

**Summary Report on the results of the DG Taxation and Customs Union open consultation on *The application of International Accounting Standards (IAS) in 2005 and the implications for the introduction of a consolidated tax base for companies' EU-wide activities.***

## **Introduction**

This document summarises the results of the recent public consultation.

The consultation was opened in February 2003 and officially ended on 30 April. A few responses were not received until May but these were all accepted. The consultation document was made available on the *Company Tax Web-site* and included a series of specific questions. A workshop with various federations and interested parties was also held in Brussels in March to discuss the document and a summary report of this was made available at the beginning of April.

Forty five contributions were received from a variety of national and European federations, organisations, academics and individuals. A complete list of contributors is attached as appendix 1 together with a breakdown of the type of organisation. The majority of the contributions were relatively detailed and this document attempts to summarise the overall responses rather than each individual contribution. Many contributors prefaced their responses to the specific questions with general comments on company taxation policy and in some instances on accounting policies and the summary includes a general section which summarises these where appropriate. This is followed by a summary of the responses to the specific questions in the consultation document.

Not all contributors addressed each question in the document and where the summary refers to 'most' or 'the majority', or a 'few', 'others' etc this generally means 'most of those contributors who responded specifically to this question' etc.

The summary does not present any conclusions. It simply summarises the written responses received. The evaluation of these and the conclusions to be drawn are continuing and will be included in a Commission Communication on Company Taxation planned for Autumn 2003 (as a follow up to the October 2001 Communication and Company Tax Report). In drawing conclusions the results of internal research and informal discussions with administrations and interested parties will also be taken into account.

DG Taxation and Customs Union would like to formally thank all those who responded to the consultation.

## **General**

Nearly all contributors welcomed the opportunity to comment on this aspect of EU company taxation policy at such an early stage in the process. Nearly all expressed themselves supportive of the establishment in principle of a common tax base, although a small minority were against the basic concept of a common base across the EU. Some expressly offered no comment on the need or desirability for a common tax base but nevertheless addressed the questions.

Some expressed doubts about the need or desirability for such a common tax base to include consolidation: for some the ‘prize’ of having common rules across the EU was sufficient. One proposed that if such a base were introduced with an appropriate allocation system Member States should be free to make their own specific adjustments to their allocated share of the consolidated base.

A minority of contributors questioned the sequence of the Commission’s work. They considered that no work should be carried out by the Commission on how to define such a tax base until Member States had agreed in principle to establish such a base. Several expressed doubt over the likely success of introducing a common tax base given the current requirement for unanimity. Several considered it premature to evaluate the implications of IAS while so many IAS were under review and before a body of experience had been built up on the implications of the change from national accounting standards. Conversely, a few contributors pressed for early action by the Commission before Member States responded individually to the introduction of IAS and possibly arrived at a range of different reactions, further fragmenting tax bases in the EU.

Many contributors called for additional research, in particular into the specific differences between IAS and individual Member State tax rules and several suggested quantitative simulations should be prepared. Some suggested that studies should be made to review the extent to which Member States use taxation to achieve specific policy objectives as this could be an important factor in agreeing a common base. Some stressed the need for neutrality if such a new tax base should be introduced, a few took the opportunity to itemise transactions which are generally not tax deductible but which should in any new system be tax deductible.

Some contributors concentrated on the particular situation of their business sector. The insurance and banking sectors in particular were concerned about specific aspects of certain IAS and the future IAS concerning insurance accounting. Similarly one contributor was specifically concerned about the implications of IAS inventory valuation rules for their sector. Several contributors concentrated on national issues rather than community wide issues, viewing IAS from a national rather than community perspective, although one contributor commented that the EU should learn from the USA and Canada where they have a single tax base. A number preferred a ‘clean sheet’ approach: arguing that the perfect solution could only be achieved by designing a tax base from first principles. One contributor computed the effects of an IAS-based tax base on the average tax burdens across eleven business sectors in four Member States and concluded that the introduction of such a base would have only a minor impact on the effective tax burden if IAS were restricted to the core elements. Several stressed that as the only common starting point IAS financial statements were the logical, neutral, starting point for the design of a common tax base. Some suggested that problems arising from the evolving nature of IAS could be avoided if the common base were initially defined in relation to the existing IAS base but was not linked thereafter, ie there would be no need to amend the base each time an IAS standard was amended or a new one introduced etc.

### **Responses to individual questions**

(reference numbers refer to paragraphs in the Consultation Document)

### 3.1

Concerning the 'legislative' framework for the preparation of IAS -

**The current endorsement procedure of IAS provides Member States with the necessary level of 'control' over accounting standards in the EU. Could it be extended or supplemented to provide sufficient taxation input for IAS to form the starting point for the tax base? (section 3.1)**

The majority of contributors did not comment specifically on the existing level of Member State 'control' but a few did not agree that the current endorsement procedure provides sufficient 'control' over the accounting standards. Their arguments included the assertion that there was a lack of parliamentary scrutiny (both at the domestic and European level) and some suggested that the Accounting Directives should be further developed instead of endorsing IAS and at the same time extended to include taxation. A few contributors also felt that business was not adequately represented in the current endorsement procedure and that more business input would be desirable in any taxation initiative, although the majority made no specific comment on this.

The issue of parliamentary, or democratic, accountability was also raised in connection with any procedure for agreeing on an IAS derived tax base. The fact that the IAS board is a private body was specifically mentioned by several contributors as problematic. Several contributors highlighted the fact that the Accounting Regulatory Committee operates on a qualified majority basis and felt this would be completely unacceptable for taxation as a policy area currently requiring unanimity. However, it was not always clear whether contributors supported the retention of unanimity voting, or whether they were simply commenting that as long as unanimity voting were in place it would be unacceptable to circumvent this via the delegation of certain decisions to a committee operating with qualified majority voting. A few contributors expressly stated that either qualified majority voting, or the use of enhanced co-operation would be necessary for a common consolidated tax base to be introduced.

Overall the majority of contributors concluded that extending the existing endorsement procedure was not advisable since the endorsement of accounting standards should be kept separate from the establishment of a tax base. However, the framework (effectively an expert committee examining the issues in detail) could be usefully developed providing the issues of parliamentary scrutiny and majority or unanimous voting could be resolved.

### 3.2

Concerning the general principles which underpin IAS –

**Are IAS too 'investor orientated' for the tax administration to use them as the primary source for determining the taxable base? To what extent do the IAS principles of materiality, fair value and 'substance over form' conflict with taxation principles? Could any conflict be resolved by the provision of supplementary supporting schedules provided specifically for taxation purposes? (section 3.2)**

It was generally accepted that IAS are primarily ‘investor orientated’ and the three principles identified by Commission were of particular importance. Nearly all contributors rejected the taxation of unrealised gains, although a number pointed out that it would be relatively straightforward to adjust any IAS statements to remove these. [Indeed the opening summary of the Consultation Document states, ‘It is clear that IAS accounts would represent at the most a starting for arriving at a tax base and not the tax base itself.’] A small minority suggested that theoretically a fair value approach could be acceptable for a tax base but in practice this was unlikely to be acceptable or advisable. A number of contributors, principally from the banking and insurance sectors, made detailed comments about the application of fair value accounting to their sectors from an accounting perspective.

Materiality was considered to be less of an obstacle: although some contributors felt it was an issue, others were keen to stress that it could be resolved without much difficulty. Similarly, reactions to the principle of ‘substance over form’ were mixed. Some contributors felt this was a major issue which would lead to significant uncertainty, others felt that it could be dealt with without too much difficulty. The concerns centred on potential unequal treatment, if for example companies were applying the principles differently; and on the potential volatility that could be introduced into the results. A relaxation of loss carry back and forward rules was mentioned as a possible solution to this volatility.

Most contributors who mentioned supplementary schedules agreed that these could usefully resolve some or most of the issues, although a few raised concerns about the potential extra administrative work these might involve. A few stressed that these must be kept confidential: part of the tax return rather than the accounts themselves. [The document does not specify which schedules should be public but was prepared on the assumption that the current rules on confidentiality of tax returns would be maintained]

Overall contributors were concerned about the three main principles identified by Commission, but a number explained how these concerns could be resolved. This was principally by disclosure and the establishment of common interpretation of how to apply them – including specifically the removal of any unrealised gains from the tax base. For a number of contributors the biggest problem was the potential lack of equality between large and small companies if a tax base were based on IAS (this was also addressed under the following question – 3.3).The proposed new IAS on Performance Measurement due to be published for discussion later this year, with its disclosure in columnar form of the ‘ordinary income’, re-measurements, and ‘reported income’ was mentioned by a number of contributors as a potentially useful development. The ‘general principles’ approach of IAS was also of concern to a minority of contributors who felt that companies had too much flexibility in applying the principles as opposed to applying specific taxation rules.

### 3.3

Concerning the number of companies likely to adopt IAS -

<b>If only a limited number of companies use IAS is it appropriate to design a common tax base around IAS? (section 3.3)</b>
--

Nearly all contributors believed that a common base based on IAS must be available to all companies, and therefore for such a base to be acceptable all companies must be able to use IAS. Currently the use of IAS for other than the consolidated accounts of some 7,000 EU listed companies is subject to authorisation by individual Member States. These Contributors variously considered that it would be discriminatory, could lead to unfair competition and/or unequal treatment if a common tax base were not open to all companies. A few suggested that this would not be a problem in practice as many Member States will eventually permit IAS reporting and that where they did not local GAAP would inevitably evolve towards IAS to such an extent that they could be considered to be using IAS and therefore eligible to use an IAS derived tax base. A few thought it should not be problem if a limited number of companies were eligible initially.

### 3.4

Concerning the potentially most significant attraction of a common tax base, the fact that it is consolidated, and the IAS Regulation is specifically directed at consolidated accounts –

**Which of the two approaches is preferable – adjusting IAS consolidated accounts to arrive at a consolidated tax base; or creating a tax specific method of consolidating the accounts of individual subsidiaries? (section 3.4)**

A number of contributors described the issue of consolidation as the most difficult. Some felt it was too early in the process to have a view, they could only form one when the mechanics of consolidation, including group definition, treatment of non EU activities etc had been studied in much greater depth. Some thought consolidation should be considered as a separate step – the establishment of a common tax base, applied individually by each Member State should be the focus of current work leaving consolidation for the future. Some were doubtful if consolidation were desirable in any case, although others stressed its importance as an integral part of a tax strategy for the EU, necessary if the Lisbon goals were to be achieved. It was also suggested that the current lack of cross border consolidation could be considered as a contravention of the EU Treaty [ presumably a reference to freedom of establishment].

Some considered that the allocation method was crucial to any discussion of consolidation and should be analysed at the same time. The potential cost to companies of any change was also mentioned as a factor to be considered along with the audit implications. One contributor suggested that the arms length principle should be maintained within any consolidated common base and that only net profits and losses established under separate accounting principles should be offset. This was founded on the opinion that an allocation by formula apportionment would not be acceptable under many Double Tax Treaties, for example it might cause problems over the creditability of EU taxes under some Treaties with third countries.

Opinion was divided over the precise question asked – whether the IAS consolidated accounts should be the starting point or whether a ‘tax specific’ consolidation process should be established. A majority favoured a tax specific process mainly because of unanswered questions over the definition of a group and what to do about non-EU activities. Even if it was not clear now how to deal with these it was generally felt

unlikely that the IAS consolidation would be acceptable without adjustment and the scale of adjustments would be such that there was no advantage in starting with IAS consolidated figures. It was also mentioned that care should be taken to ensure that actions to simplify activities in the Internal Market did not make trade outside the EU more difficult or complex – a reference to the potential complexities of extracting EU data from global consolidated accounts.

### 3.5

Concerning the principle of dependency, an issue which is not unique to a common tax base derived from IAS accounts –

**Is ‘dependency’ sustainable if a common tax base is adopted across the EU? Can the additional features currently secured via dependency, be provided without requiring dependency? (section 3.5)**

Many contributors approached this question from their own specific national experience. Contributors who were used to a system with strong dependency tended to be concerned that any movement away from dependency could result in duplication – companies would have to maintain two sets of accounts, one for tax, one for statutory accounting. Where contributors were used to weaker dependency they tended to view a weakening of the links as inevitable, although the need for reconciliation was stressed. Some European contributors were undecided or divided. One contributor thought it was not feasible to retain dependency if standards were set without reference to tax implications. Some felt it was no longer an issue as dependency was gradually being eroded throughout the EU. The need for a thorough study of individual IAS before reaching a conclusions was also stressed. The treatment of dividends, capital gains and fair value adjustments was highlighted as a particular factor to be considered.

### 3.6

Given the number of fundamental questions raised concerning the use of IAS some consideration is also given to alternative methods of establishing a common tax base. In particular the possibility of creating a series of ‘Tax Recommendations’ is suggested, which could themselves make use of IAS –

**If using IAS as a starting point for a common base is too ambitious does the existing framework for introducing IAS provide a useful example for how specific tax Recommendations could be introduced? Should such Recommendations seek to define only the tax base itself or seek to explain how to adjust IAS based figures to arrive at the recommended tax base? (section 3.6)**

Contributors were divided on the comparative merits of Regulations, Directives and Recommendations. Regulations were felt by some to be the better way forward, others thought these were weaker as they removed individual parliamentary scrutiny, [Regulations are directly applicable, the effect of Directives has to be transposed by way of national legislation approved by individual Member States parliaments – although they can in certain cases be directly applicable, Recommendations carry no actual legal authority]. Recommendations were favoured by some contributors as the only realistic way of proceeding, a good start and could be useful. Other contributors thought they would not bring about the necessary convergence and although they

might lead to a degree of approximation they would never lead to the uniformity of treatment required for a common base.

Several identified the key factor as the likelihood of Member States supporting one or other approach. There seemed to be a general recognition that a tax base has to be founded on legislation – ie Directives or Regulations but several contributors were prepared to accept Recommendations as being the more realistic method of moving towards a common consolidated tax base. The size of the task of obtaining agreement to Directives was mentioned by several contributors and some preferred not to comment other than along the lines that the method of introducing a common base was a matter for Member States. One contributor specifically rejected the concept of an ‘EU Tax Board’ establishing best practice, Recommendations or guidelines as unwelcome by both companies and MS.

As regards whether the instruments should seek to define the tax base or the adjustments to IAS required to reach the tax base most of those contributors who commented did not think it really mattered. However, those who supported Recommendations tended to assume these would recommend how to adjust from IAS and those who favoured Directives assumed it would be the tax base itself which would need to be defined – not least because of the tendency for IAS to evolve over time.

### 3.7

Finally, the particular situation of the *Societas Europaea* is discussed which because of its specific form could be an example of how IAS could be exploited from a tax base perspective without some of the difficulties which a wider application might involve.

<p><b>Is the SE an appropriate corporate vehicle for establishing a pilot project for a common tax base based on IAS? If yes, what additional practical steps would be required to implement this? (section 3.7)</b></p>
--

Contributors were divided on this question. Some were against the idea of a pilot in principle, some pointed out that the ‘newness’ of the SE entity would make it difficult to evaluate the results of a pilot. Other contributors thought the SE an appropriate vehicle for a pilot, although the terms would have to be very clearly defined (eg length of time, treatment if pilot ended etc). The risk to MS revenues was considered to be lower if the SE were the pilot, but some thought a ‘simulation’ pilot would be better than an ‘actual’ pilot. The need for an impact study before implementation was also mentioned. One contributor emphasised that the issues to be resolved were exactly the same for an SE as for any other company, in particular an allocation mechanism would be required; although it was also pointed out that the transitional issues should be more straightforward with new SEs.

Problems with competition and discrimination were also raised by some contributors, although the existence of similar inequalities within existing systems between different forms of entity was also pointed out. Some were reluctant to single out the SE for special treatment, others thought it was necessary to ensure that that the SE succeeded as a corporate form. Another contributor thought that a new untried tax base might deter companies from establishing an SE because of uncertainty. The avoidance of consolidation issues (an SE could operate as a single entity across the

EU without needing to produce separate branch accounts for consolidation) was seen as both an advantage – simplicity; and a disadvantage – the pilot would not ‘test’ any consolidation methods. One contributor suggested Home State Taxation would be more appropriate for SEs although very large companies should not be eligible for any such scheme.

## **Contributors to the consultation**

	<b>Name</b>		<b>Type</b>	<b>Lang</b>	<b>Nationality</b>	<b>Sector</b>
1	EBIT		Assoc	EN	Euro	General
2	Fédération Bancaire Française		Assoc	F	French	Insurance
3	Fédération Française des Sociétés d'Assurances		Assoc	F	French	Insurance
4	Verband der Chemischen Industrie		Assoc	DE	German	Chemicals
5	Association Française des Sociétés Financières (ASF)		Assoc	F	French	Finance
6	Institute of Directors		Assoc	EN	UK	General
7	Wirtschafts Vereinigung Metalle (WVM)		Assoc	DE	German	Metals
8	Japanese Business Council in Europe (JBCE)		Assoc	EN	Japan	General
9	Industriellen Vereinigung		Assoc	DE	Austrian	General
10	Association of British Insurers		Assoc	EN	UK	Insurance
11	Federation of Enterprises Belgium (FEB)		Assoc	EN	Belgian	General
12	Bundesverband Deutscher Banken (BDB)		Assoc	EN	German	Banking
13	British Vehicle Rental & Leasing Association (BVRLA) }		Assoc	EN	UK	Leasing
14	European Car and Truck Rental Association (ECATRA) }		Assoc	EN	Euro	Leasing
15	European Savings Bank Group		Assoc	EN	Euro	Banking
16	Bundessteuerberater Kammer (BStBK)		Assoc	DE	German	Professional
17	Comité Européen de Assurances (CEA)		Assoc	EN	Euro	Insurance
18	Mouvement des Entreprises de France (MEDEF)		Assoc	F	French	General

19	General Association of German Insurers		Assoc	DE	German	Insurance
20	Prof.Dr Andreas Oestreicher and PD Dr.Christoph Spengel		Individ	EN	German	Academic
21	Jacek Safuta		Individ	EN	Polish	Individual
22	Dipl.-Kfm. Klaus Feinen		Individ	EN	German	Academic
23	Professor Rädler		Individ	EN	German	Professional
24	Professor Jaress		Individ	DE	German	Academic
25	Mr Graeme Macdonald		Individ	EN	UK	Academic
26	Mr Adam Craig		Individ	EN	UK	Individual
27	Price Waterhouse Coopers	(Two)	Prof	EN	Euro	Professional
28	Law Society of England and Wales		Prof	EN	UK	Professional
29	Linklaters de Bandt		Prof	EN	Belgian	Professional
30	Groupe d'études et développements (GED)		Prof	F	French	Professional
31	ICAEW Tax Faculty		Prof	EN	UK	Professional
32	Confidential	Confidential	State			State
33	European Banking Federation (FBE)		Assoc	EN	Euro	Banking
34	Conseil Supérieur de l'Ordre des Experts-Comptables		Prof	FR	French	Professional
35	Confederation of Swedish Enterprise		Assoc	EN	Swedish	General
36	Fédération des Experts Comptables Européens (FEE)		Prof	EN	Euro	Professional
37	VNO - NCW		Assoc	EN	Dutch	General
38	BITKOM		Assoc	DE	German	General
39	AFEP AGREF		Company	FR	French	Company

40	European Association of Cooperative Banks (EACB)	Draft	Assoc	EN	Euro	Banking
41	DATEV		Company	DE	German	General
42	Tax Executives Institute (TEI)		Assoc	EN	Euro	General
43	Chartered Institute of Taxation (COIT)		Prof	EN	UK	Professional
44	Union of Industrial and Employers' Confederation of Europe (UNICE)		General	EN	Euro	General
45	German Association of Chambers of Commerce & Industry (DIHK)		General	DE	German	General

		European	State	Austria	Belgium	France	Germany	NL	Japan	Sweden	Poland	UK
<b>Academic</b>	4						3					1
<b>Individual</b>	2										1	1
<b>Banking</b>	4	3					1					
<b>Finance</b>	1					1						
<b>Insurance</b>	5	1				2	1					1
<b>Leasing</b>	2	1										1
<b>Chemicals</b>	1						1					
<b>Metals</b>	1						1					
<b>General</b>	15	4		1	1	2	3	1	1	1		1
<b>Professional</b>	9	1			1	2	2					3
<b>State</b>	1		1									
	45	10	1	1	2	7	12	1	1	1	1	8