EUROPEAN BUSINESS INITIATIVE ON TAXATION

Enabling Business Innovation

IAS CAN ONLY BE A STARTING POINT TO DETERMINE A TAX BASE

EBIT contribution to the EC consultation on IAS and the CCTB

(1) This paper forms the contribution of the **European Business Initiative on Taxation** (EBIT)[1] to the Commission's Consultation Document 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. In this paper, EBIT is only commenting on the suitability and use of IAS as a consolidated tax base, and not on the IAS standard itself.

EBIT is a group of leading European-based businesses, which was created in September 2001 to respond to the challenge of modernising direct tax policy in Europe, in order to facilitate business compliance with tax regulations and optimise the environment businesses operate in.

EBIT thanks the Commission for opening consultations with stakeholders on this important issue at this early stage, especially as it sees this consultation as a first step in a long-term process.

This paper has been produced by the tax practitioners working in EBIT with the support of a team of experts from PricewaterhouseCoopers. It contains the collective views of EBIT and should not be read as a point of view of any individual member of EBIT or of PricewaterhouseCoopers.

(2) Based on its experience and work, EBIT believes that **IAS as such are not appropriate to determine a tax base**, the accounting and the tax logic being two separate worlds. Accounting standards generally are based on conservative principles and seek to match revenue and expenditure, whereby consistency

1 The European Business Initiative on Taxation currently includes Buhrmann, Cisco Systems, Deutsche Post, Ford, General Electric, Hewlett-Packard, Microsoft and Nutreco.

between years and materiality are important concepts. Income tax accounting, on the other hand, is generally based on statutory rules which are designed to raise revenue, associate the payment of tax with the realisation of revenue (i.e. tax gains when cash is present rather than on a mark to market basis), and may include provisions designed to reach politically desirable objectives or reduce non-desirable behaviours.

(3) EBIT would also like to point out that the fact that IAS only applies to about 7000 multinational corporations raises important questions, for example:

- What would be the base for all the other companies?
- How would discrimination be reduced?

(4) However, a European-wide common consolidated tax base (CCTB) can offer some advantages for the Single Market and for business, and EBIT is keen to contribute to the discussion on whether IAS can be of help in this respect, e.g. by providing a starting point. EBIT believes that **two essential conditions have to be met** in this perspective. IAS could only be considered for tax purposes if its use remains:

- '**tax neutral'**, i.e. it does not lead to an increase in the levels of current overall taxation nor in the related administrative burden;
- **optional**.

(5) It is clear to EBIT that IAS accounts will require significant adjustments to arrive at a consolidated tax base, and EBIT feels that further in-depth studies are needed in this respect.

EBIT is grateful to the Commission for opening this debate now and, in line with its commitment to engage in a constructive dialogue, it will be happy to further contribute to this debate.

(6) On the road to a CCTB, EBIT thinks that the exact role of IAS should be made clear and that progress and success will be conditioned by a progressive approach based on in-depth studies and further consultations.

What role for IAS in taxation?

(7) EBIT is of the opinion that IAS should only be considered if the benefits of simplification and cross-border consolidation clearly outweigh the cost of change and uncertainty for business and administrations alike.

(8) EBIT understands that the Commission intends to adopt a pragmatic and 'tax-neutral' approach toward using IAS for tax purposes, and warmly welcomes this. However, EBIT is concerned that the use of IAS could effectively lead to an increase in the level of taxation and that businesses could for example end up being taxed on unrealised profits.

(9) Fair value accounting principles would have a significant impact on taxation. EBIT agrees with the conclusions of the Commission's recent Company Taxation Study (p. 321):

> "*The Council has recently adopted a directive*[2] *allowing Member States to permit or impose "fair value accounting" for certain financial assets and liabilities. This new approach will essentially remove the traditional realisation principle (i.e. profits are only accounted for when they are "realised" in a clear transaction). Instead of transactions simple value changes would constitute the accounting base; financial instruments are thus valued at market value (instead of historic cost). Thus, the linkage between financial accounts and tax accounting becomes virtually impossible*".

(10) A system that would tax consolidated profits (offsetting cross-border losses) and suppress the burdens of transfer pricing could be appealing. However, if this would mean relying on formulary apportionment, EBIT believes that, at this stage of the debate, the lack of empirical evidence stands in the way of forming any sensible and rational opinion.

As a group of expert practitioners, EBIT would find it adventurous to move into such a direction. Critical questions must be addressed before considering any apportionment systems; these include *inter alia*:

- What is the cost of change for business and for administrations; when will these be absorbed?
- How are companies audited (e.g. in the Member State of the head office)?
- What is the impact of the level of trust between Member States' administrations?

(11) Still, EBIT would see benefits if transfer pricing practices could rely on a common EU-wide accounting system.

(12) EBIT sees the Societas Europaea (SE) as an appropriate pilot project for a CCTB and it therefore welcomes the Commission's recent initiative for a

2 Adoption on 31 May 2001 of the proposal for a Directive of the European Parliament and of the Council amending Directives 78/660/EEC and 83/349/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies, COM(2000)80, February 2000.

further analysis of potential competition and discrimination issues relating to such a pilot scheme, which it sees as very valuable. EBIT feels that such a pragmatic approach is more acceptable to EU Member States and therefore more realistically achievable. It could then be used to provide 'additional' flexibility and be a further step towards a true Single Market.

What further studies?

(13) EBIT would propose that the Commission conduct further studies on the contribution of IAS to achieving a CCTB. For example, the Commission might wish to consider a study on the extent to which the Member States rely on base changes to achieve specific objectives (e.g. encouraging commuting versus company cars or to raise revenue) to ascertain whether a CCTB is politically feasible within the boundaries of the principle of subsidiarity.

(14) In addition, EBIT believes that to understand the full impact and hidden consequences of the adoption of IAS as the base for CCTB, one should also look at the impact this has on taxable profits of subsidiaries. EBIT considers it important to address this issue in more detail as well.

(15) EBIT believes that the present differences between statutory and tax accounting would and should remain. In any instance, the cost involved in aligning systems should also be noted, although it should prove cheaper and beneficial in the long run for companies to have one consistent, pan-EU system of statutory accounting.

(16) EBIT's experience and work has led the Group to conclude that **IAS accounts will require significant adjustments to arrive at a CCTB**. Examples of where such adjustments would be needed are provided below. This (non-exhaustive) list also highlights potential conflicts between the accounting and the tax logic. Furthermore, EBIT trusts that this also indicates where further research efforts are needed.

- **Tax Loss Carry Forward (TLCF)**: the amount of deferred taxes on TLCF should be deductible from the tax base

- **Temporary differences**: the amount of deferred taxes on temporary differences should be deductible from the tax base

- **Amortisation**: the period should continue to be different for certain applicable assets

- **Goodwill**: it should be possible to balance and amortise goodwill in appropriate periods

- **Hybrid cost**: e.g. cost related to stock option schemes, restrictive share plans, IPOs, etc. should be deductible from the tax base

- **Investment in subsidiaries**: IAS is based on current value, while for tax purposes this is based on historical cost; increases in the tax base for investment under IAS should be deductible

- **Foreign exchange results, currency hedging**: it should be possible to continue to report certain assets at historical rates or defer gains/losses on the hedging

- **Historical values**: valuation of certain assets like investments in subsidiaries or buildings should continue to be different.

To develop this paper, EBIT has relied more on the practical experience of its members than on a theoretical analysis. The input it provides is rooted in daily practice of experienced business executives, who believe that this should be of help to address issues of such importance for the European economy. In this respect, EBIT would like to encourage the Commission in its consultation efforts.

EBIT is committed to discussing its views with all stakeholders and can be contacted through its secretariat:

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