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# **SUMMARY RECORD OF THE MEETING OF THE COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP**

**Held in Brussels on 2 June 2005**

## **I. OPENING OF THE MEETING**

1. The third meeting of the Commission Working Group on the Common Consolidated Corporate Tax Base (hereafter the 'Group') was attended by experts from all 25 Member States (hereafter MS) and was chaired by the Commission Services. The Chair welcomed the participants and opened the meeting.

## **II. ADOPTION OF AGENDA**

2. The Chair presented the draft agenda to the participants and it was adopted by consensus.

### **III. REPORT AND DISCUSSION ON PROGRESS OF SUBGROUP ON ASSETS AND TAX DEPRECIATION (Working Document 'An overview of the main issues that emerged during the discussion of tax depreciation of assets' CCCTB/WP/012)**

3. The Chair of the Subgroup on assets and tax depreciation (hereafter the SG1) presented the report on progress made during the two meetings of the SG1. He mentioned that four members of the Group and the Commission Services had commented on the first draft of the report. He pointed out that the appendix had been added to provide more background detail on the draft definition of an asset. He also summarised the discussion on the definition of a depreciable asset, the individual and pooling approaches and depreciation methods. As regards the value or cost to be depreciated there was broad agreement on the principles although some differences over detail remained. As regards self-generated intangible assets there was general agreement that these should not be treated as depreciable assets. He mentioned that several interesting features of the pooling system emerged during the second meeting of the SG1. The Chair of the SG1 agreed with the Commission Services' identification of the main issues (CCCTB/WP/012), stressing that it was important for the main Group to decide how much further work should be carried out by the subgroup now, and how much should be 'put to one side' for further work when progress had been made on other linked structural elements. He agreed that the common points of individual depreciation and the pooling system should be analysed by SG1 in more detail.

4. The Commission Services went through the list of issues identified in the Working Document 'An overview of the main issues that emerged during the discussion of tax depreciation and assets' (CCCTB/WP/012) and invited members of the Group to comment on each of them.

#### *Definition*

5. First the definition of depreciable assets was discussed. The Commission Services explained that in their opinion the definition of an asset should not be primarily linked to the balance sheet or 'tax balance sheet'. The Commission Services proposed to discuss the question of a tax balance sheet separately and indicated that it should be understood more as a general matter of what documentation should be obligatory for tax purposes, rather than as an issue only related to assets and tax depreciation.

6. Several members of the group observed that they do not use the 'tax balance sheet' for corporate tax purposes. One, who was not familiar at all with the concept of the tax balance sheet asked for further explanation. Another member of the Group, together with the Commission Services, explained that the 'tax balance sheet' may be specifically prepared for the tax return and may differ from the one prepared for the financial accounts of companies because of differences between tax rules and financial accounting rules. In such circumstances the conditions for the recognition of an asset in the tax balance sheet are at the same time determining whether an asset is going to be depreciated or not for tax purposes – ie if an asset qualifies for capitalisation in the tax balance sheet then it also qualifies for tax deductible depreciation. This member of the Group pointed out that the definition of an asset may of course be the same in taxation as in accounting, but because currently neither all accounting definitions nor all tax

definitions across the EU are the same a CCCTB definition has to be agreed which will be applied in all participating Member States.

7. One member of the Group thought that an asset should be defined for CCCTB purposes in the same way as it is defined in IAS 16 and 38 unless there is a good reason to take a different approach. However, another pointed out that a more detailed definition would be needed. The Commission Services commented that the current use of IAS was not as wide as the potential use of CCCTB and all MS would have to accept and apply the same definition. Another member of the Group agreed with the Commission Services that the tax balance sheet concept should be seen as a separate matter of documentation and that the definition of an asset should not be linked to it. A member of the group from a MS in which tax balance sheets are used warned against having a false and useless debate – in his opinion where it exists the tax balance sheet is a simple instrument derived from the financial accounts and all Member States by definition need to adjust their financial accounting information for tax purposes. It is a secondary question what this is actually called and to which extent such reconciliation is formalised.

8. One member of the Group suggested deleting the word 'financial' in the definition of an asset proposed by the Chair of the SG1 (*Assets are tangible, intangible, and proprietary benefits (rights, monetary worth, actual conditions, specific possibilities) for which the enterprise incurred expenditure, which are under accepted standards capable of being valued independently and which generate a use over several financial years.*).

9. Several members of the Group raised the question to what extent it is desirable to separate commercial and tax profits, however some of them wanted to postpone the discussion on it to a later stage.

10. One member of the Group mentioned the problem of assets received free of charge (eg. through a donation). He stressed that it was extremely important for his MS whether they should or should not be depreciated and referred to existing national jurisprudence.

11. It was suggested that an explanatory note on the concept of the 'tax balance sheet' should be prepared for a future meeting of the Group. This should include *inter alia* the distinction between the tax balance sheet and the financial accounts balance sheet and how this may arise when there has been a move away from tax and accounting dependency so that the financial accounts are no longer necessarily the same as the tax accounts but a balance sheet is still required for tax purposes. The Commission Services expressed their preparedness to draft such a note and may approach individual members for input.

#### *Economic ownership*

12. The Commission Services pointed out that although most members of the Group have agreed that the economic owner should be allowed to depreciate an asset under certain circumstances the scope of the term economic ownership and even financial

lease is not the same in all MS. The Commission Services therefore proposed that SG1 to continue its work on the common definition of economic ownership and its conditions for CCCTB purposes. Several members of the Group agreed that although the understanding of what 'economic ownership' is seems to be common in general, the varying civil law in different MS may cause some problems. One member of the Group thought that it should be defined with specific reference to who is eligible to depreciate an asset because even definitions of legal owner may be different in different states. It may not be sufficient to say 'ownership in accordance with civil law' because of these differences and a tax definition may be required, which may of course not correspond to current practice in all MS. Another member of the Group was of the opinion that it was important to take into account risks related to ownership.

13. Several members thought that legal ownership should be taken as a basic concept and it should be studied in more detailed what the economic ownership is. It was particularly important for several members to analyse and deal with financial leasing, not only in terms of who should be able to depreciate the asset but also in terms of who should be taxed on any leasing income.

14. Members of the Group in principle agreed that more work in the SG1 on this issue would be very useful.

#### *Pooling and individual systems, estimated useful life*

15. The Commission Services invited members of the Group to discuss the issue of pooling and individual depreciation together with the estimated life of depreciable assets. This is very complex and the views of SG1 members on it still vary after two meetings. The Commission Services suggested that more work in SG1 on estimated useful lives of depreciable assets (eg. how the estimated useful life is fixed and allocated to particular assets) may be useful as well as work on procedures ensuring the common assessment of assets within all CCCTB jurisdictions. The common features of individual and pooling systems may become more apparent after such analysis and it may be easier to find a compromise solution. The Chair of the SG1 called for a sensitive approach and suggested basing the next subgroup meetings on specific models and sought input from other members of the Group.

16. Several members appreciated this approach and thought that it is important to look at how many groups in respect of the estimated useful lives would be, or currently are, needed. One member of the Group thought that pooling moves away from actual reality and that the specific character of various sectors has to be taken into account. The pooling system may create a difference between distributable profits and taxable profits according to this member. The pooling system is a simplification but it has a distorting effect on a balance sheet which would not be acceptable for IAS and the national civil law. The connection between taxable profits and distributable profits should not be destroyed. In the pooling system there is a risk that an asset escapes taxation on the company level.

17. The Chair proposed that the SG1 continues its work and should try to find some sort of compromise. One member pointed out that with the individual system even

within their State there were sometimes different interpretations in relation to the same assets and the Commission Services stressed that a harmonised approach would be needed across the whole EU under the CCCTB. Several members of the Group highlighted that the differences between the pooling and individual approaches are in many cases not as significant as one might initially think, which should facilitate a compromise: most 'individual depreciation' systems use standardised tables listing industry-specific depreciation patterns, thus in reality achieving an almost group-type segmentation, whereas pooling systems are often based on more than one group. However one member observed that for the CCCTB the pooling method would in any event not constitute a meaningful simplification as individual depreciation is compulsory under IAS/IFRS and will thus need to be carried out anyway for financial reporting purposes where IAS/IFRS is followed.

#### *Straight line and declining balance methods*

18. The Commission Services observed that the views on what methods should be applied have varied amongst members of SG1 as well. They reminded members of the Group that it is important how the particular method is actually employed (eg. calculation, rate) and whether a pooling or individual system is applicable. Finding a solution to the previous questions should facilitate the decision on applicable methods as well. Several members thought that there is no need to decide between straight and declining balance method and that there should be an option to choose between the methods. They thought that this solution enables taxpayers to reflect how the asset is actually used in the tax depreciation.

#### **IV. REPORT AND DISCUSSION ON PROGRESS OF SUBGROUP ON LIABILITIES, RESERVES AND PROVISIONS (Working Document 'An overview of the main issues that emerged at the first meeting of the subgroup on reserves, provisions and liabilities' CCCTB/WP/011)**

19. The Chair of the Subgroup on reserves, provisions and liabilities (hereafter SG2) presented the Chair's Report of the first meeting of the subgroup that took place in Rome on 28 and 29 April 2005.

20. The Chair of SG2 informed members of the Group that three issues were discussed at the meeting: definitions of reserves and provisions; deductibility of reserves and provisions; and how to deal with reserves and provisions required by national legislation for purposes other than fiscal ones. As regards definitions, IAS 37 could be a starting point, but additional criteria may be necessary. The question was raised whether doubtful debts should be dealt with by SG1 (as they are linked to assets) or SG2. SG2 was very much interested in other members' views on this issue.

21. As regards deductibility of provisions and reserves, substantial criteria can guide the decision whether a reserve/provision is tax deductible or not. Possible criteria were mentioned. For instance, provisions could be deductible if recognised to satisfy obligations towards third parties. In that respect, profit shares earmarked for managers and/or employees represent provisions and not reserves, as they are recognised to satisfy obligations towards third parties. The substantial criterion must be

complemented by additional criteria, especially if provisions are in principle tax deductible unless otherwise provided (a negative list). If the opposite approach is adopted in CCCTB (provisions are **not** deductible unless otherwise provided, i.e. positive list) it will be necessary to draw up a list, and MS are invited to provide examples of provisions that they consider tax deductible.

22. As regards legally required provisions and reserves, members of the SG2 agreed that non fiscal legislation such as commercial, labour or environmental legislation should not directly affect the tax base. However, there are specific sectors to be dealt with (such as the banking and insurance sector, where non-fiscal legislation requires the recognition of specific reserves and provisions in the annual accounts) and areas where it is commonly accepted that legally required reserves and provisions are in principle recognised for tax purposes as well (eg. labour and social security legislation). Here again, suggestions and examples from MS are welcome.

23. The Commission Services presented a working document 'An overview of the main issues that emerged at the first meeting of the subgroup on reserves, provisions and liabilities'. They pointed out that as the SG2 had only met once the work was not as advanced as that on assets (SG1) but nevertheless it was important to keep the whole Group informed of the progress to date and seek their views on a number of issues. They highlighted areas where further guidance from the Group and more work by SG2 was needed and invited members of the Group to comment. Both the Chair of the SG2 and the Commission Services stressed the importance of the defining of provisions and reserves and the distinction between them and they mentioned potential techniques that may be employed (a positive list, a negative list). The Commission Services pointed out that there is a difference between defining provisions which are all assumed to be tax deductible and defining provisions that are in principle non deductible and have to satisfy a further set of defined conditions in order to be tax deductible. A definition of tax deductible provisions would have to be more carefully structured.

24. The Commission Services also mentioned that the approach to bad debts should be discussed. It was not clear after the first meeting of SG2 whether the topic of bad debts should be discussed by the SG1 or the SG2. Some members of SG2 had been of the opinion that the definition of provision should cover only those linked to liabilities. However, the Commission Services suggested, for a number of reasons, that bad debts and/or provisions for them should be addressed by SG2. After a brief discussion it was confirmed that bad debts would be dealt with by SG2.

25. Both the Commission Services and the Chair of the SG2 agreed that while looking for the solution for legally required provisions it is very important to look at the examples of particular national legislations.

## **V. DISCUSSION ON CAPITAL GAINS AND LOSSES (WORKING DOCUMENT CCCTB/WP/010)**

26. The Commission Services introduced the new Working Document and invited members of the Group to comment on it. It was pointed out that the topic emerged during the discussions of tax depreciation of tangible and intangible assets. The

Commission Services suggested linking the topic to the work of the SG1. The Chair encouraged the participants to comment on the paper section by section and drew their attention to the questions at the end of each section. Members were also asked to provide the Commission Services in due course with written comments on each section.

27. One member of the Group observed that although the separation of capital gains and losses on financial assets from those on depreciable assets seems to be a logical step it should be considered very carefully. He pointed out that shares represent ownership rights on other assets. Therefore the approach to both types of gains and losses has to be thoroughly consistent. Several other members of the Group agreed that the treatments have to have the same effect when assets and shares representing rights to assets are sold.

28. Two members of the Group found it very important to ring fence gains and losses incurred on capital assets from ordinary business income. This was principally because of the tax planning opportunities which arise from companies' ability to crystallise gains and losses in specific tax periods, in contrast to ordinary income which is taxed on an accruals basis. One member thought it would be practical to tax capital gains and losses completely separately from ordinary business income. However, several members were of the opinion that capital gains and losses should, subject to carefully identified exceptions like for instance reinvestment reserves, be treated in the same way as ordinary business income. This should be without any prejudice to any specific treatment of some capital gains and losses for instance in case of reinvestment reserves.

29. One member of the Group thought that gains and losses on financial assets need to have a specific treatment. Several members of the Group agreed that the topic could be analysed further by the SG1 as did the Chair of the SG1.

30. On unrealised gains and losses one member of the Group commented that they should not be subject to taxation. Another two members of the Group mentioned the problem of exit taxation and the principle of territoriality.

## **VI. ANY OTHER BUSINESS AND CONCLUSIONS**

31. The Chair informed members of the Group that at the September meeting of the Group, in addition to reports from the two subgroups, the Commission Services would, in accordance with the Work Programme, present a paper on a new structural element of the CCCTB. This will cover income recognition and expenses and it is expected that the Group will wish to continue more detailed work in a new subgroup.

32. He also informed members of the Group that, in accordance with the Work Programme, the Commission Services plan to prepare a report on progress of the Group by the end of the year 2005 in order to inform the higher political level of the progress and obtain feedback. The Commission Services will present a draft of the report at the December plenary session of the Group. The Commission Services may also organise a pre-meeting the day before the December plenary session of the Group to exchange

views with non governmental experts. Members of the Group will be invited to participate in this pre-meeting as well.

33. Two members of the Group asked how the non governmental experts will be selected and whether the list of potential experts would be available at the September plenary session of the Group. The Chair explained that the Commission Services will approach professional federations at the EU level and invite them to identify interested individuals. He invited members of the Group to provide the Commission Services with the names of any competent experts who they know are not part of recognised EU federations. He confirmed that the list of individuals will not be available at the September plenary session of the Group.

34. The Chair concluded the meeting as follows:

- The SG1 will continue and will work further on the definition of an asset, the scope of economic ownership together with the question of who is eligible to claim tax depreciation charges and on capital gains and losses. Members of the Group are invited to provide the Commission Services with their input on further work of SG1, particularly:

- the definition of a depreciable asset,
- what the coverage of economic ownership in CCCTB should be and what are the main characteristics of legal ownership in their civil laws,
- what could assist in reaching a compromise between pooling and individual depreciation, how many pools or 'groups' of individual assets currently exist or how MS deal with the administrative burden of assessing useful lives for every individual asset, eg. are similar assets grouped together in administrative 'groups' etc.

- Members of the Group are invited to provide the Commission Services with their comments on the Working Document on capital gains and losses by 23 June 2005. The SG1 also seeks input from members on the above questions.

- The SG2 will continue its work and will concentrate on issues along the lines identified in the WD 011. The SG2 should extend their work to include provisions related to bad debts. The second meeting of the SG2 will take place in Rome on 27 and 28 June.

35. The next plenary meeting of the Group is planned on 22 September 2005. The Commission Services will prepare a new working document on taxable income. The Chair promised a short follow up reminder of key dates and information requests within a few days.