methods of integration of both taxes). The "incentive to incorporate" is assessed by comparison of top personal income tax rates and overall effective statutory tax rates on dividends.
The papers shows that lower corporate income tax rate for SMEs is not restricted only to the countries with relatively high corporate income tax rates. The relative difference between basic and lower /preferential tax rates could be even higher than half of the basic rate. It could be concluded that in general overall lower statutory effective dividend tax rates for SMEs compensate for relatively higher overall effective statutory dividend rates. Most countries with reduced corporate income tax rates for SMEs do not possess the disincentive to incorporate and vice versa. However, Croatia and Slovenia, with no preferential corporate income tax rate for SMEs are at the advantage concerning both analyses done.
Two thirds of the old EU members apply different tax reliefs for SMEs. Almost all of them allow classical investment incentives as well as some additional incentives (R&D, innovations…).
Most new EU members and almost all SEE allow also some corporate income tax reliefs/incentives for SMEs, but the predominant here are different simplification measures, mostly in the form of less frequent or no tax prepayments at all. Some countries even apply simplified calculation of corporate income tax for SMEs that is not based on corporate profit.

Keywords: SMEs, corporate income tax, tax rates, tax incentives, OECD, EU, SEE

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1 Introduction

The paper is concerned with preferential tax treatment of SMEs as one of the measures to boost economic growth. Unlike most papers, that talking about small business concentrate on business entities that pay personal income tax (unincorporated businesses), the analysis of this paper is concentrated solely on the corporate income tax (CIT) treatment of SMEs (incorporated small and medium-sized businesses).
It is directed towards relatively comprehensive comparative analysis of different elements of preferential tax treatment of CIT taxpayers, including different tax rate reductions, different reliefs and simplification measures inside the CIT, as well as reliefs for some other (corporate income related) taxes.
Tax rate comparison is done using statutory CIT rates, including different surcharges and local taxes, as well as overall effective statutory dividend burden (including related PIT with all the integration measures). Such ultimate burden is, again, compared with top PIT rates in order to establish incentive/disincentive to growth (incorporation) of mature small unincorporated business.
The CIT rate analysis and effects cover OECD/EU as well as SEE countries, with special reference to Croatia and Slovenia. The CIT incentive analysis covers EU and SEE.
Paper starts with the review of the arguments in favor of preferential tax treatment. After that the comparative analysis starts with the brief overview of concepts and methods of giving the preferential tax rates for small business. The most favorable SMEs CIT rates are presented, including effective statutory dividend tax rates. Their differences as well as incentive to incorporate are analyzed. In the end, the analysis of different other tax reliefs and incentives is presented.

2 Tax favoring of small business - reviewing the arguments

Preferential tax treatment of SMEs is backed up by different arguments. Among them, the mostly mentioned are (for instance Gravelle, 1993, p. 284-286; Holtz-Eakin, 1995, p. 390-393; Chen, Lee and Mintz, 2002, p. 6, 19; Carpentier and Suret, 2005, p. 10; Nicodeme, 2008, p. 6-7; OECD, 2009, p. 84-94):

- Positive externalities (innovations – new ideas, products and technological advance, training of skilled labor force);
- Relatively high tax compliance costs (absence of the economy of scale and resulting greater burden of tax compliance costs measured as a percentage of turnover/number of employees/assets…);
- Other higher costs resulting from the absence of the economy of scale and resulting higher burden (different fixed costs);
- Capital market imperfections resulting from asymmetric information (difficulties in getting credits or additional (portfolio) equity, excess interest, costly "signaling"[1]);
- Higher risk of failure;
- Difficulties to get highly-skilled staff, because of a lack of visibility;
- No deductibility of interest expense and economic double taxation of dividends and capital gains[2];
- Cross border tax planning opportunities (available to (large) multinational enterprises;
- Employment generator (small businesses create new jobs in excess of their share in labor force).

[1] Potentially successful companies have additional costs to signal to potential investors their quality and high returns in the future, such as high dividend payout ratio (for instance Miller and Rock, 1985) or high debt-equity ratio (for instance Ross, 1977).
[2] Both forms of distortion are typical for the entire corporate sector. However, inside that sector they still favor large and established firms, which have easier access to bank loans and penalize start-ups, which rely on new equity to finance their developments.

However, most of those arguments are strongly criticized in the taxation literature. Gravelle (1993, p.284) points out that positive externalities ("spillover effects") for high-tech equipment are not consistent with the small business, since 60 percent of investment tax credits for small business would go to the trade and services industries and only 5 percent to manufacturing. Holtz-Eakin (1995, p. 391) admits that it may be the case that the interaction of market forces with technological linkages may require that the government impose a combination of subsidies and taxes on target industries (based on Holtz-Eakin and Lovely (1995)), but points out that it is an unresolved empirical issue as to whether the small businesses provide a disproportionate share of innovations and other activities leading to new processes and products. Even if this is the case, one must demonstrate that these activities have external effects not captured by the firms themselves (Holtz-Eakin, 1995, p.391).

Relatively high tax compliance costs for SMEs could be even higher due to some complicated incentives or multiple rates schemes for SMEs. So, this problem rather calls for simplification measures, especially in the countries with less developed financial and accounting systems.

The capital market failure argument, often criticized, was proven again by recent large-scale empirical research about financial constraints to growth in countries with different development levels (Demirguc-Kunt, Maksimovic and Beck, 2005). It was determined that the smallest firms are consistently the most constrained. Financial and institutional development diminishes the effects of financial, legal, and corruption constraints, and small firms experience the greatest benefit. Following this logic, tax favoring of small business is especially important for countries that are less developed, for instance transition countries and especially SEE countries. As it will be seen later, they mostly implement simplification measures, caused by the previously mentioned problem of relatively high tax compliance costs.

However, correcting capital market failures by different preferential tax regimes could result in the misallocation of resources and welfare losses. Capital could be shifted away from more profitable investment into the "preferred" areas. Such welfare/efficiency losses could offset efficiency gains from correcting market failures. This is a "classical" neutrality argument in taxation literature in favor of absence of any tax incentives and privileged treatment.

In the end, the lack of capital or high costs of capital could be offset by more direct non-tax measures relating to banking and capital markets.

It is evident that small business faces higher risk to failure. Although "small is beautiful", bit is "too big to fail". However, neither public finance theory nor empirical research completely supports the assumption that increased taxation reduces the willingness of individuals to undertake risky investments (Holtz-Eakin, 1995, p. 392).

Although small businesses are not in the position to exploit different international tax planning opportunities, there are special tax planning opportunities available right to SMEs. So, certain personal expenses may be characterized as business expenses and in some countries they could exploit more options to find more suitable organizational structure (OECD, 2009, p. 97).

Concerning positive employment effects, there is a little evidence that small firms disproportionately create jobs, especially the permanent ones (Brown, Hamilton and Medoff, 1990), but they are still (Europe's) „net job creators" (EC, 2009, p.3).

Moreover, lower tax rates for SMEs can discourage their growth when small business owners try to keep reported income below certain thresholds to take advantage of the preferential tax treatment of small businesses. Lower taxes may encourage entrepreneurs to divide businesses into separate components for tax purposes. Small firms may not even benefit from many of these incentives since they need to be profitable before they can make use of tax credits and other measures (Chen, Lee and Mintz, 2002, p. 19).

The cost-effectiveness of tax incentives and all forms of privileged tax treatment is doubtful in general. So, even in the case of SMEs tax expenditures (revenue foregone) could be high in terms of desired effects achieved. Empirical literature does not give the ultimate conclusion ranging from relatively positive (for instance Boyns, Cox and Spires, 2003) to negative (for instance Carpentier and Suret, 2005; Nam and Radulescu, 2007).

Despite the relative criticism in taxation literature, the tax systems of most OECD and EU countries include preferential tax regimes for SMEs. The EU fiscal state aid provisions allow the preferential tax treatment of SMEs.
In times of financial and economic crises temporary state aid measures to support financing of SMEs such as lump sum aids, state guarantees for loans and subsidized interest rates (EC, 2009, p. 31) could be needed more urgent. Lower tax rates (as well as incentives) could have little immediate impact, given the weak current profitability of most SMEs. However, they might be expected to enhance growth over the longer term. (OECD, 2010, p. 29).

3 Preferential small business tax rates

The lower corporate income tax rate is one of the mostly used form of the privileged tax treatment for small (and medium sized) business (see Table 1 for OECD countries; some other EU and SEE countries are referred to below). Although it seems to be the most straightforward and transparent way to give tax incentive to small business, its practical implementation is far away from simplicity. The variety of the criteria for the definition of size and of the schemes applied could bring to the different classification of the countries applying reduced CIT rate for SMEs:

- **Size definition**. Although most countries define size in terms of taxable corporate income (taxable profit), it is also possible to use turnover (France, Spain) or total income (Macedonia), capital (Japan, Canada) or combined criteria. So, Lithuania combines number of employees and taxable profit, Romania number of employees and turnover and one entity of Federation of Bosnia and Herzegovina (Republika Srpska) number of owners, number of employees and total sales. Greece and Lithuania link the benefits to the types of companies. So, Greece allows lower rate for partnerships and civil law associations and Lithuania gives additional benefits for small businesses (defined with the already stated combined criteria) for sole proprietorships and partnerships.
- **Tax base**. The bulk of countries use taxable income as tax base. However, turnover or total income (revenues) is used in Romania, Macedonia and entity of Federation of Bosnia and Herzegovina (Republika Srpska), probably mostly due to the simplification reasons.
- **Tax rate(s)**. Most countries apply only one reduced rate. However, Belgium, Japan and United States apply two reduced rates. Lithuania, besides lower rate, applies even zero rate for small companies that are partnerships or sole proprietorships[3].
- **Withdrawal of the tax relief (lower rate) with the rise of income**. Most countries use different schemes (higher – neutralizing rates, size definition outside the taxable corporate income…) to withdraw the tax relief (lower rate) allowed for the corporate income below some threshold when the corporate income rises. However, the Netherlands, Korea, Portugal, Hungary (see Table 1 with "*") apply classical direct progression, leaving also "larger" corporations to benefit from the lower rate of the first income tax bracket.

First four columns of Table 1 compare preferential tax rates for small business (presented by the lowest rate possible)[4] with the basic (general) CIT tax rate of those countries.

[3] A small company is subject to a reduced corporate income tax rate of 5% (13% before 1 January 2010) if its average number of employees does not exceed ten persons and its taxable income during the taxable period is less than LTL 500,000.
In the case of sole proprietorships and partnerships where the average number of employees does not exceed ten persons and the income during the taxable period is less than LTL 1 million, the profit up to LTL 25,000 is taxed at a 0% rate and the remaining profit is taxed at a 15% rate (20% before 2010).
From 1 January 2010, the general (basic) corporate income tax rate is 15% (previously 20%).

Table 1: Differences between basic CIT rates and CIT rates for SMEs as well as capital taxation of non-corporate and corporate sector (distributed profits – dividends (DIV)): OECD countries with preferential CIT rates for SMEs (2009)

Rate / Country	CIT basic	CIT SMEs	**Δ CIT**	ΔCIT/ CIT basic[1]	DIV basic[1]	DIV SMEs[1]	**Δ DIV**	**ΔDIV/ DIV basic**	Top PIT	**ΔPIT –DIV basic**	**ΔPIT –DIV SMEs**
	1	*2*	*3= 1-2*	*4=3/1*	*5*	*6*	*7= 5-6*	*8=7/5*	*9*	*10= 9-5*	*11= 9-6*
Belgium[2]	33,99	24,98	**11**	0,32	44	36	**8**	**0,18**	53,70	**9,7**	**17,7**
Canada	31,32	15,92	**15**	0,48	47	35	**12**	**0,26**	46,20	**-0,8**	**11,2**
France[3]	34,43	15,00	**19**	0,55	56	43	**13**	**0,23**	40,00	**-16,0**	**-3,0**
Greece[4]	25,00[4]	20,00	**5**	0,20	25[4]	20	**5**	**0,20**	40,00	**15,0**	**20,0**
Hungary*[5]	20,00	14,00	**6**	0,30	40	36	**4**	**0,10**	36,00	**-4,0**	**0,0**
Japan	39,54	24,79	**15**	0,38	46[6]	32[6]	**14**	**0,30**	50,00	**4,0**	**18,0**
Korea*	24,20	12,10	**12**	0,50	46	38	**8**	**0,17**	38,50	**-8,0**	**0,5**
Luxembourg	28,59	27,55	**1**	0,04	43	42	**1**	**0,02**	38,00	**-5,0**	**-4,0**
Netherlands*	25,50	20,00	**5**	0,20	44	40	**4**	**0,09**	52,00	**8,0**	**12,0**
Portugal*	25,00	12,50	**12,5**	0,50	40	30	**10**	**0,25**	42,00	**2,0**	**12,0**
Spain	30,00	25,00	**5**	0,17	43	39	**4**	**0,09**	43,00	**0,0**	**4,0**
UK	28,00	21,00	**7**	0,25	46	41	**5**	**0,11**	40,00	**-6,0**	**-1,0**
USA	39,10	20,02	**19**	0,49	50	34	**16**	**0,32**	41,85	**-8,1**	**7,8**

* Denotes countries with classical progression of CIT rates, where benefits of lower rates for SMEs (lower profits) are not "withdrawn" for larger companies (their first or even second corporate income tax bracket). The stated basic CIT rates are in effect rates for general (upper) corporate income tax bracket (profits above the threshold). The same applies indirectly to overall (combined) dividend tax burden.

[1] Rounded data

[2] The CIT (and dividend) rates for Belgium are not comparable with those of other countries, since they are in effect much lower, depending on the share of notional interest (tax allowance for corporate equity) in the taxable profit. Higher profits (with lower share of notional interest) will be burdened with higher tax rates, since the difference between taxable profit and notional interest (final tax base) will be higher. On the other hand, more capital intensive companies will have hither equity and higher notional interest, which will make their final tax base (and effective tax rate) lower.

[3]Local business tax and social solidarity tax (whose tax base is not corporate income) are not included in the CIT and dividend rates. Social taxes, whose tax base is gross income are not included in PIT.

[4]The basic (general) CIT rate is reduced by one percentage point (to 24%) in 2010 and will be reduced gradually by 1 percentage point each year until it is finally set at 20% in 2014. Since dividends are fully exempt at the shareholder level, the CIT rate equals overall dividend rate (DIV). Special contribution for higher incomes is not included.

[5]The 4% surcharge (which is included in CIT and dividend rates) is abolished in 2010. However, the basic statutory CIT rate is raised from 16 to 19% in 2010. For the progressive scale to be applied (lower CIT of 10%), inter alia, the taxpayer cannot make use of any incentives, it must employ at least one employee in the tax year and it has to pay social security contributions with respect to each of its employees in an amount equalling at least the double amount of the contributions payable on the statutory minimum wage (in underdeveloped regions only up to the amount payable on the minimum wage) (IBFD, 2010).

[6]2008 data

Source: Author's calculations based on OECD, 2010**,** Part II., Table II.2. and II.4.; OECD, 2010, Part II, Table II.2. and II.4; data for Portugal and top PIT based on IBFD, 2010; OECD, 2010, Part I, Table I.1 and I.2; Canada Revenue Agency, 2010; www.worldwide-tax.com (Japan) and

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[4] the tax rate of the first income bracket

http://www.justlanded.com/english/South-Korea/South-Korea-Guide/Money/Outline-of-taxation-in-South-Korea (Korea).

Although one can imply that a preferential/lower tax rate for small business is necessary for the countries with relatively high CIT rates (such as non EU OECD members: USA and Japan[5]) even some countries with relatively low rates, such as Hungary, Portugal, Greece and the Netherlands as well as non OECD member Lithuania (see footnote 3) allow such an incentive.
This raises the question whether even Slovenia and Croatia, with the 20% rate could consider such an incentive. Needless to say that for the SEE countries, which are in the 10% CIT rate zone (BiH, Serbia, Macedonia[6], Albania, Montenegro with even 9% as well as Bulgaria) this does not seem to be the imperative. However, some of them allow extremely low rates on a broader tax base (total income, turnover) mostly for the simplification reasons (see Table 3).
As it could be seen from the column 3 of the Table 1 the absolute differences in CIT rates range from negligible 1 for Luxembourg to almost 20 percentage points (France, USA), so the relative difference could be even higher than half of the basic CIT rate.

4 Differences in overall (combined) effective statutory dividend tax rates

The effect of the preferential CIT rates for incorporated SMEs is not complete without taking into the consideration the later taxation of distributed profits – dividends at the shareholder level (personal income tax – PIT)[7], including all forms of integration of CIT and PIT and their reflection in dividend relief and lower PIT in order to mitigate the economic double taxation of dividends.[8] Following the above analysis, the most favorable CIT rate for SMEs is taken into account for each country applying preferential CIT rate(s) for SMEs to get the highest tax advantage for SMEs[9]. The overall (combined – "all-in") effective statutory dividend (distributed profit) tax rates[10] for basic CIT rates and preferential SMEs rates (DIV basic and DIV SMEs) are compared (Table 1, columns 5-8).
The first impression of such a comparison is the fact that the absolute differences in tax burden are smaller (due to the same PIT rate for dividends used for both overall rates)[11]. The relative differences are more or less in line with the absolute ones and are, again, smaller than the previous differences in only statutory CIT rates. Still, the fall in absolute differences is mostly considerable in countries with the higher taxation of dividends at the personal level (France, Korea) and vice versa (Japan, Spain).
Similar to the CIT rate analysis, the question could be put whether the lower CIT and overall lower dividend tax rate for SMEs compensates for relatively higher CIT and PIT rate on dividends. Overall dividend rates for OECD countries (OECD, 2010) range from even 58,8% for Denmark to even 19% for Slovak Republic, with the latter and Iceland (23%) being the only ones below 30% . More than half of OECD countries overall dividend rates are in the relatively high range of 40-50%, as are the overall rates of all countries with preferential CIT rates for SMEs, so this argument mostly holds.

[5] and to some extent France also
[6] The effective tax rate on profit in Macedonia is even lower, since only distributed profits (and some non-deductible expenses) are taxable. So, similar as in the case of Estonia, the retained profits are not taxed at all.
[7] Both CIT and PIT rates are combined (central and sub-central) statutory tax rates inclusive of surtax (if any).
[8] As usually, in the cases of different dividend taxation at the personal level, the highest marginal rate is applied.
[9] In contrast to the recent OECD comparison, that, in order to make comparisons at the "equal levels", compares tax burden at the different average wage earnings (OECD, 2009, p. 42 – 82).
[10] Using standard OECD methodology (OECD, 2010, Part II., Table II.4.) as well as ordinary calculations that were developed a long time ago by Cnossen, (1993) and applying the same to the combined preferential rates for SMEs. Similar calculation is done also for 2000. in Chen, Lee and Mintz (2002).
[11] With the exception of Greece due to the dividend being completely exempt from the PIT.

Slovenia, with overall 36% rate on dividends[12], presents country with moderate burden. On the other hand, Croatia follows pattern of full dividend exemption, typical for Estonia[13] and Latvia, as well as Slovakia and recently also Bosnia and Herzegovina (IBFD, 2010), so its entire burden equals its CIT rate (20%). For such countries only this calculation and comparison, unlike the previous one, underlines the advantage of those countries, which would be especially pronounced concerning tax incentive for SMEs to incorporate (see 5.).
Such an analysis is concentrated on distributed profits. For the growing SMEs the concentration on retained profits could be more appropriate. However, since taxation of capital gains depends on the decision of owner to realize them (so it could be deferred indefinitely) and the burden usually declines with the holding time, such an analysis could be roughly restricted to the comparison of the CIT rates[14].

5 Tax incentive to incorporate

The comparison of overall taxation of business income of corporate and non-corporate sector shows whether the tax system distorts the choice of business form and impedes or induces further growth of small–unincorporated business into incorporated form. It could be expected that such disincentive especially exists in the situation with no preferential CIT rates for small business and vice versa, but, of course, even countries with lower CIT in general as well as dividend taxation could achieve the same goal.
The stated analysis could be done for the case of profit retention or profit distribution, the later being used more frequently[15]. It could in effect be reduced to the comparison of tax rates on capital income of both sectors: the combined (overall) tax rate on dividends (distributed profits of corporate sector) and top marginal PIT rate (including also local taxes and surcharges), that usually applies to the capital income of non-corporate sector (with the exception of dual income tax countries)[16]. It is usually assumed (see for instance OECD, 2009, p. 46) that the labor income in both sectors (in already stated case of "high" incomes and successful growing small businesses) is taxed at the highest PIT rate (the owner of the incorporated business is paying himself salary taxed at the highest marginal PIT rate and the same rate applies to labor income of unincorporated business)[17]. All PIT reliefs are realized through salary and resulting PIT in the former case and through PIT of unincorporated small business entrepreneur in the later case.
So, the analysis is reduced to the mature small business distributed profits (Table 1, last three columns). The last two columns of Table 1 demonstrate how lower CIT rates for SMEs abolish or reduce disincentive to incorporate or increase such an incentive. Almost all countries with reduced CIT rates for SMEs do not possess the disincentive to incorporate. In the remaining three countries, the disincentive is remarkably reduced (France), almost negligible (UK) or generally small before and after the rate reduction (Luxembourg). For the countries with no preferential CIT rates for SMEs, there exists in general the disincentive to incorporate (the overall rate on dividends is higher than the top PIT) (OECD, 2009, p. 48). In Croatia and Slovenia, there is, however, the incentive to incorporate, which is especially strong in Croatia

[12] 20% CIT and 20% PIT on dividends
[13] Similar as with Macedonia, the overall effective tax rate is lower, since only distributed profits are taxed.
[14] For the calculation and comparison of effective tax rates for incorporated (as well as unincorporated) SMEs for EU (and candidate countries) that comprise preferential tax rates for SMEs as well as some but not all tax incentives (relief from other taxes and modifications in tax base) see Devereux, Elschner, Endres and Spengel (2009, p. E-7 – E-10)).
[15] In the former case, the general conclusion (with the exception of flat tax countries with same CIT and PIT rate and dividend exemption from taxation) is that there is an incentive to incorporate, due to the higher top PIT rates then CIT (see Table 1) and deferral of personal taxation through reinvestment of profits.
[16] In dual income tax countries (Nordic countries) the income of unincorporated business (self employed) is, according to the dual income tax principle, divided into labor income and capital income. The former is taxed at progressive rates and the later at a flat rate.
[17] Of course, such assumptions are pretty doubtful for the less developed small enterprise.

with the top PIT rate of 45 % and CIT rate of 20% (with the exemption of dividends on personal level, making that also final DIV rate).[18]

6 Tax incentives for SMEs

Although the lower CIT rate could be seen as a tax incentive (in the broader sense) also, this chapter is concentrated on the tax incentives for SMEs (in the narrower sense). The following comparative analysis (Table 2 and Table 3) presents (other) tax incentives offered only for SMEs (and not for all enterprises) or offered for SMEs above those offered by other enterprises. These are tax incentives in the narrower sense (tax allowances and tax credits for investment, R&D, employment, education…, accelerated depreciation and immediate write-offs, tax holidays and other exemptions, notional interest on capital invested, relief for capital gains or mergers…) as well as simplification measures and reliefs from other taxes allowed for SMEs.
Incentives are divided into two groups. First group are investment incentives/reliefs in the narrower sense (tax allowances and tax credits for the new investments as well as accelerated depreciation including immediate write-off), where the amount of relief/incentive is mostly directly related to the investment value. "Other incentives" could refer to incentives in the broader sense also – for instance notional interest / allowance for corporate equity (equity allowance) is also some sort of tax relief for investment, but it is calculated on equity (own capital invested at the beginning of the year, which comprises "old" and "new" capital – retained earnings) and not new investment only. Similar is true for tax holidays, since they are not related to the investment value. R&D incentives could also be regarded as some sort of investment incentives. On the other hand, here are also some completely non-investment incentives such as reliefs for disabled as well as employment or education incentive (still, they could be regarded as "human capital" investment)[19].
For the purpose of this analysis the countries are grouped into "old" EU members – EU 15 (Table 2) and "new" members and SEE countries (Table 3).

Table 2: CIT tax incentives for SMEs for EU 15 (2009/2010)

	Investment incentives	Other incentives	Simplification measures and reliefs from other taxes
Belgium 3.2010.	TA 12.5%[1] of depreciation – CF Tax-exempt investment reserve of up to 50% of the profits - L	TA 22.5%[1] of an investment in safety measures > notional interest > TC for R&D for bigger SMEs	
Finland 3.2010.	Accelerated depreciation (>50%) first 3 y. for inv. made in least developed regions		
France 2. 2010.	TC 20% for Corsica-CF TC 20% for investments in new	Tax holiday for innovative new companies engaged in	Relief from local business tax and

[18] Top PIT in Slovenia is 41% and overall DIV 36%
[19] Although some investment incentives included are very specific and motivated by other reasons (such as investment in safety measures, export, innovations).

	technologies - L	R&D: first 3 y. exemption, second 2y. 50% reduction of a tax base Capital gains from the sale of branch (partially) exempt from tax on capital gains TC 50% of the expenses related to the hiring of one employee to develop export activities outside the EU– L	social solidarity tax (threshold being higher for the later)
Germany 3.2010.	Additional depreciation up to 20% of the cost of new movable assets + deduction up to 40% of the prospective costs of future depreciable assets - L		
Greece 3.2010.	Additional TA (10-20%) for the existing TA (depending on investment type and region - CF	Mergers: Lower rate and various exemptions	
Ireland 3.2009			Simplified tax prepayments
Netherlands 3.2010.	TA up to 25%	TC for R&D (18 or 20%) – L, CF	
Portugal 12.2009.	TC (10-20%) for EU inv. – L Accelerated depreciation in less developed areas (130% basic rate) for buildings, equipment, patents, licenses and know-how - L	Notional interest (3% of equity)	Lower local tax (if exists)
Spain 11.2009.		TC 6% for internet and e-commerce expenses	The choice of the tax prepayment calculation method Exemption from local business tax
United Kingdom 1.2010.		The immediate write-off for R&D expenditures increased to 175% - L	No tax prepayments

L – straight-line, DB - declining balance (depreciation)
TA – tax allowance, TC – tax credit (their percentages (%) denote percentage of the investment value, which is the TA/TC base; if TA/TC have another base (for instance corporate income, depreciation…) this is stated explicitly
CF – possibility of carry forward of unused incentives (TA or TC)
L – denotes upper limit for the incentives (mostly in absolute amount)
[1] Rise for 2010 (usual percentages 13,5 % for the investment incentive (general) and 10,5 for the incentive for investment in safety measures)
Source: IBFD, 2010.

Two thirds of the old EU members apply different tax incentives for SMEs. Almost all of them allow investment incentives. They comprise all classical form of these reliefs: accelerated depreciation as well as tax allowances as tax credits. As it is well known from the taxation literature (for instance Shah, 1995;

Boadway, Shah, 1995; Mintz and Tsiopoulos, 1995; McLure, 1999, p.331-332) such forms of investments incentives have some additional advantages in comparison with lower tax rates (and some other investment incentives): concentration on new investments only instead of the old ones and new ones at the same time, direct relation to the investment value, lower tax expenditure, possible concentration on the “desired” investment forms/regions/sorts of enterprises.

Again, almost all of the analyzed countries offer some additional incentives for SMEs. The most striking is the notional interest, which is in the case of Belgium higher for SMEs, while in Portugal offered only for SMEs. The form, that has been favored in the taxation literature, especially in the consumption-based one as “equity allowance”, “protective interest” or “ACE tax” or for a long time[20], has finally found its implementation in the developed economies. Its first practical implementation was in one transition country – Croatia (1994-2001) with some similar developments in Austria and Italy.

Among other activities favored for SMEs are R&D activities and different innovations.

France, Spain and Portugal exempt small business from local business tax, while UK, Ireland and Spain apply different simplification measures.

Table 3: CIT tax incentives for SMEs for EU 12 and SEE (2009/2010)

	Investment incentives	Other incentives	Simplification measures and relief from other taxes
Albania 3.2010.			Less frequent tax prepayments
B&H (RS) 2.2010.			Cash accounting 2% on total income
Bulgaria 1.2010.			No tax prepayments
Croatia 3.2010.		> TA for R%D (20% higher for SEs and 10% higher for MEs) > TA for education (70% for general and 35% for special)	
Czech Republic 3.2010.			No tax prepayments
Hungary 2.2010.	TC for development TC 40% of interest for credits for tangibles - L Immediate wrote-off for machines and equipment in less developed regions	TA = 200% salaries of disabled persons - L TA = increase in number of employees x 12 min. wages	No tax prepayments
Latvia 12. 2009.	Highest L (70% inv.) for TC (80% of tax due) cumulative with some other incentives		
Macedonia 10.09.			1% on total income
Malta	>TC (50% for small, 40%	>TC for R&D (up to 35%)	

[20] This form was proposed for the first time by Boadway and Bruce (1982; acc. to Kaiser, 1992, p. 71) and Wenger (1983, 1985) (acc. to Wiswesser, 1999, p. 95 and Kaiser, 1992, p. 71). It was later further developed and strongly advocated by Rose (1991; acc. to Rose, 1999), Rose and Wenger (Rose, Wenger, 1992.), Rose, Wenger, Wagner and Lang (1992; acc. to Wiswesser, 1999, p. 95) as well as IFS (IFS, 1991; acc. to for instance Keen and King, 2002, p. 402) and Devereux and Freeman (1991.; acc. to Keen and King, 2002, p. 402).

3. 2010.	medium sized enterprises)		
Poland 2.2010.	Immediate write-off for some assets - L Milder conditions for TA for inv. in special economic zones		Less frequent and lower tax prepayments
Romania 12.2009.			3% on turnover
Serbia 2. 2010.	>TC (40%) - L,CF		
Slovak Republic 08.2009.			No tax prepayments
Slovenia 12.2009.			Less frequent tax prepayments

L – straight-line, DB - declining balance (depreciation)
TA – tax allowance, TC – tax credit (their percentages (%) denote percentage of the investment value, which is the TA/TC base; if TA/TC have another base (for instance corporate income, depreciation…) this is stated explicitly
CF – possibility of carry forward of unused incentives (TA or TC)
L – denotes upper limit for the incentives (mostly in absolute amount)
Source: IBFD, 2010; Tax Administration of Republic of Croatia, 2010.

Similar as with EU 15, most new EU members and all SEE (except small country of Montenegro) allow some CIT incentives for SMEs.
However, unlike in the former case, the mostly used forms of incentives are different simplification measures, mostly in the form of less frequent or no tax prepayments at all (Montenegro has allowed it for all taxpayers of CIT from 2010 (IBFD, 2010)). Some countries even apply simplified calculation of CIT for SMEs that is not based on corporate profit (Macedonia, Romania and Republika Srpska of Bosnia and Herzegovina).
Unlike EU 15, most countries here do not use investment incentives for SMEs - similar with the fact that they do not use lower tax rate for SMEs (with the exception of Hungary). Hungary and Poland use such incentives mostly, with immediate write-off (and tax credits) being predominant. Serbia is the only SEE country that uses such incentives (increases its tax credit).
Even smaller number of countries of this group (only three – Croatia, Hungary and Malta) use other tax incentives. They are in the area of R&D and employment.

7 Conclusion

Despite the relative criticism in taxation literature, the tax systems of most OECD and EU countries have accepted arguments in favor of preferential tax treatment for SMEs and apply such preferential tax regimes. Such measures could have little immediate impact in times of financial and economic crises. However, they might be expected to enhance growth over the longer term.
The lower CIT rate for small business is not only applied in the countries with relatively high CIT rates (US, Japan), but also in some countries with relatively low rates, such as Hungary, Portugal, Greece, the Netherlands and Lithuania. The differences between basic CIT rate and lower rates for SMRs could reach almost 20 percentage points (France, USA), so the relative difference could be even higher than half of the basic CIT rate.
Taking into account the overall dividend burden, it could be concluded that in general, lower CIT and overall lower dividend tax rates for SMEs compensate for relatively higher CIT and PIT rate on dividends. Only this calculation underlines the advantage of Croatia and Slovenia, which is, again especially

pronounced in Croatia concerning tax incentive for SMEs to incorporate. This is in contrast with most countries with no preferential CIT rates for SMEs, where there exist in general the disincentive to incorporate. Almost all countries with reduced CIT rates for SMEs do not possess the disincentive to incorporate.
Two thirds of the old EU members apply different tax reliefs for SMEs. Almost all of them allow investment incentives, which comprise all classical form of these reliefs: accelerated depreciation as well as tax allowances as tax credits, which have some additional advantages in comparison with lower tax rates (and some other investment incentives). Again, almost all of those countries offer some additional incentives for SMEs. Among other activities favored for SMEs are R&D activities and different innovations. France, Spain and Portugal exempt small business from local business tax, while UK, Ireland and Spain apply different simplification measures.
Most new EU members and all SEE (except small country of Montenegro) also allow some CIT reliefs/incentives for SMEs. However, the predominant are different simplification measures, mostly in the form of less frequent or no tax prepayments at all (Montenegro has allowed it for all taxpayers of CIT from 2010). Some countries even apply simplified calculation of CIT for SMEs that is not based on corporate profit (Macedonia, Romania and Republika Srpska of Bosnia and Herzegovina).

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