BDI

Federation of German Industries - 11053 Berlin, Germany

Taxation and Fiscal Policy

Mr. Thomas Neale
Via Email

Date
21. November 2007

Dear Mr. Neale,

We would like to thank the European Commission for giving us the opportunity to comment on the working document regarding the possible technical elements of a common consolidated corporate tax base (CCCTB/WP057) that was published on 2 October 2007.

We would like to point out that the paper is a very good first step in outlining the elements of a future CCCTB. We would like to further encourage the European Commission on advancing on this topic due to its high importance for the business community in Europe. Also, we would like to stress our support for the optional character of a CCCTB.

Please find below our comments on this subject. The numbers mentioned in the individual headings correspond to the text numbers of the above mentioned paper.

Section 9: Reference to IAS/IFRS

We support the opinion of the European Commission of not linking a possible common tax base to the principles of IAS/IFRS. IAS/IFRS pursue an aim (i.e. information for investors and shareholders) that in itself is incompatible as a base for tax calculation.

Using IAS/IFRS as a starting point for calculating a tax base would only be possible in case a comprehensive catalogue of adjustments and reconciliation was established.

Section 10-18, 116: Scope; Sharing Mechanism

According to the paper local taxes are only considered as a potential deduction item concerning the individual MS share of the consolidated tax. The European Commission does not propose to apply the CCCTB also to local taxes.

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In some member states, local taxes account for a significant portion of the overall tax burden (for instance, the German “Gewerbesteuer” (trade tax) will constitute about half of the total tax burden for German businesses as of 2008). In order to eliminate tax obstacles to the common market, it is therefore crucial that the CCCTB is the basis of the local taxes as well. Firstly, cross border consolidation is significantly less helpful in case it only applies to half of the tax burden. Secondly, companies would still be required to determine two separate tax bases if local taxes were not calculated according to CCCTB principles. As a consequence, a reduction of compliance costs cannot be achieved.

Therefore, we would highly appreciate it if member states were urged to design their local tax bases according to CCCTB principles. This should be mandatory in case the local taxes account for a significant portion of the overall tax burden, maybe providing for a 1/3 threshold.

Section 17 and 18: Treatment of withholding taxes

There would be no withholding taxes or other source taxation on payments of any kind made between taxpayers of the same consolidated group. The question arises whether source taxation should continue to be imposed on payments made between two single taxpayers or separate consolidated groups. In order to reduce unnecessary administrative burdens, it would be preferable to completely eliminate source taxation on such payments (i.e. option a).

Generally speaking, this is also the preferable solution for payments made by a taxpayer to a non-taxpayer. If withholding taxes are deemed indispensable, they should be harmonized within the member states to allow simplicity and transparency.

Section 25 and 28: Treatment of expenses for certain goods

Regarding non-deductible business expenses, the cost for entertainment and for representation should be regulated separately. Normal business meals and also food and drinks at customer or employee events should be recognized as fully deductible business expenses since these are purely business related. On the other hand, expenses with a clearly private character like visits to sports events, receipt of personal services etc. could be classified as a 100 % non-deductible expense.

Treatment of the cost for expensive cars as non-deductible is not recommended. This will lead to classification problems of what constitutes an “expensive” car and thus will make the application of a CCCTB more complicated.

Section 26: Low cost assets

Where the cost of acquisition, construction or improvement of an asset is less than EUR 1,000, the cost would be immediately deductible. The

threshold of EUR 1,000 is well-chosen since it is practical and consistent with business realities. We thus highly support the introduction of such a threshold.

Section 36 - 38: Long-term contracts

In the paper, the preferable method for considering the effects of long term contracts in the tax base is the percentage-of-completion method. While we do support this, we also believe that the traditional completed contract method should be allowed as an alternative if used consistently and by all companies within the consolidation.

Section 40 - 41: Bad debt provisions

The paper prefers the allowance of bad debt provisions under certain conditions only for individual receivables that are at risk of not being paid. As the commission correctly points out, this method in most cases reflects commercial reality better than a fixed approach. In order to make the application of a CCCTB more practical, however, the option of forming a bad debt provision in the amount of a lump percentage based on previous experience should be considered. Especially for companies with lots of individual small debts (e. g. mail order houses) this would constitute an important simplification.

Section 51 - 54: Inventory valuation

As stated in the paper, the cost of inventories should include all costs of purchase, costs of conversion, and other direct costs. The small variations coming from different branches and different business habits should be allowed provided that the same valuation methods are used consistently over the years.

Section 65: Depreciation of improvement costs

Improvement costs should always be depreciated over the remaining useful life of the improved asset. If done otherwise (i.e. separate depreciation of the improvement costs) situations could arise where a given asset reaches the end of its useful life while some improvement costs still remain to be depreciated. This does not align with economic reality.

As a consequence, the improvement costs should be depreciated at a higher rate over the remainder of the depreciation period for the underlying asset.

Section 66: Assets depreciated on an individual basis

The introduction of a threshold regarding the classification of fixed assets in general is very practical. It does not reflect economic reality, however, to write down all assets with the value of over EUR 5,000,000 over a time

frame of 25 years. It is easily imaginable that many expensive assets over a single value of EUR 5,000,000 have a shorter lifetime than 25 years. If this can be properly evidenced, taxpayers should be allowed to determine a shorter individual useful lifetime for a given asset.

In addition it has to be pointed out that long depreciation periods negatively affect reinvestment decisions. This is especially important with regards to environmental reasons as well as safety aspects (e.g. aviation). Furthermore, the liquidity of businesses will be negatively effected by long, unrealistic depreciation periods.

Section 84, 100 - 105: Treatment of losses

We support the treatment of losses as suggest by the Commission. The principles established are practical and reflect business reality.

Section 89: Qualifying subsidiary

In the paper it is stated that a given subsidiary can only be part of the tax group if at least 75 % of its voting rights are held by the qualifying parent company.

In our opinion, the 75 % threshold is not justified, randomly chosen, and impractical. Instead, the qualifying threshold should be reduced to more than 50 % (i.e. 50 % +). In our opinion there is no reason for excluding subsidiaries that are effectively controlled by the parent company, but that do not reach the 75% threshold. Otherwise, the flexibility of doing business in raising capital in Europe would be unnecessarily limited. For instance, partial initial public offerings (in order to raise capital) would be limited to 25% only for tax reasons.

In this context we would also like to point out the special case regarding joint ventures. In order to extend the CCCTB principles to this construction, special rules would have to be implemented.

Section 107 – 109: Treatment of the sale of shares in a group company

When a group sells shares in a group company and the company leaves the group, this would not be taxed if participation exemption rules apply. Then the question arises as to whether it is necessary to have a mechanism for bringing into charge the unrealised gain on underlying assets in the departing company.

The valuation of the individual assets is a time consuming and often complex procedure. Furthermore, the valuation of goods and assets often gives rise to disputes between the taxable person and tax authorities due to different interpretations and assumptions employed. For practicality reasons, a normal exemption in full should thus be applied in all cases.

In order to avoid abuse, the disposal of such shares should not be exempted to the extent that assets were transferred to the departing company within the present or previous tax year and their disposal would have triggered a gain.

Section 112: Consolidation methods

There are two basic approaches for consolidation. Intra-group income and expenditure other than that related to depreciable assets can either be

(i) ignored completely or
(ii) can be included by each group company and netted off when the consolidation is carried out.

While alternative (i) above is more practical and thus preferable, alternative (ii) should be made available on an optional basis.

Section 114: Stock valuation

In the paper it is said that stock valuation resulting from intra-group sales is problematic. Calculating the gain included in stock purchased from another group company accurately is extremely complicated and not practical. Groups should only be subject to the obligation to use a given valuation method consistently.

Section 117 – 136: Foreign income and participation exemption

As mentioned in the paper, portfolio dividends and other passive income would be taxed with a credit for withholding tax paid. Where income is taxed it would, if received by a member of a consolidated group, be shared among the MS in accordance with the apportionment key and the cost of the credit for foreign tax would likewise be shared. A mechanism would be required for calculating the limit of the credit to be given by each MS.

Instead of applying the credit method, the exemption method should be used. Exemption is preferable to credit because credit is complex to operate in practice, requiring the recalculation of profits of all subsidiaries according to rules of the country giving the credit. The complication is furthermore exacerbated by having to split up the withheld taxes as well as the cost of credit according to an allocation key.

Administrative issues, consideration of specific business sectors and other general remarks

We would like to point out that the success of a CCCTB for businesses is only granted if the proclaimed simplification and reduction of compliance costs is indeed achieved. This, however, is only possible if the administrative and procedural frame is designed in a way that is practical and reliable for businesses as well as legally binding for national tax authorities. We

would highly appreciate it if the European Commission could consider this point in the further developments regarding the creation of an administrative framework.

Also, we would like to encourage the European Commission to also consider the special factors inherent in certain industries, such as aviation, shipping, and financial services. In particular we would like to point out the possible interaction between Article 8 of the OECD Model Convention ("home-state-taxation") for shipping and air transport. In case the European Commission is in need of tax experts from one of the industries in question for consultation, we would be happy to recommend contact persons for the individual industries.

As a general remark, we would like to point out that the application of the CCCTB-principles must not lead to a broadening of the tax base compared to the status quo. This would be the case, for example, if only those measures leading to a broadening of the tax base were accepted by member states while those aspects leading to a reduction in the base are not incorporated. This would lead to a taxation that is not proportional to the economic capacity of businesses. As a consequence the competitiveness of European businesses would be impaired. This does not align to the principles with the Lisbon agenda.

A final point that has to be considered is the fact that in Germany, tax accounting is based on the commercial accounts which are generally used as a starting point in calculating the tax base. The commercial accounts in return have to be composed independent of a given tax base calculation. This interdependence has to be borne in mind when establishing and applying the CCCTB-principles. E.g. the planned pool depreciation will not lead to a simplification of German businesses since such a pool depreciation currently is not allowed for purposes of commercial accounting. Thus, the introduction of a pool depreciation for CCCTB-purposes will not constitute a simplification for German businesses unless a harmonization is also taking place with regards to commercial accounting. An unsystematic interference between commercial and tax accounts should be avoided in order to reach the intended goal of reducing compliance cost as well as increasing the competitiveness of European businesses.

We would like to thank you again for providing the opportunity to submit our comments on this topic. Please do not hesitate to contact us in case of questions.

Kind regards


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