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

Held in Brussels on 23 September 2005

I. OPENING OF THE MEETING

1. The fourth meeting of the Commission Working Group on the Common Consolidated Corporate Tax Base (hereafter the 'Group') was attended by experts from all Member States (hereafter MS) but Malta, plus observers from Bulgaria and Romania 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 and provided Members[1] of the group with an overview of documents distributed before the meeting. The agenda 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 at the third meeting of the subgroup on assets and tax depreciation' CCCTB/WP/014)

3. The Chair of the Subgroup on assets and tax depreciation (hereafter the 'SG1') presented the report on the result of the third meeting of the SG1, which was held on 11-12 July in Berlin.

4. He explained that SG1 met to discuss in detail the Commission Services working document on capital gains and losses (CCCTB/WP/010), which was introduced at the previous meeting of the Group, and to progress on some outstanding issues related to tax depreciation of assets such as: a possible definition of assets; a possible definition of economic ownership; and a possible compromise between the individual and pooling methods of depreciation.

5. The Chair of the SG1 reiterated that as regards **definitions**, it was agreed that due to the existence of 25 different national systems, common definitions of assets will be necessary for the CCCTB. SG1 reached consensus on possible definitions that can constitute a valid basis for the future work on the CCCTB.

6. As regards a possible compromise between the **individual and pooling** methods of depreciation, the Chair of the SG1 stated that despite an intense debate, it was not possible to reach a common view. The compromise proposed by the Chair of the SG1 (having several groups of assets, within which the pooling system could be applied) did not meet the agreement of the participants. One objection was that if the main advantage of the pooling system is its simplicity due to the existence of a single pool of

[1] Throughout the document the terms 'members', 'experts', and 'Member States' (MS) are used. In common with other documents these should be understood to refer to individual experts participating in the meeting. They do not indicate any formal position or view of a Member State.

assets, establishing several groups does not serve this purpose. Therefore the majority of SG1 was in favour of an individual system of assets depreciation, with depreciation tables stating for each asset its economic useful life and its depreciation rate. However, members of SG1 observed that such a depreciation system could be simplified by means of harmonising and simplifying the existing depreciation tables. The Chair of SG1 also mentioned that the Commission Services had expressed concerns regarding the complexity of harmonising existing tables, since some of them contain thousands of items. He also informed members of the Group that one Member suggested at the last SG1 meeting that those MS who currently make use of depreciation tables and individual depreciation of assets could work together to harmonise and simplify such tables for the CCCTB. The Chair of the SG1 found this proposal interesting and suggested starting work on it, although this would not mean that a final choice between pooling and individual depreciation has been taken.

7. As regards **capital gains and losses**, the Chair of the SG1 pointed out that this was the first time SG1 had considered the topic and had covered only capital gains and losses on tangible and intangible depreciable assets. It was generally agreed at the SG1 meeting that realised capital gains and losses should be treated as part of the ordinary business income of companies. Most members of SG1 could agree that in principal gains should be fully taxable and losses fully relievable, capital gains should be taxed only upon realisation, and unrealised capital gains should not be taken into account for CCCTB purposes. It was generally agreed that inflation corrections of taxable gains (and tax relevant losses) should not be taken into account. The Chair of SG1 highlighted that views differed on the tax treatment of unrealised capital losses. Some Members support a symmetrical treatment of gains and losses whereas others prefer asymmetrical treatment for unrealised losses; in application of the more general principle of prudence (the majority prefer symmetry).

8. The Chair of SG1 noted that as regards the possible treatment of extra-ordinary wear and tear (to take into account the economic situation of an enterprise) it was generally accepted that extra-ordinary wear and tear should be taken into account, although views differed on the practical way how to do that. The possibility of allowing roll-over relief had also been discussed but views on this issue differ.

9. The Chair of the SG1 concluded that a considerable amount of work has been done by SG1, but more work is still required in particular as regards the issue of pooling versus individual depreciation. The Chair of SG1 stressed that although the Commission Services have shown their preference for the pooling method, as did the Industrial Federation “UNICE” in a recent paper, most Members seem to prefer the individual method of depreciation. In addition, a number of Members from MS which currently use depreciation tables are ready to work together for harmonising and simplifying such tables.

10. The Commission Services introduced the issues identified in the Working Document 'An overview of the main issues that emerged at the third meeting of the subgroup on assets and tax depreciation' (CCCTB/WP/014) stressing that the main purpose of the current discussions was to have comments and views from those experts

who had not attended the SG1 meeting, although comments from all Members were welcome.

11. With reference to the discussion on **pooling** and the **individual** method of depreciation, the Commission Services drew attention to the UNICE (Industrial Federation of the European Community) position paper, which could possibly be discussed at the forthcoming meeting with academics and business representatives planned on 7 December (see below for details). To this end, although the initiative put forward by some MS to work on harmonising depreciation tables is welcome, it may be more appropriate to postpone it to the beginning of next year.

12. As regards **definitions**, the Commission Services agreed that there is a need for common understanding of terms and welcomed the definitions submitted by the SG1 as a valuable input for the future work.

13. As regards **capital gains and losses**, the Commission Services noted that within SG1 there are areas where there is general agreement (such as that capital gains and losses are part of the ordinary business of a corporation, and that unrealised capital gains should not be tax relevant) but there are also areas where experts have different views. Examples of the latter include the treatment of unrealised capital losses and the approach to roll-over relief, which is partly linked to the discussion of pooling versus individual depreciation in that a pooling system contains an element of automatic roll-over relief.

14. As regards next steps, the Chair pointed out that financial capital gains and losses have not been dealt with deliberately, due to their specificity, but they will be in the future. A future working document could cover not only capital gains and losses stemming from the sale of financial instruments, but also more generally gains and losses of financial institutions, such as insurance and banking institutions.

15. The Chair asked for comments from Members, suggesting in the light of the achievements obtained so far by SG1, and the forthcoming meeting with academics and business representatives where the issue of pooling and individual depreciation may be raised again, that Members may wish to consider whether SG1 should suspend its work for the time being.

Individual and pooling depreciation

16. Several experts from MS who currently apply an individual method of depreciation of assets for tax purposes did not see it as complex compared to the pooling method as described in the Commission Services document. The harmonisation of existing tables could bring about more simplification and such an initiative deserves full support. One Member thought that it could be postponed until after the meeting with stakeholders, although it is unlikely that Members who currently favour the individual system will change their views after that meeting. Several Members were very supportive of the idea that some Members could come together and try to harmonise/simplify their national depreciation tables currently in use.

17. One Member mentioned that pooling requires special caution due to its potential effects on the revenue-raising ability of MS exchequers. The MS in question has to use the declining-balance method and he was of the opinion that this method produces faster depreciation than the straight line method. In the MS individual depreciation is currently used and it is not excessively complicated. A common useful life of 8 years is applicable for practically all plant, machinery and equipment.

18. Another member pointed out that the individual method should definitely not disappear for some specific assets, for example real estate, airplanes, and ships. One expert from a MS who currently applies the pooling method expressed the wish that any initiative concerning the development of depreciation tables should be open to all experts and not only those from MS who currently apply them. The Commission Services agreed that everybody should be allowed to participate in such an initiative. Even though the Commission Services have already expressed their preference for the pooling system, they are open to discussion and will not hinder such an initiative. This issue could be dealt with again after the December meeting.

Capital gains and losses

19. Some experts expressed their preference for a "symmetrical" treatment of capital gains and losses, including unrealised ones. One expert in SG1 stressed the importance of agreeing valuation rules. Another expert pointed out that some companies apply the fair value rules referred to in IAS (but not all of them). If the fair value of assets is recognised in the commercial accounts this can lead to unrealised capital gains being taxed. Simply not taxing these (i.e. a different treatment of capital gains for accounting and tax purposes) could lead to the distribution of untaxed profit to shareholders where distributable reserves are determined by commercial accounting rules. However, it was also pointed out that the taxation of unrealised capital gains could lead to a taxation of the worth or value of a company, rather than a taxation of income. Therefore, a careful approach is needed. Another expert stressed once more that care is needed in the design of rules to deal with financial assets due to the tax-planning opportunities provided by such capital gains/losses (corporations can choose the most "fiscally convenient" taxable period in which a capital gain or loss should be crystallised).

Future work of SG1

20. Several Members of the Group recognised that SG1 had produced a valuable amount of work and it was agreed that its activities could be temporarily suspended.

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 second meeting of the subgroup on reserves, provisions and liabilities' CCCTB/WP/015)

21. The Chair of the Subgroup on reserves, provisions and liabilities (hereafter 'SG2') presented his Report of the second meeting of the subgroup that took place in Rome on 27 and 28 June 2005.

22. The Chair of the SG2 reported the main issues discussed at the meeting: the two possible approaches for the deductibility of provisions (deductible with exceptions or non-deductible with exceptions); mutual recognition of legally required provisions (e.g. social and environmental legislation); and the treatment of bad debts.

23. The Chair of the SG2 reminded members of the Group that as regards the deductibility of provisions, one could consider treating provisions as either generally deductible with a “negative” list of non-deductible items or generally non-deductible with a “positive” list of deductible items. He expressed a strong preference for the latter and disagreed with the Commission Services when they state in the working document CCCTB/WP/015 that the two methods may lead to the same result on the basis that they are only two different techniques. According to the Chair of the SG2, the negative list may lead to fundamental erosion of the taxable base and therefore he would recommend the "positive list" approach. He also mentioned that if the positive list approach is to be chosen, the distinction between a provision and an accrual would be important. The Chair of SG2 acknowledged that the discussions held during the SG2 meeting showed that the two points of views still exist; with a majority of experts preferring the negative list approach (although some of these are currently applying the positive list approach).

24. As regards the deductibility of provisions which are required by legislation other than tax legislation ('legally required' provisions), it emerged from the discussion at the last SG2 meeting that the only workable approach would be a sort of "mutual recognition" of the non-tax legislation of the other MS. This would mean that if a provision is required by the domestic legislation of a given MS, the other MS would allow that provision in the CCCTB. As an example, the provisioning for warranties was mentioned, where some MS allow it and some others do not.

25. As regards bad debts, the Chair of SG2 reported that it was generally agreed in SG2 that provisions for bad debts should be allowed; however views differed on possible methods, such as a fixed-rate approach (a certain percentage of the total amount of debts) a "timing" approach (bad debts are deductible if overdue more than a certain number of months) or a case-by-case approach. It was also generally agreed at the SG2 meeting that a formal legal proceeding for the recovery of the bad debt should not be a pre-condition for recognising a provision.

26. The Commission Services then presented the working document 'An overview of the main issues that emerged at the second meeting of the subgroup on reserves, provisions and liabilities' (CCCTB/WP/015). They pointed out that here again the main purpose of the discussion was to inform the main group about the progress achieved by the SG2 and seek their views on a number of issues. The Commission Services identified four main points: the deductibility principle; the recognition of provisions (especially when it is difficult to estimate a correct amount of provisioning); the issue of legally required provisions; and bad debts. Experts were invited after each individual issue was introduced.

Deductibility principle

27. The Commission Services explained that it is in favour of the general deductibility of provisions that meet the conditions of the common definition of provisions (negative list approach) for several reasons. First, only provisions made for actual liabilities that would be deductible from the taxable base when paid should be covered. Therefore it is not an issue of tax base erosion but of deferral. Second, the positive list approach would require the drafting of a list, which is not an easy task (a list would need to be continuously kept up-to-date to the technological development and the new risks linked to it). Finally, if provisions are not deductible, taxpayers might tend to recognise accruals instead; this would require a lot of work on the definition of accruals.

28. Some experts expressed their preference for the general deductibility of provisions; others seemed to be in favour of the positive list. Several experts mentioned that it is important to set up a common definition of (tax deductible) provisions for the CCCTB, which may currently follow from the accounting rules in many tax systems. Some experts commented that under their system, a provision is generally tax deductible if (i) it has been recognised in the accounts in accordance with generally agreed accounting principles and (ii) it is not explicitly disallowed by the tax rules.

29. Another two experts pointed out that the negative list is a more appropriate tool for the CCCTB purposes because the definition of tax deductible provisions allows the setting up of common conditions for when provisions are deductible whereas the positive list would require the setting up of conditions when provisions can be created. They suggested agreeing on principles: if there is a legal obligation to a third party (such as an order from the public authority to clean-up a site for environmental reason) and therefore it is a liability, the amount or the timing of which is uncertain, a provision should be allowed as tax deductible. They found the definition of provisions given by IAS 37 extremely useful also for the CCCTB purposes and stressed that the Group needs to concentrate on definition of common principles not lists of individual items.

30. One expert commented that both points of view were understandable and expressed the opinion that the negative list is closer to the IAS solution which is currently also used in his MS for tax purposes. This expert thought that a negative list with the common definition of tax deductible provisions should provide MS with sufficient protection of the tax base. It was suggested to continue work on this issue in SG2, possibly to compare 'lists' of provisions which are currently allowed in each MS.

Recognition of provisions

31. The Commission Services presented cases where liabilities are difficult to be estimated, such as warranties (although this is not a reason for disallowing them); liabilities related to long-term obligation, such as clean-up costs or pensions; or constructive liabilities in the meaning of IAS 37 (they do not derive from legal or contractual obligation, but from specific corporation policies).

32. An expert commented that in any provision there is an element of uncertainty, this is unavoidable. However, agreement should be reached on possible requirements (such as a time-limit on long term provisions, for example) for such provisions to be deductible.

Legally required provisions

33. The Commission Services recalled that there was general agreement in the SG2 meeting that a kind of "mutual recognition principle" should apply when dealing with provisions required by legislation other than fiscal legislation. However, higher requirements of, for example, the environmental or social legislation in a given MS could result in a reduction of the taxable income which, in the context of consolidation among several MS, could turn into a loss of revenue in another MS. In other words, the risk here is that one MS "pays" for higher environmental or social standards of another MS.

34. One expert found this situation a logical consequence of the existing tax competition among MS and thought that certain level of mutual recognition will be necessary in the CCCTB. Another one suggested that if these differences lead to significant loss of revenues, disallowances or ceilings could be envisaged. Another expert recalled that a provision was linked to a future expenditure. The question was not whether a provision is deductible or not, but whether the cost itself is deductible. This should be dealt with when discussing taxable income according to this expert.

Bad debts

35. The Commission Services opened the discussion by recalling the two main approaches which emerged at the SG2 meeting, and that can co-exist: allowing a provision based on a percentage of the total amount of debts and/or allowing a case-by-case provision for a larger amount. Different rules should apply for financial sectors (banking, insurances, etc.) although such sectors are harmonised at EU level and therefore a common approach within these sectors should be achieved more easily. Specific rules should also apply for intra-group transactions (i.e. arm's length principle) where one of the associated companies does not apply the CCCTB (if it does, the consolidation should eliminate the issue).

36. One expert suggested the level of harmonisation of the financial sector at EU level should not be over-estimated – there are still several important differences. Several experts agreed that clear requirements must be fixed for recognition provisions for bad debt, such as a certain time delay or the start of a civil action to recover the receivables. One expert mentioned that it is also possible to write down the value of the asset instead of recognising a provision.

37. As a conclusion, it was recognised that further work is required in SG2 to progress on outstanding issues (for example, suggestion for items to be inserted in a list of deductible provisions, and how to deal with provisions recognised as accruals for tax planning purposes). The Chair of SG2 agreed to host a third meeting on 26 October. Those Members of the Group who would like to attend should confirm their participation before the end of September.

V. DISCUSSION ON TAXABLE INCOME (WORKING DOCUMENT CCCTB/WP/017)

38. The Commission Services introduced the new Working Document and pointed out that two main elements should be covered. First, how to calculate the taxable income, and second, which kinds of income and expenses are to be taxable / relevant for CCCTB purposes. The two elements may be discussed relatively independently of each other. Experts were invited to express their preliminary views on questions asked at the end of each section of the working document as well as on the issue in general.

39. Several experts gave some preliminary remarks, and confirmed that they would also submit written comments in due course. On the question concerning the method of calculating the taxable income (balance sheet or profit and loss) several experts said that both methods should be somehow combined and a solution where the two could co-exist should be sought. The two systems co-exist already and the method of calculating taxable income should not be changed dramatically, in order to avoid excessive compliance costs for companies.

40. One expert pointed out that in normal double- entry bookkeeping any transaction is recognised as both an item in the balance sheet and an item in the profit and loss account. There are however some transactions that are only recognised in the balance sheet (examples would be provided in writing) so it is necessary to take into account both the balance sheet and the profit and loss statements when calculating taxable income.

41. Several experts commented that in general any income earned by companies should be taxable without distinction, even though some specific items (such as dividends) may deserve a different treatment. As regards deductions, several Members agreed that what is needed is a general and relatively broad definition of tax deductible expenses together with an explicit list of tax not deductible items.

42. One expert mentioned that to be deductible, expense must occur in connection with the carrying out of the business. In addition, the expenses should be deductible only insofar as they served to produce taxable income. However, if income is exempt from taxation, expenses incurred in relation to such income should be non deductible. Another expert pointed out that it should not be possible to distribute untaxed income.

43. As regards recognition, timing and measurement, the Commission Services pointed out that many rather technical issues such as inventory, long term contracts, foreign currency exchange rates revaluations, government grants, etc. are covered in the working document and that the topic of taxable income is relatively broad, so that it would be more practical to deal with details in a smaller group. Therefore the Commission Services suggested creating a new sub-group (SG3). The expert from France volunteered to organise and chair the newly established SG3 and announced that a first meeting could be held on 7 November. Members of the Group agreed that the working document on taxable income together with experts' comments will create a good basis for the work of the SG3.

44. The Chair asked those experts who would like to participate in SG3 to confirm their participation to the Commission Services before the end of September.

VI. DISCUSSION ON THE CONCEPT OF TAX BALANCE SHEET (WORKING DOCUMENT CCCTB/WP/016)

45. The Commission Services introduced a document on the concept of the tax balance sheet. The working document was prepared because at the previous meeting of the Group it was mentioned by some experts that the concept of the tax balance sheet is not completely clear to them so the Commission Services agreed to provide the Group with more information. The purpose of the document is to clarify that a tax balance sheet is one of the possible methods for the determination of taxable income. The document complements parts of working document CCCTB/WP/017.

46. The Commission Services wished to avoid overstating the importance of the tax balance sheet, it should be considered as a possible tool for CCCTB purposes rather than an end in itself. However, some MS use the tax balance sheet for other tax purposes as well (such as inheritance tax) and therefore it can be very important from a domestic point of view in some MS.

47. The Commission Services explained that the document also mentioned the issue of dependency and reverse dependency, to the financial accounts. In a CCCTB context, however, due to the co-existence of 25 domestic accounting rules, a very flexible approach is required concerning dependency from financial accounts. They also pointed out that, at present, they had no preferred solution for which particular methodology to adopt for computing taxable income (balance sheet or profit and loss account).

VI. ANY OTHER BUSINESS AND CONCLUSIONS

48. The Chair informed Members of the Group that the next meeting of the Group is planned for 8 December 2005. Back to back with that meeting, and as announced at the previous meeting of the Group, an extended meeting with representatives from the business community and academics is planned for 7 December 2005.

49. The Commission Services will invite European Federations such as EATLP (European Association of Tax Law Professors), UNICE (Union des Industries de la Communauté Européenne), FEE (Fédération des Experts Comptables Européens), CFE (Confédération Fiscale Européenne), EUROCHAMBRES (Association of European Chambers of Commerce), FBE (European Banking Federation), ERT (The European Round Table of Industrialists), CEPS (Centre for European Policy Studies), AMCHAM (American Chamber of Commerce), UEAPME (European Association of craft & small and medium sized enterprises. It will be for the federations to appoint their representatives (the Commission Services will not send individual invitations to individual experts), with the aim of ensuring the widest representation of countries and sectors as possible. Around 60 experts will be invited at this meeting on 7 December, plus the usual experts from MS administrations.

50. The Chair informed Members of the Group, that the Commission Services will prepare a draft report on the progress made by the Group for the meeting on 7 December. Achievements and outstanding issues, such as for example the choice

between pooling or individual depreciation will be covered by the draft report. It is planned to submit a finalised report to the Council in the form of a Commission Communication in early 2006.

51. As regards the next meeting of the Group on 8 December 2005, the probable items on the agenda will be: (i) the report on the activities carried out by SG2 (after its third meeting in Rome on 26 October 2005); (ii) the report on the activities carried out by SG3 (after its first meeting in Paris on 7 November 2005); (iii) a new working document on another element of the CCCTB, possibly the international aspects of the CCCTB. Members of the Group will have a chance to discuss the draft report (on the agenda of the meeting on 7 December) on 8 December as well if they so wish.

52. The Chair concluded the meeting as follows:

- SG2 will continue its work on the outstanding issues, and in particular on deductibility of provisions. Members of the Group who want to attend should inform the Commission Services before the end of September;

- A new subgroup (SG3) will be established. It will deal with the issue of taxable income. Its first meeting takes place on 7 November. Members of the Group who want to attend should inform the Commission Services before the end of September;

- Members of the Group are invited to provide the Commission Services with their comments on the Working Document on taxable income in writing by 14 October 2005. The replies will create a valuable input for further work of SG3.

- The next plenary meeting of the Group is planned for 8 December 2005. The Commission Services will prepare a working document on a new element as mentioned above. Back to back with this meeting it is planned an extended meeting with academics and representatives from the business sectors on 7 December 2005.