

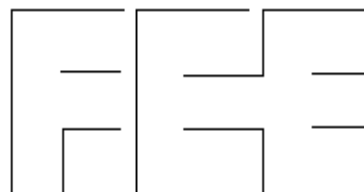
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Mr. TC Neale  
European Commission  
Directorate General Taxation and Customs Union  
Office MO 59 6/12  
B-1049 Brussels



Dear Mr. Neale,

Re: European Commission Consultation Document: "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"

FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) participated in the EC Workshop on March 18, 2003 and is submitting its comments to the Commission on the related Consultation Document. Owing to the greater prominence of IAS in Europe, FEE welcomes the initiative of the Commission to examine the use of IAS as a starting point for arriving at a consolidated tax base.

Below we provide you with some general comments, followed by responses to the specific questions raised in section 3, and by comments on issues not directly addressed by the questions.

We have discussed and responded to this document bearing in mind that Member States will allow but not require entities to use the consolidated tax based system. The consolidated tax base is optional as set out in the EC Communication of October 2001. The national taxation rules would still be maintained for entities not opting for a consolidated tax base (for example SMEs).

## General

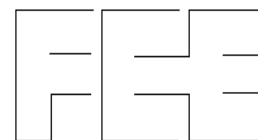
### *Consolidated tax base*

We recognise that a consolidated tax base will be beneficial to companies with cross-border activities and brings simplifications for them. However we are aware of the political obstacles that may arise in achieving a consolidated tax base in Europe due to the risk of undermining tax power in Member States. Member States will remain free to fix their corporate tax rate. They need to continue to have the possibility for national adjustments after allocation of the tax base to their country, as a tool of achieving aims of economic policy.

We assume that consolidated tax base means a system in which net profit according to consolidated financial statements for commercial/accounting purposes is first adjusted for tax purposes according to a single set of EU rules; secondly allocated by country according to a predefined formula; and thirdly the individual Member State tax rate applied, after any national adjustment. An optional consolidated tax base system would be of interest to all companies with cross border activities, including SMEs.

### *IAS*

IAS represents the only common set of standards in use for financial reporting in Europe. In our opinion therefore IAS represents the only common starting point for a consolidated tax base within the European Union.



## Responses to the Questions Raised

### Question 3.1

*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?*

IAS are prepared for accounting purposes rather than for taxation purposes. We are strongly of the opinion that accounting should not be driven by tax considerations. Therefore we see no need for taxation input to IAS. The endorsement of IAS as envisaged under the IAS Regulation should only be driven by accounting considerations.

The creation of a separate committee composed of members of the European Commission and Member States, together with a technical expert group, including experts of the accountancy profession, seems useful to decide on the tax adjustments to be applied to the IAS prepared financial statements to arrive at the IAS consolidated tax base. Both the Committee and the expert group should be independent and separate from the endorsement process introduced under the IAS Regulation. IAS develop over time and with each amendment of a standard or the introduction of a new standard, the implication for the tax base and the related tax adjustments need to be considered. Therefore, the Tax committee and technical expert group would have a permanent task. We see this task, however, totally separate from the main accounting standards endorsement process. The tasks of a future committee and a technical expert group for tax purposes need to be well defined. A tax expert group would allow to involve real experts in the area which should be committed to provide independent advice.

The starting point for the tax base should, however, be the *endorsed* IAS in order not to complicate the current endorsement mechanism of IAS in the EU.

### Question 3.2

*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?*

“Investor oriented” IAS prepared financial statements does not invalidate their use as the primary source for determining the taxable base by the tax authorities. As noted earlier, IAS prepared financial statements represent the only possible common starting point in Europe today.

We agree that some individual IAS and some general principles may be in contrast with some basic tax rules deriving from the ‘ability to pay’ principle (only to pay tax when cash is received for an asset). For instance, IAS use at several instances the measurement basis “fair value” and have different recognition requirements, which may diverge from tax practice in certain countries of taxing only realised gains and losses. It is important to retain the important principle that profits should not be taxed until they are realised.

We furthermore would like to observe that in general there is no difficulty with the principle of “substance over form”. It is also a common principle for taxation purposes although there are in certain countries some exemptions from the principle. We therefore disagree with the emphasis in the text of the consultation document on page 12.

As regards to fair value measurement, we would like to point out that the IASB has a project on reporting performance, which will result in changes to the format of the income statement, the statement of changes in equity and the cash flow statement. The main focus of the project is the development of a single statement of comprehensive income (a statement that reports all recognised income and expenses). An exposure draft is expected to be published before the summer. This performance reporting statement might be useful in overcoming the issues caused by IAS principles and features

contrasting with tax principles. According to the Performance Reporting project, there is a columnar presentation of the income statement, with separate identification of re-measurement and future gains and losses. Most of the adjustments creating conflicts with tax principles (i.e. unrealised gains and losses) would be presented in a separate column of the statement, which includes only re-measurements. This would allow a reconciliation from IAS to arrive at the tax base and would replace the need for any supplementary supporting schedules.

We disagree that the concept of materiality as used under the IAS Framework is a serious concern. All companies would account for their transactions, and most will do that to be accurate to a single unit of currency (as the tax authorities require). Where an individual IAS is not applied in the circumstances of a particular company's financial statements on the grounds its requirements are immaterial, this does not mean the company has not recorded the underlying transaction/s in its books and records from which the financial statements are drawn. The text in the Consultation Document implies such immaterial transactions would not be recorded and gives the impression that a large multinational would therefore have bigger differences.

We also refer to our more detailed observations on IAS under Other Comments 2.

#### Question 3.3

*If only a limited number of companies use IAS is it appropriate to design a common tax base around IAS?*

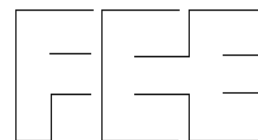
We believe that the general trend in Europe is an increase in the number of companies adopting IAS for their financial statements. One should bear in mind that the number of companies involved is far greater than 7,000 because of all the subsidiaries and associated companies that will have to use IAS internally at least for consolidation purposes as well. Also many Member States are expected to allow the use of IAS for other companies and some of them also for the individual financial statements. It is moreover not just a question of listed or unlisted companies, as in the mid term, Local GAAP across Europe may converge to IAS. The latter may therefore become indirectly compulsory for statutory accounting as well. In the UK the local accounting principles are already adjusting to IAS. In most of the future new Member States, local GAAP have been developed, inspired by IAS.

At present, the IASB has a project on IAS for SMEs which might give some relief for smaller companies, at least in the disclosure area. An IAS on SMEs may make that more companies move on a voluntary basis to IAS. Furthermore, as we understand that the consolidated tax base system would be optional, it will not create a problem for companies not applying IAS as they may remain under the current tax regime.

#### Question 3.4

*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?*

FEE prefers the first approach. Under adjusting IAS prepared consolidated financial statements to arrive at a consolidated tax base, the structure could be to allow IAS as a starting point and reconcile IAS based equity and profit with tax based equity and profit, with few exceptions as possible. Consolidations could be done in a two-step approach, in order to arrive at the EU tax basis. If IAS were to be introduced as a tax base with a reasonable time scale, before a wide use of IAS is in place, it needs to be considered that it will discriminate companies not using IAS at that moment.



#### Question 3.5

*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?*

The current situation, in which there are different levels of dependency of accounting and tax within the EU, poses difficulty in developing an EU-wide consolidated tax base. FEE is strongly of the opinion that accounting should not be driven by tax considerations. As noted in our comments under General and Question 3.1, common tax adjustments to be applied to the IAS consolidated accounting profit need to be agreed upon to arrive at the consolidated tax base to be allocated to the Member States (see our comments under General and Question 3.1).

#### Question 3.6

*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?*

Accounting standards need to be developed independently of tax considerations. The aim should be to harmonise the tax adjustments across Europe. As observed before, IAS are the only common standards in Europe at present, and seems therefore the only starting point in a consolidated tax base.

FEE supports the possibility of creating a series of 'Tax Recommendations' in order to explain how to adjust IAS figures to arrive at the consolidated tax base (see Question 3.1). However, Recommendations may not be the appropriate legal vehicle to have mandatory rules throughout Member States.

#### Question 3.7

*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?*

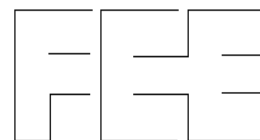
FEE does not believe in the need for pilot testing a tax base based on IAS, and fosters its direct implementation, since the system would be optional. However, if there is to be a pilot project, then we would not object to using of the SE for testing a IAS tax base. A disadvantage would, however, be that there is no past history to compare with.

In any pilot testing the difficulty of discrimination of other companies needs to be assessed.

#### Other comments

##### 1. Technical issues related to consolidation:

The application of a common tax base will require sub-consolidation of EU activities for international groups. We have concerns on the technical complexity of such consolidated system. Several issues need to be further examined including whether in case of groups with a parent company outside the EU with subsidiaries within the EU, it will be necessary to create a holding company based in one of the Member States, both for accounting consolidation and for determination of the national jurisdiction for tax assessment. In the case of non-EU subsidiaries having activities within the EU, one solution could be to ignore those in the EU consolidation, even if they have permanent establishments in the EU. If a group has a sub holding company outside the EU, the consolidation could be done disregarding the sub holding and considering the subsidiaries as directly owned by the parent.



## 2. Current IAS and amendments:

It seems that the Consultation Document in section 2.7 on individual IAS does not consider the existing proposed amendments to IAS. For example, under the proposed improvement to IAS 2, LIFO method will not be allowed anymore, and under the exposure draft on business combinations (IAS 22) the pooling of interest method is abandoned. Also, IAS 14 should not be seen as a problem for taxation as it only relates to disclosure of information and has no measurement or recognition effects. Furthermore, even though alternative treatment of capitalizing at fair value is allowed for intangible assets (IAS 38), it is used very exceptionally at present.

There is no reference in the document to the IAS Framework with regard to the definition of expenses and revenues, which would be of more interest to arrive at a comparable tax base. The document does not mention IAS 12 but it might as well be of help for the tax authorities as it concerns requirements for disclosure and recognition of tax differences.

## 3. Specific industries:

There may be some industry specific issues, like for the insurance industry. Industry specific issues would therefore need further consideration.

We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,

David Devlin  
President