2. Don’t penalise the solvency of family businesses

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In the aftermath of the European debt crisis it’s very important that companies sort out their capital. All European countries are focusing heavily on sustainable growth and innovation. And the European Commission has the goal of creating equal tax conditions for companies in all member states. Yet things go wrong occasionally in practice.

Hence the absence of coordination between member states with regard to taxes on profits sometimes makes it difficult to do business in Europe. European companies can encounter different forms of corporation tax in all 28 member states. Companies can base themselves in the country where they pay the lowest corporation tax. On the other hand it can also lead to double taxation.

Taxes on profits were largely introduced shortly after the First World War, a time when multinationals were mainly industrial companies which produced tangible products. The management of companies was often decentralised, and it was clear to see within production processes what happened at the parent company and what happened at the subsidiaries. Taxation at source was relatively easy to apply, because it was clear where the profits were being made.

But as European integration progresses ever further, it is becoming more difficult to determine in what country value and profit are being generated. The European Commission has recognised these omissions and in March of this year, measures were announced to create greater transparency in the various forms of corporation tax. This is the first step towards greater harmonisation in this area.

Another incongruity which I believe needs to be harmonised is the unequal tax treatment of own capital and borrowed capital. Interest on borrowed capital can be deducted from the result. It’s a cost for the business, as a result of which the corporation tax is reduced. The companies with a high level of solvency, which make little or no use of borrowed capital and finance from their own capital, don’t enjoy this deduction.

In family businesses, the capital often remains within the business; dividend payments of 10% or less are not uncommon. Shareholders are less interested in maximising shareholder value than in the future of the family business. They do not only strive for gradual growth, but also for healthy solvency. That allows these companies to fund investments and innovations from their own capital. A solvency level of more than 50% is not uncommon in family businesses.

The unequal treatment of company capital and borrowed capital is a strange approach. The lowest possible solvency level at a company is currently being encouraged, whilst we actually want companies to have a solid financial base so that they have some resilience, even in times of crisis.

Belgium has the ‘notional interest deduction’ also known as the ‘deduction for risk capital’, which is a fictitious interest on the invested company capital. The Belgians are thereby seeking to encourage companies to reinforce the capital structure with their own funds. Sweden has similar plans.

State Secretary of Finance Eric Wiebes has proposed a more equal treatment of company capital and borrowed capital. It would be good if the Netherlands were to take a leaf out of our southern neighbours’ books and took up Wiebes’ challenge.

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