

European Conference on Company Taxation
**EU Corporate Tax Reform: Progress and New
Challenges**

Riforma della tassazione societaria nell'UE: sviluppi e nuove sfide

Ostia, 5 and 6 December 2003

Session 2 – 'Pilot schemes as a concrete way of making progress towards an Internal Market without company tax obstacles'

Speech by Robert Verrue, Director-General 'Taxation and Customs Union', European Commission

Good morning ladies and gentlemen,

I am very pleased to be able to participate in this morning's session, and with such a distinguished panel assembled I look forward to a very interesting debate.

In his opening address yesterday Commissioner Bolkestein emphasised some key points and the main political messages in the Commission's recent company tax Communication 'An Internal Market without company tax obstacles: achievements, ongoing initiatives and remaining challenges'. He went on to say that I would be giving a more detailed overview of the contents this morning.

Two areas have already been covered in some detail yesterday in the sessions on the role of Community law and the consequences for the tax treaty policies of EU Member States. I won't add anything on these this morning.

I propose, therefore, first to outline briefly the state of play today - how far we have got as regards implementing some specific aspects of our 2001 strategy – and second, to focus on the way forward for the future.

I don't want to give the impression that our achievements to date as regards the 'short term' targeted measures are somehow less important, but you can read about these in the Communication itself. I should like to take this opportunity to go into our plans for the future in some more depth. By concentrating on these future plans I believe we can make the most of this gathering of distinguished tax experts and, through debate and discussion, move closer to achieving our goals.

So I start with a brief outline of the state of play.

As regards the 'short term' targeted measures I am very pleased with progress to date on the revisions to the two company tax directives – the Parent/Subsidiary Directive and the Merger Directive. We at the Commission have delivered on our commitment to bring forward proposals for revision.

The Council has effectively reached political agreement on the Parent/Subsidiary Directive and the formal opinion of the European Parliament is expected in the near future.

Technical discussions in Council on the Merger Directive have already started and I am optimistic that rapid progress will be made.

I should like here to draw particular attention to the work of the Italian Presidency which has included these Directives in their priorities. We will all benefit from their hard work.

The Joint Transfer Pricing Forum is also well established, bringing together representatives from tax administrations and the business world to consider pragmatic non-legislative responses to the growing problems associated with intra-group transfer pricing. Good progress has been made, not least thanks to the skilful President of the Forum Mr Bruno Gibert, and an interim report to Council is expected in the new year.

Finally I should also mention our work on two other issues highlighted in 2001. We are advancing in our analysis of the dividend taxation of individuals and work is now underway on a legal analysis of cross – border loss relief possibilities. We hope to issue a Communication on Dividends before the end of the year. We will also issue a Communication on loss relief, but here, mindful of the complexity of the subject and the outcome of cases currently with the European

Court of Justice, we do not expect to complete work until late next year or early 2005.

Such targeted measures are important because they can help resolve some of the tax obstacles to cross border trade. But we all understand that a more comprehensive solution is the only long term answer and I should like now to turn to our plans in this field.

As you are aware the Commission's long term goal is to provide companies with a consolidated corporate tax base for their EU-wide activities. We see many advantages in this – I don't think I need to go into them in any detail here. I should just like to comment that, as we consistently emphasise that the setting of the tax rate would remain a Member State decision, we are somewhat surprised by the tone and content of some of the criticisms that are reported in some Member States. But I shall return to the role of Member States later.

In our view a common base would be much simpler for companies, more appropriate for the Internal Market and, since the effective tax rate would become more transparent with a common base, we also believe that fair tax competition between Member States would be encouraged.

In our Communication we report on the work we have been doing over the last two years. Principally work on Home State Taxation and work on the possibilities that the new common accounting standards – the International Financial Reporting Standards (formerly known as

International Accounting Standards or IAS) – create for designing a common tax base. We also of course draw attention to the need for a mechanism for sharing the EU tax base between Member States and outline our work in this area.

The Home State Taxation project is the more advanced. First, I should like to emphasise that we view Home State Taxation as a targeted measure which can be brought in relatively quickly to address some specific obstacles which Small and Medium-sized Enterprises experience. We do not think Home State Taxation is the longterm answer for large companies and that is why we continue our research into a common tax base. Indeed, in the long term, when a common tax base is introduced there is no reason why it should not eventually apply to all companies including Small and Medium-sized Enterprises. However, I'm looking a long way into the future here; let's get back to our present plans.

Home State Taxation applies the Internal Market principle of mutual recognition to company taxation and permits companies to calculate their tax base in accordance with a single set of rules – those of its 'home state'. It does not entail any form of tax harmonisation. We believe that this initiative addresses precisely the tax issues which hamper Small and Medium-Sized Enterprises (SMEs) the most. Compliance costs are often disproportionately high for SMEs and the current lack of cross border loss relief hits SMEs particularly hard. SMEs are one of the key drivers in economic growth and job creation in the EU. In other words, if we provide assistance to SMEs, we in

the Internal Market will all benefit. It is for these reasons that we have suggested a pilot Home State Taxation scheme for SMEs.

Our consultation exercise earlier this year demonstrated that it has the support of many interested parties, federations and academics. We have not solved all the potential problems but we have identified the critical areas we must concentrate on when developing the detailed arrangements for how the pilot scheme could be introduced. These are as follows:

- It must obviously be a practical test; theoretical modelling will not provide sufficient evidence of the benefits for SMEs.
- We will have to start from the existing EU definition of SMEs, although we recognise that there could be some form of proportionate reductions in some of the figures.
- The test will have to run for about five years and we will need to work on special rules for some of the complex situations which might arise – such as changes in ownership, etc.
- We should also be realistic - extending the pilot project to partnerships and to other taxes such as VAT would be preferable, but would probably too complex for a pilot.
- We also need to ensure that the formalities of submitting tax returns can be kept to a minimum; submitting a combined return to the Home State for distribution should be sufficient.

- Similarly we will have to keep the 'share out' of the consolidated base as straightforward as possible. It will be a great advantage to make use of the home state domestic group tax provisions and we must ensure that these benefits are not 'clawed back' by introducing a complex apportionment or sharing mechanism. To this end we currently believe a simple formula, perhaps based on payroll or number of employees should be sufficient, given the likely sizes of tax bases being shared between Member States.

There will be other issues which we will also have to resolve and over the next twelve months my staff will be arranging meetings with interested parties and Member States to work on the details.

The involvement of Member States is obviously crucial – this is not an initiative that the Commission is going to propose formally as a Directive or Regulation.

Member States could indeed, in theory, establish independently a Home State Taxation system or systems by bilateral or multilateral agreements, although without coordination at the EU level many of the advantages could be lost.

What the Commission is suggesting is that we work together with the interested parties and Member States to resolve the outstanding issues.

The Commission will then come forward towards the end of next year (2004) with some form of recommendation of how the pilot scheme could be introduced. This will attempt to provide a 'blueprint' or best practice statement on the pilot scheme. It will then be for Member States to implement a pilot or pilots, although obviously over the next few months we hope to be able to work with Member State administrations to produce such a model which is workable and acceptable to them.

I should like now to turn to another possible pilot scheme, this time not based on existing tax systems in the way Home State Taxation is, but on a genuinely new common tax base.

This is the possibility of a pilot scheme for companies created under the European Company Statute – *Societas Europaea*.

We believe that this new corporate form is in danger of being under-used precisely because it does not have a European tax system to match its European corporate form. Its tax treatment under the existing rules is no simpler than the current treatment that companies experience when they operate across the EU. Indeed in some ways its tax treatment is more complicated simply because it is a new form. It certainly does not provide any tax advantages over a traditional group structure, be it based around separate subsidiaries or branches in different Member States.

The *Societas Europaea* therefore deserves attention. At the same time we are already working on the long term goal of a common tax base. If we can resolve the potential discrimination issues surrounding a pilot scheme then it could make sense to introduce such a tax base as a pilot, rather than attempting to introduce it for all companies at the same time in some sort of 'big bang' approach.

Hence the concept of a pilot for *Societas Europaea* was born. Here we have an EU corporate form in need of an EU tax base whilst at the same time we are working on a common tax base which we will need to 'test' at some stage. By piloting such a base with a new corporate form we also of course avoid many of the transitional issues which existing corporate structures would present.

However, we are at an early stage – and we recognise that not everyone is convinced about the wisdom of such a pilot scheme in the first place, and others question why the *Societas Europaea* should be singled out. We believe it is worth examining and we have recently commissioned a study by outside experts to consider in more detail the potential discriminatory aspects of such a pilot.

However, before we can recommend a pilot scheme we first have to have a 'common base' system to pilot! I shall now try and outline our views in this respect.

Designing a new tax base is a major exercise. We can take one existing tax base and try and adapt it for wider use, or in our case

take twenty five and try and merge them into one. Or, we can lock a group of experts away and 'wait for the white smoke to emerge' to indicate that they have completed their task – and then try and sell the new idea to administrations and business. Or, we can do as we have doing for the last couple of years and take a pragmatic approach.

As from 2005 every listed company in the EU, and by implication their subsidiaries, will be recording and collecting accounting information in accordance with a common set of accounting standards – the International Financial Reporting Standards (IFRS). The listed companies will then be publishing consolidated accounts in accordance with these common standards.

We consider this development to have major implications for the creation of a common tax base.

Indeed in our recent Communication we ask the following question: 'If EU companies are reporting profits according to a common standard why not use this common measure of profitability as a starting point for taxation purposes?'

Well, we had already been working on this before we posed the question. Earlier this year we held a workshop with interested parties and published a consultation paper for comment. On the basis that the accounts would represent at most a starting point for arriving at a

tax base, and not the tax base itself, we identified a number of key areas of particular interest.

These included inter alia questions concerning the general principles of these accounting standards and their relevance and applicability to taxation, the number of companies likely to adopt IFRS, the possible use of the consolidated accounts as the starting point and the mutual dependency of accounting and taxation.

We had a very good response with a large number of detailed submissions. Some were in favour of using the new accounting standards as the starting point, some against, but in general there was widespread support for the concept of a common base. Some aspects would clearly require particular attention.

For example where 'fair value' accounting is applied there was almost unanimous agreement that the taxation of such unrealised gains would have to be avoided by adjusting the accounting profit to arrive at the taxable profit.

Similarly the number of companies who can use International Financial Reporting Standards when they file their individual statutory accounts was also a major issue.

I could continue for some time reporting the detailed comments and our detailed conclusions but you may read these at your leisure – either by consulting the report of the consultation on our web-site or

by reading our recent Communication. What I should like to explain in more detail is what we plan to do over the next couple of years.

First we recognise that accounting dependency, by that I mean the linkage between the financial accounts and the tax base, is key. Not just to a common tax base explicitly derived by adjusting the accounts but to any common tax base. At the moment Member States have varying degrees of dependency and this might cause problems for any common tax base. We are therefore proposing a sort of 'Accounting dependency group' where we would meet with Member States to understand better how this linkage works in each Member State.

In this group we would also seek to better understand how the introduction of the new accounting standards is already affecting their tax bases. We also need to discuss with Member States how they are going to respond to the option contained in the Regulation which gives Member States the option of permitting or requiring companies to prepare their individual accounts in accordance with the new standards. Extending this to a wider range of companies is one of the key issues which emerged during our public consultation as it determines to a certain extent how much we can rely on these new standards as a 'building block' for a common tax base.

We are also planning to arrange for experts to meet to discuss in more detail the tax principles to be applied. For this we believe we can benefit from input not only from administrations but also from

outside experts. We want to avoid arguments over which existing tax system is 'best' and believe therefore that approaching individual structural elements of the tax base via a review of individual International Financial Reporting Standards can provide us with a neutral starting point.

So, to sum up the current state of play:

We have just released a Communication which confirms our 2001 twin track strategy, and reports on progress to date.

We are making good progress on the targeted measures.

We are also moving closer to providing a solution for Small and Medium-Sized Enterprises by finalising the details for a recommended pilot Home State Taxation scheme.

We are also progressing on the wider long term goal of a common consolidated tax base.

We believe that the new accounting standards can help us in this work and we propose two approaches. First, we want to examine with Member States the issue of accounting dependency, and deepen our research into the implications of the new standards and their possible use by a wider range of companies. Second, we want to work, with Member States and the business world, on some of the detailed tax principles to be incorporated into any common tax base. International

Financial Reporting Standards are not the 'finished article' as regards a tax base, but they represent a very powerful tool to use in the construction of such a base.

Finally, I said I would return to the issue of Member States' support.

We clearly need their support, and we need to keep reminding them that a common tax base does not necessarily mean a common tax rate – setting tax rates will remain a decision for Member States. And here we need the help of business, which needs constantly to make the case for removing tax obstacles and improving the Internal Market by moving towards a common tax base.

Contrary to what some politicians want to make you believe, we do not have an inherent desire for tax harmonisation.

All we want to do is to create a sound tax framework for companies engaged in cross-border economic activities in the Internal Market.

We will also need business input for our developing work on the allocation or tax base 'sharing out' mechanism – but time is short and I think that is a subject for another day...

Ladies and gentlemen, thank you for your attention. I hope I have managed to 'flesh out' some of the details behind the Commission's company tax policy and I look forward to the rest of this morning's session with great anticipation.