

ACHIEVING A COMMON CONSOLIDATED CORPORATE TAX BASE IN THE EU

MALCOLM GAMMIE QC
SILVIA GIANNINI
ALEXANDER KLEMM
ANDREAS OESTREICHER
PAOLA PARASCANDOLO
CHRISTOPH SPENGL

DECEMBER 2005

The Centre for European Policy Studies (CEPS) is an independent policy research institute in Brussels. Its mission is to produce sound policy research leading to constructive solutions to the challenges facing Europe. As a research institute, CEPS takes no position on matters of policy. The views expressed are entirely those of the authors.

This report is based on discussions in the CEPS Task Force on the harmonisation of tax bases in the EU and among the experts who drafted the report. A list of participants, invited guests and speakers appears at the end of this report.

The authors are Malcolm Gammie CBE QC, Chambers of Lord Grabiner QC and Chairman of the Expert Group of the Task Force; Silvia Giannini, University of Bologna; Alexander Klemm, Institute for Fiscal Studies, London; Andreas Oestreicher, University of Goettingen; Paola Parascandolo, Assonime and Christoph Spengel, University of Giessen. They also wish to thank Krister Andersson, Confederation of Swedish Enterprise, for valuable input into the report.

We wish to thank H. Onno Ruding, Chairman of the Board of Directors of CEPS, for his guidance of the work, and the companies BP, Deutsche Bank, Merloni, Siemens, and Unilever for their financial support.

ISBN 92-9079-599-9

© Copyright 2005, Centre for European Policy Studies.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means – electronic, mechanical, photocopying, recording or otherwise – without the prior permission of the Centre for European Policy Studies.

Centre for European Policy Studies
Place du Congrès 1, B-1000 Brussels
Tel: (32.2) 229.39.11 Fax: (32.2) 219.41.51
E-mail: info@ceps.be
Website: <http://www.ceps.be>

CONTENTS

| | |
|---|------------|
| Preface by H. Onno Ruding | i |
| Executive Summary | iii |
| 1. Introduction | 1 |
| 1.1 Tax obstacles to EU-wide economic activities | 1 |
| 1.2 Approaches to EU company taxation..... | 2 |
| 1.3 Challenges of EU law to EU company taxation | 5 |
| 1.4 Objectives and structure of the survey | 8 |
| 2. Principles for the definition of a common EU tax base | 10 |
| 2.1 Introduction..... | 10 |
| 2.2 Why impose corporate income taxes? | 11 |
| 2.3 Criteria for evaluating tax rules..... | 12 |
| 2.3.1 Neutrality | 12 |
| 2.3.2 Equity | 14 |
| 2.3.3 Simplicity..... | 15 |
| 2.3.4 Enforceability..... | 15 |
| 2.3.5 Tax capacity | 16 |
| 2.3.6 Revenue provision | 16 |
| 2.3.7 Public policy..... | 17 |
| 2.3.8 Cost of reform | 18 |
| 2.3.9 Other constraints | 18 |
| 2.4 General guidelines from tax principles for the design of the tax base..... | 18 |
| 2.5 An aside: Neutral tax systems | 21 |
| 3. Corporate tax and IAS/IFRS bases in the EU member states | 23 |
| 3.1 Introduction..... | 23 |
| 3.2 Comparison of corporate tax and IAS/IFRS bases..... | 23 |
| 3.2.1 Relationship between financial accounting and tax accounting | 23 |
| 3.2.2 Realisation date of earnings..... | 25 |
| 3.2.2.1 Sale of goods | 25 |
| 3.2.2.2 Construction contracts..... | 25 |

| | | |
|-----------|---|-----------|
| 3.2.3 | Assets and liabilities | 26 |
| 3.2.3.1 | Assets (self-created intangibles)..... | 26 |
| 3.2.3.2 | Liabilities (provisions and bad debts) | 30 |
| 3.2.4 | Initial measurement | 31 |
| 3.2.4.1 | Acquisition costs | 32 |
| 3.2.4.2 | Production costs | 33 |
| 3.2.4.3 | Simplified valuation (inventories) | 34 |
| 3.2.5 | Subsequent measurement | 35 |
| 3.2.5.1 | Fixed assets | 35 |
| 3.2.5.2 | Inventories..... | 39 |
| 3.2.6 | Financial assets | 40 |
| 3.2.7 | Group taxation..... | 44 |
| 3.3 | Analysis of common and inherent accounting principles | 46 |
| 3.3.1 | Conceptual accounting principles | 46 |
| 3.3.2 | Accrual principles | 46 |
| 3.3.2.1 | Realisation date of earnings..... | 46 |
| 3.3.2.2 | Matching principle..... | 48 |
| 3.3.3 | Treatment of losses..... | 48 |
| 3.3.4 | Simplification, miscellaneous | 50 |
| 3.3.4.1 | Immediate write-off | 50 |
| 3.3.4.2 | Simplified valuation of inventories | 51 |
| 3.3.4.3 | Depreciation..... | 51 |
| 3.3.4.4 | Cash orientation | 52 |
| 4. | Scope of IAS/IFRS as a starting point for a common EU tax base..... | 53 |
| 4.1 | IAS/IFRS and tax principles | 53 |
| 4.2 | Some concrete examples..... | 55 |
| 4.2.1 | Examples in which the overall balance between the different tax principles could make the IAS definition acceptable for tax purposes..... | 55 |
| 4.2.2 | Examples in which adjustments to IAS accounting would be required to avoid excessive taxpayer discretion | 57 |
| 4.2.3 | Examples in which adjustments to IAS accounting would be required for other reasons | 60 |
| 5. | Conclusion | 65 |

| | |
|-------------------------|-----------|
| References | 67 |
|-------------------------|-----------|

Appendices

| | |
|--|-----|
| 1. Relationship between financial accounting and tax accounting..... | 69 |
| 2. Realisation date (Sales of goods) | 72 |
| 3. Construction contracts | 73 |
| 4. Definition of capital assets/ intangible assets | 74 |
| 5. Recognition of self-developed intangible assets | 77 |
| 6. Provisions | 81 |
| 7. Provisions for bad debts | 83 |
| 8. Acquisition costs..... | 85 |
| 9. Production costs..... | 89 |
| 10. Measurement of inventories | 90 |
| 11. Regular depreciation..... | 94 |
| 12. Depreciation of goodwill..... | 103 |
| 13. Measurement of financial assets..... | 105 |
| 14. Group taxation..... | 113 |
| 15. Loss treatment..... | 117 |
| 16. Immediate write-off of assets..... | 119 |

List of Tables

| | |
|--|----|
| 1. Harmonised tax base and tax obstacles to cross-border EU-wide activities | 3 |
| 2. General principles of IFRS vs. common principles of taxation | 8 |
| 3. Relationship between financial accounting and tax accounting..... | 24 |
| 4. Construction contracts (taxation) | 25 |
| 5. Recognition of self-created intangible assets (IFRS) | 27 |
| 6. Recognition of research and development costs (taxation) | 28 |
| 7. Recognition of establishment costs (taxation) | 28 |
| 8. Recognition of self-created rights and intellectual property (taxation) | 29 |
| 9. Provisions (taxation) | 31 |
| 10. Provisions for bad debts (taxation) | 31 |
| 11. Acquisition costs (taxation)..... | 32 |
| 12. Production costs (taxation)..... | 33 |
| 13. Simplified valuation of inventories (taxation)..... | 34 |

| | |
|--|----|
| 14. Depreciation on industrial buildings (taxation)..... | 36 |
| 15. Depreciation on intangibles (taxation) | 37 |
| 16. Depreciation on machinery (taxation) | 38 |
| 17. Depreciation on goodwill (taxation)..... | 39 |
| 18. Subsequent measurement (inventories) | 40 |
| 19. Initial measurement of financial assets (taxation)..... | 41 |
| 20. Revaluation of financial assets (taxation)..... | 43 |
| 21. Write-down of financial assets (taxation)..... | 44 |
| 22. Definition of a group (taxation)..... | 45 |
| 23. Type of group relief (taxation)..... | 45 |
| 24. Loss treatment (taxation)..... | 49 |
| 25. Immediate write-off of assets in tax accounting (acquisition costs)..... | 50 |

PREFACE

This report addresses an important aspect of European integration and comes at a propitious moment. The completion of the internal market of the European Union requires a certain degree of harmonisation or coordination of the national corporate tax policies of the member countries. The business sector, in particular, is keen to see the removal of instances of double taxation that daily confront many companies engaged in cross-border transactions or investments, unlike their counterparts that confine their activities to only one country. These distortions and discriminations continue to create obstacles to the proper functioning of the single market and should be eliminated.

As early as 1992, the Committee of Independent Experts on Company Taxation – which I had the privilege of chairing – recommended in its report prepared for the EU Commission that it should focus not only on changes in national tax systems and statutory corporate tax rates, but also on changes in the national tax bases, if Europe wants to achieve this goal. From 2001 onwards, the Commission has wisely given priority to EU-wide harmonisation of the corporate tax base – a difficult and ambitious task, both politically and technically.

In 2004, CEPS took the initiative to assemble a Task Force of highly competent experts in this field to make proposals to promote harmonisation of the corporate tax base in Europe. I am delighted that this Task Force has produced a clear report presenting a profound analysis of the subject and a number of concrete recommendations. This report makes, rightly in my view, a link between the rules for the tax accounting of corporate profits and the recently agreed uniform IAS/IFRS international rules for the financial reporting of the same corporate profits.

I express the hope that this report will assist the European Commission, the member states, the business sector and tax professionals in making progress towards a consolidated corporate tax base in Europe.

H. Onno Ruding
Chairman of the Board of Directors, CEPS

EXECUTIVE SUMMARY

The adoption of international financial reporting standards (IFRS) within the European Union from 1 January 2005 offers a unique opportunity to advance the cause of a common consolidated corporate tax base (CCCTB) for member states. The Commission and many commentators have long recognized the need for a CCCTB to resolve the issues and costs that 25 different company tax systems present for European businesses. A major problem, however, has always been to find a suitable starting point for developing a CCCTB. IFRS offers that prospect.

Most corporate tax systems draw upon the rules of financial accounting in varying degrees to arrive at a measure of taxable profits. In some countries, such as Germany, tax and financial accounts have gone hand in hand for many years, to the detriment in some eyes of the informational value of financial accounts. As commercial and financial accounting in these countries has sought to break free from the constraints imposed by taxation, so the linkage between the two has loosened, and specific tax rules have replaced the earlier dependence on financial accounts. In other countries, such as the UK, there has been no formal linkage between the measurement of income for tax purposes and commercial accounting. Commercial accounting has developed independently from the tax system. Nevertheless, the tax system has always had regard for the rules of commercial accounting and in recent years has increasingly looked to those rules as a means of resolving particular aspects of income measurement. Here, as commercial accounting has acquired greater objectivity, governments have strengthened the formal linkage between tax and accounting measures of profit.

As these trends illustrate, it is generally not possible to align tax and accounting measures of profit completely and at the same time achieve the different objectives of the tax system and commercial accounting. Nevertheless, this does not mean that the objectives of each are incompatible or non-complementary. In many respects, tax and accounting

do indeed share similar and complementary objectives. Furthermore, from the tax perspective, simplicity and the need to moderate compliance costs make alignment a desirable objective. It is against this background that this report has been prepared.

A major part of the report is devoted to an assessment of the extent to which IFRS is compatible with its adoption for tax purposes and to an examination of the different tax accounting rules of member states as compared to IFRS. The report concludes that the principles of tax and financial accounting are broadly compatible and that, in principle, there is no general conflict between IFRS and the current rules for tax accounting in member states. There are aspects of IFRS, however, such as the adoption of fair value accounting for certain assets and liabilities, that are problematic for tax systems.

Nevertheless, it is possible to distinguish three broad situations under IFRS:

- those elements of IFRS that are acceptable for tax purposes,
- those for which some adjustment to IFRS is needed to avoid giving taxpayers excessive discretion in determining taxable profits, and
- those in which the adoption of IFRS would be inappropriate for other reasons, such as corporate liquidity and the ability to pay.

This classification does not indicate that IFRS represents a poor starting point for a CCCTB. Instead it identifies those elements of IFRS that could be adopted relatively easily, and which are already broadly compatible with the tax accounting rules of many member states. It then contrasts those elements with the other elements where IFRS and the CCCTB must diverge to some extent. As such the classification identifies the aspects of the CCCTB on which the debate needs to focus to determine what modifications are needed to IFRS for tax purposes and what special tax rules must replace IFRS entirely.

In this respect, the report does not attempt to propose solutions to these particular issues it identifies. It aims nevertheless to provide materials against which the discussion on the CCCTB can usefully proceed.

The report does not, however, advance uncritically the case for a CCCTB in any form. It identifies several key features that a CCCTB must possess if it is to resolve satisfactorily the issues that 25 company tax systems currently pose for European business. In particular, the adoption of a common tax base in each member state is likely to be of little overall benefit to European business without the further possibility of

consolidation and the allocation of the consolidated base among member states. Agreement of the CCCTB is a necessary step in that broader objective but it is not a sufficient end in itself.

Furthermore, if Europe is to realise the Lisbon objectives, it is important that the CCCTB should recognise and reflect global trends in company taxation. It is not necessarily true that any form of CCCTB, even with consolidation and allocation, will be an improvement over the current situation if, overall, the CCCTB is uncompetitive or inflexible relative to developments elsewhere in the world. It is essential that any CCCTB should be well designed and flexible and should represent an efficient and competitive tax system for European business.

With that in mind, this report examines the principles that should underlie the development of a CCCTB and the various criteria of neutrality, equity and simplicity and the desirability of a broad base, low tax rate strategy. The report recognises that member states have frequently acted to narrow the tax base by implementing specific incentives for a variety of their own public policy reasons. Under a CCCTB, however, it is important that member states should have no scope to deviate from the rules of the CCCTB. Tax incentives should be implemented either as part of the agreed rules of the CCCTB applicable in every member state or through the use by specific member states of tax credits and cash grants within the permitted scope of the state aid rules. Tax credits and cash grants can often be better targeted and are more transparent. By contrast, any unilateral freedom to modify the rules of the CCCTB in some respect in their application to a particular member state directly undermines the aims of the CCCTB and the benefits that it seeks to achieve.

In recent years the European Court of Justice (ECJ) has made clear to member states on many occasions that while they retain competence in the direct tax field, they can only exercise their competence in a manner that is compatible with Community law. As a result, member states have been forced to make major changes in their corporate tax systems to adopt a 'Community perspective' in place of a 'national perspective' to their cross-border tax rules. As the reports notes, however, member states have tended to respond unilaterally to ECJ decisions and often in a manner that is detrimental to European business by further complicating domestic tax systems. There is no guarantee, therefore, that the ECJ's action will over time bring about greater uniformity in company tax systems or make a CCCTB easier to achieve.

Accordingly, the need for progress by the ECOFIN working party on the CCCTB remains as important as ever. It is with that in mind that the CEPS Task Force presents this report as a constructive contribution to the discussion of a CCCTB.

1. Introduction

1.1 Tax obstacles to EU-wide economic activities

In its study of 2001,¹ the European Commission highlighted the main tax obstacles to EU-wide economic activities. The underlying cause of additional tax burdens on cross-border activities in the EU compared to purely domestic activities is the co-existence of 25 separate tax systems within the EU. Each member state has its own set of rules, in particular laws and conventions on financial accounting, rules for determining taxable profit, and arrangements for the collection and administration of tax, and its own network of tax treaties. The need to comply with a multiplicity of different rules entails a considerable compliance cost and represents itself a significant barrier to cross-border economic activity. This may in particular hamper cross-border activities of small and medium-sized enterprises. According to the Commission's European Tax Survey (2004),² compliance costs in the case of multinational enterprises amount to 1.9% of the tax payments while they amount to 30.9% in the case of medium-sized enterprises.

Furthermore, the fact that each member state is a separate tax jurisdiction has a number of other negative consequences. In particular:

- cross-border relief for losses incurred by associated companies located in other member states is not allowed in many cases;³

¹ See European Commission (2001).

² See European Commission (2004)

³ Although the decision of the European Court of Justice (ECJ) is awaited in Case C-446/03 *Marks & Spencer plc v Halsey*, which may oblige member states as a matter of Community law to extend their domestic loss relief systems to associated companies in other member states in certain circumstances.

- the allocation of profits of multinationals to different jurisdictions on an arm's length basis by transaction-based transfer prices causes methodological problems and results in double taxation;
- in many situations cross-border reorganisations give rise to capital gains taxation and bear the risks of double taxation; and
- double taxation may occur as a result of conflicting taxing rights (e.g. thin capitalisation rules,⁴ deduction of headquarter costs).

1.2 Approaches to EU company taxation

In its study of 2001, the Commission made clear its intention to pursue targeted solutions to a number of these problems, which it has done through the initiative of the EU Joint Forum on Transfer Pricing and in proposing the amendment of the existing Parent/Subsidiary and Merger Directives. It nevertheless also proposed in its study of 2001 more comprehensive solutions that seek to address the underlying causes of the tax obstacles.⁵ Comprehensive solutions envisage a consolidated tax base. In this respect, home state taxation (HST) and a common consolidated corporate tax base (CCCTB) are at the centre of discussion. Whether or not it is HST or CCCTB that is applied, there are three distinct steps in arriving at a consolidated tax base for each jurisdiction:

- 1) each group member calculates its taxable profits separately but according to the same set of rules;
- 2) the resulting profits are aggregated to form the consolidated tax base; and
- 3) the consolidated tax base is allocated to the different member states by applying specific factors (e.g. formulary apportionment).

Finally, each member state has the right to tax the allocated portion of the consolidated tax base at its domestic tax rates.

⁴ The ECJ has found that such cross-border rules can infringe Community law; see Case C-324/00 *Lankhorst*. Its decisions have not, however, produced a uniform response from member states. Furthermore several member states have responded by extending their cross-border rules to domestic situations, thereby further complicating their tax systems.

⁵ See also CEPS (2001) for an independent analysis of the issues.

Table 1. Consolidated tax base and tax obstacles to cross-border EU-wide activities

| Approaches to EU company taxation with different degrees of cross-border cooperation | | | |
|--|--|--|---|
| | | Common consolidated tax base throughout the EU with one set of tax accounting principles | Common consolidated tax base throughout the EU with one set of tax accounting principles Consolidation (e.g. deferred taxation of intra group transfers) |
| Reduction/elimination of tax obstacles to cross-border EU-wide activities | consolidated tax base throughout the EU with one set of tax accounting principles | Cross-border loss relief | Allocation of the consolidated tax base |
| Compliance costs | Achieved | Achieved | Achieved |
| Cross-border loss relief | Not achieved Only to the extent that member states already provide cross-border loss relief | Achieved | Achieved |
| Transfer prices | Not achieved Transfer prices are still required for the division of the tax bases. | Not achieved Transfer prices are still required for the division of the tax bases | Achieved Transfer prices are substituted by formula apportionment |
| Reorganisations | Achieved But only if the tax treatment of reorganisations is harmonised | Achieved But only if the tax treatment of reorganisations is harmonised | Achieved But only if the tax treatment of reorganisations is harmonised |
| Double taxation as a result of conflicting taxing rights | Not achieved | Not achieved | Achieved |

Policy-makers of different member states increasingly recognise that only a comprehensive solution can provide a systematic elimination of tax obstacles to cross-border EU-wide activities. There is therefore growing support for some form of common tax base. There seem to be at least three different views of what a common tax base would involve, which may not correspond to the original conception of a consolidated tax base. Each view involves a different degree of mutual cooperation, with each eliminating tax obstacles to cross-border EU-wide activities to a different extent (see Table 1).

- (1) The minimum degree of coordination involves applying a single set of tax accounting principles in each member state. To avoid any discrimination against purely domestic operations and thus to avoid constitutional problems at least in some member states (e.g. Germany) the common tax base should be applied to both domestic and international companies.⁶ Such a model clearly would reduce compliance costs on cross-border activities. All other tax obstacles on cross-border activities, however, would remain.⁷
- (2) A common tax base facilitates cross-border consolidation. Loss relief could be made available by deducting losses of a foreign subsidiary from any profits of the parent company. The losses would be added back to the parent company's tax base if the subsidiary becomes profitable in later periods. This corresponds broadly to the former proposal for cross-border loss relief by the Commission.
- (3) The systematic elimination of tax obstacles to cross-border EU-wide activities, however, requires a consolidated tax base. This means that the allocation of the total taxable profits of the group can no longer be based on transfer prices. Instead, some kind of mechanism or formula is needed to allocate the consolidated tax base to different member states.

Even though all three alternatives can improve on the current situation, it is only the final one that represents a comprehensive attempt to address the problems of having to deal with 25 parallel tax systems. Double taxation, problems related to transfer pricing and the lack of any benefits of consolidation are three of the obstacles that most hamper cross-border

⁶ See Schön (2004, p. 436); Spengel (2004a, p. 134).

⁷ It seems to be possible that double taxation on cross-border reorganisations could also be avoided by amendments of the Mergers Directive if a harmonised tax base is established.

business activities within Europe. In achieving the Lisbon objectives, a CCCTB should thus preferably be designed along the lines of the third alternative.

In discussions of a common consolidated tax base, however, it is important not to lose sight of the fact that the Lisbon objectives are framed by reference to the global economy. A common consolidated tax base cannot therefore necessarily be designed solely from the European perspective. It must take account of global trends in corporate tax systems and be flexible enough to accommodate whatever future trends may emerge. Thus it is not necessarily true that *any* form of common consolidated tax base represents an improvement on the current situation or will advance the Lisbon objectives. It is possible to envisage, for example, a CCCTB of sufficient complexity and inflexibility or that is built solely on some 'lowest common denominator' approach that it both increases compliance costs and makes European business less competitive in global markets. It is essential, therefore, that any common consolidated corporate tax base that emerges should be well designed, flexible and should aim to represent an efficient and competitive tax system for Europe.

1.3 Challenges of EU law to EU company taxation

The EC Treaty makes no specific provision for direct tax measures. Those corporate tax measures that have been agreed have been implemented under the approximation of laws measures of the EC Treaty. All tax proposals require unanimous agreement which itself reduces the scope for action. Although competence in direct taxation remains with member states, the European Court of Justice (ECJ) has on many occasions emphasised that member states may only exercise their direct taxation powers in a manner that is consistent with Community law.

Two particular principles of Community law are proving to impose significant constraints on member states' freedom of action in the corporate tax sphere. First, the domestic tax laws of a member state (the host state) may not discriminate against nationals of other member states who choose to exercise their freedom to establish in the host state or otherwise participate in its markets through the provision of services or capital. Second, the tax laws of a member state may not impede or restrict the exercise of any of the Treaty freedoms by its own nationals, or those of any other member state.

Member states as host states have generally been able to adapt their domestic tax laws to ensure that nationals of other member states who establish in the host state and are liable to tax there (as subsidiaries or branches) are taxed on the same basis as comparable domestic enterprises. Eliminating nationality discrimination has proved relatively straightforward and in many respects uncontroversial. Member states are finding it more difficult, however, to adapt their corporate tax systems to what is demanded by the market access requirements of Community Law.

This is because national tax systems function internationally by drawing a line at the national border and taxing cross-border transactions differently from domestic transactions. In many cases, however, the different (and usually less favourable) taxation of international transactions will impede or restrict cross-border activity and therefore involve a prima facie breach of the market access rules. The ECJ permits member states to justify a breach of its market access rules in certain cases, provided the member state is acting proportionately in doing so. However, the ECJ does not permit a member state to rely on the preservation of national tax revenues as a justification of a particular measure. In particular, the ECJ adopts a Community view of tax systems so that, for example, a member state cannot justify a national measure on the grounds that another member state has chosen a different and possibly less onerous tax requirement.

As most cross-border tax rules are designed to protect the national Treasuries from tax leakage abroad, there is limited scope for member states to justify many of their measures. Thus, the ECJ has ruled against the use of cross-border thin capitalisation rules,⁸ tax charges on emigration,⁹ the restriction of cross-border finance leases¹⁰ and rules imposing tax charges on the transfer of assets outside the home jurisdiction.¹¹ Pending cases will test restrictions on cross-border loss relief,¹² the credit system of dividend taxation¹³ and controlled foreign company legislation.¹⁴

⁸ Case C-324/00 *Lankhorst*. See also C-524/04 *Test Claimants in the Thin Capitalisation Group Litigation*

⁹ Case C-9/02 *Lasteyrie du Saillant*.

¹⁰ Case C-294/97 *Eurowings*.

¹¹ Case C-436/00 *X and Y*.

¹² Case C-446/03 *Marks & Spencer plc v Halsey* and C-231/05 *Esab*.

¹³ See C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* and C-446/04 *Test Claimants in the FII Group Litigation*.

The ECJ's action can be seen in a positive light in maintaining pressure on member states to resolve their tax policy differences and move towards a common system of taxation. On the other hand, the ECJ cannot act proactively in adjudicating on the particular tax measures referred to it by national courts and striking down those in breach of the EC Treaty. Furthermore, despite the need for all member states to react to particular decisions, member states appear to have been reluctant to coordinate their responses. Instead they have chosen to respond with unilateral national measures rather than at an agreed Community level.

In practical terms on a unilateral basis a member state may be forced into adopting one of two courses:

- 1) extending a particular cross-border tax rule to its taxpayers and their transactions in its domestic market, or
- 2) extending its domestic tax rule to its taxpayers and their transactions throughout the single European market.

Faced with that choice, member states have in several cases chosen the first option, resolving the Community law issue but, in doing so, making domestic rules more stringent without producing any advantage for the single market. There will be no advantage for businesses, for example, if member states respond to a requirement to extend domestic loss relief rules to cross-border situations with the abolition or restriction of domestic loss relief rules.

In its more recent decisions,¹⁵ the ECJ may have signalled that the solution may not necessarily be to impose the same rule in both domestic and cross-border situations as in (1) or (2) above but instead to secure an *equal treatment* of the two situations after allowing for the fact that domestic and cross-border situations are not the same. On this basis, the *Bachmann* coherence or cohesion justification may have new life for member states.¹⁶

Nevertheless, while the body of direct tax case law continues to grow at the ECJ and as member states necessarily react to its decisions, it is

¹⁴ See C-196/04 *Cadbury Schwepps plc and Cadbury Schwepps Overseas Ltd v. Commissioners of Inland Revenue*, C-201/05 *Test Claimants in the CFC and Dividend Group Litigation v. Commissioners of Inland Revenue* and C-203/05 *Vodafone 2 v. Her Majesty's Revenue and Customs*.

¹⁵ See in particular Case C-319/02 *Manninen*.

¹⁶ Case C-204/90.

apparent that the ECJ's action has so far failed to produce a sea change in attitude by member states on corporate tax issues and will not by itself result in a degree of uniformity within member states' tax systems that will be sufficient to address the problems the Commission has identified.

1.4 Objectives and structure of the survey

The adoption of international financial reporting standards (IFRS) within the EU from 1 January 2005 offers the possibility of a common starting point for a common consolidated corporate tax base. To what extent IFRS could serve as a starting point for a common tax base is discussed in this report. This question is mainly dealt with by comparing the principles of IFRS and taxation (Table 2). Since the aims of taxation and financial accounting may conflict – the main task of IFRS is to provide decision-useful information to participants in the capital markets while tax accounting seeks to compute a reliable and fair base for income tax – many people from the academic community, the professions and business believe that IFRS and the income tax base cannot be linked.

Table 2. General principles of IFRS vs. common principles of taxation

| IFRS | Taxation |
|---------------------|-------------------|
| True and fair view | Neutrality |
| Materiality | Equity |
| Reliability | Tax capacity |
| Decision usefulness | Simplicity |
| | Enforceability |
| | Revenue provision |
| | Public policy |

This conclusion, however, seems to be too narrow. To decide whether and to what extent IFRS and tax accounting rules are similar in member states, one has to compare concrete accounting standards and the corresponding member states' tax practice. This is one of the major objectives of our survey. The results of these comparisons will enable us

- to identify general, common principles of tax accounting in member states and
- to find out whether and to what extent particular IFRS are in line with these principles and could therefore serve as a starting point for a common tax base in the EU.

To the extent that there are variations between IFRS and taxation practice in member states, the general principles of tax accounting could also serve as a benchmark to deduce common tax rules.

The survey takes into account all 25 member states of the European Union. The remainder of this report is organised as follows. Section 2 introduces common principles of taxation and evaluates whether these principles can serve as guidelines for the definition of a common tax base. Afterwards, Section 3 compares selected IFRS for the capitalisation and valuation of assets and liabilities with the corresponding tax practice in the member states and develops general, inherent principles of tax accounting that are common in the member states. Section 4 goes through some examples of current rules, their similarities with IAS/IFRS and possible reforms and harmonisation on the basis of the principles summarised in Section 2. Finally, Section 5 offers conclusions.

2. Principles for the definition of a common EU tax base

2.1 Introduction

If one accepts the case for the harmonisation of tax bases in Europe, the question arises of how to proceed with it. The introduction of common rules, which would be likely to require changes in all member states, provides an opportunity to think about what rules would be optimal from an economic point of view so that the common rules might not only be an improvement in being the same, but also in creating a less distortionary tax system.

There is however a dilemma: the closer the definition of a tax base is to an optimal one, the more radical are the changes that are needed to the majority of tax systems. This in turn diminishes the chances of the reforms being acceptable to member states and hence threatens also the other goal of at least having common rules, even if not optimal ones.

Before addressing the question of how to define an optimal tax base for a corporate income tax regime, one may start with the more fundamental question of why corporate income should be taxed at all. Despite much research, this remains a controversial issue among economists. While this report briefly considers the arguments, it generally assumes that corporate income taxes are here to stay, at least within a foreseeable timeframe. But it should be borne in mind, that the search for an optimal tax base is only necessary if a corporate income tax is desired, and that there is no consensus on the desirability of such a tax.

The aim of this chapter is to discuss possible principles to be followed when defining a common European tax base. It is structured as follows: Section 2.2 considers the question of whether corporate income should be taxed at all, as this is a precondition for considering specific rules for tax systems. Section 2.3 discusses principles following from economic theory

which may guide future reforms. Finally, section 2.4 discusses in broad terms the issues regarding the choice of a tax base.

2.2 Why impose corporate income taxes?

Given the widespread use of corporate income taxes, it may appear surprising that the case for their imposition remains controversial, both for theoretical and practical reasons.

One of the reasons for disagreements about the merits of corporate income taxation is the conceptual difficulties with such a tax. The main difficulty is that its incidence is uncertain, i.e. it is not clear who bears the burden of corporate income taxes. The corporation itself, which is a legal person, cannot bear any of the burden. The incidence of a tax levied on corporations therefore falls on its owners, employees and customers. But there is no agreement about how the burden is distributed among these groups, except in certain highly stylised models. If, for example, capital is fully mobile and labour is immobile, then the burden of a corporate income tax imposed in a small country, would fall on labour only. In such a world, labour could just be taxed directly instead.

Despite this result, the corporate income tax is often thought of as a tax on the owners of capital. In that case, one justification for it is that it is a prepayment of income tax. While dividends could also be taxed more directly – and often are, in effect creating economic double-taxation – reinvested profits are difficult to tax without a corporate income tax. The reason for that is that capital gains cannot be easily taxed as they accrue and as a result most systems only tax them when they are realised. The corporate income tax is thus helpful in countries that aim to tax income comprehensively as it accrues.

The question whether income should be taxed comprehensively remains controversial, however. Economists concerned about inter-temporal efficiency, i.e. that two individuals should pay the same tax if the present discounted value of their earnings is the same, argue in favour of consumption taxes instead. A consumption tax would exclude reinvested returns from savings and would hence not require a corporation tax as a pre-payment of income tax (or, at least, would not require corporate taxes in their current form).

Other arguments used to support the taxation of corporate income include the argument that it is a payment for services provided by

governments, such as the provision of infrastructure or an educated workforce. It is also argued that it may be a payment for the value of limited liability. Neither of these arguments is very convincing, however, because the amount of tax a company pays is not related to the level of public services it consumes or the value of limited liability. The first argument would call for user charges instead, and the second for a charge based on bankruptcy risks.

Apart from theoretical reasons for doubts about the usefulness of corporate income taxes, there are also practical ones. These include the high administration and compliance costs of such taxes. Partly these are the result of unnecessary complexity in tax codes, but complexity is difficult to avoid entirely because corporate income is such a difficult item to define in a robust way. A related problem is that it is becoming increasingly difficult to enforce this tax as internationally operating firms follow tax-minimising strategies.

Nevertheless, the remainder of this report is based on the premise that corporate income taxes are here to stay.

2.3 Criteria for evaluating tax rules

2.3.1 Neutrality

A key concept in the economic analysis of corporate taxes is neutrality. It should be noted that there is more than one possible definition of neutrality. The most frequent one might be that investment decisions should not be affected by the presence of tax. There is also more than one tax system that can achieve such neutrality, as discussed briefly in section 2.5 below.

A weaker requirement than neutrality with respect to investment would be neutrality across different types of investment. If the tax system reduces investment compared to an economy without corporate income taxes, then at least the tax system should not favour certain industries, activities, legal forms or sources of finance.

The latter requirement is particularly relevant. Most countries adopt a traditional definition of profits, which allows the cost of debt to be deducted, and therefore discriminates against equity finance. This

discrimination is important¹⁷ and increasingly more difficult to justify, given the loosening distinction between debt and equity instruments.

In addition, the tax should be neutral with respect to international investments. The three most important definitions of international neutrality put forward in the literature are:

1) Capital Import Neutrality (CIN)

This implies that all investors, irrespective of their residence, are taxed the same in a given country.

This is achieved if all countries tax profits at source only.

2) Capital Export Neutrality (CEN)

This implies that an investor in a given country faces that same tax, irrespective of where in the world he invests.

This is achieved if all countries operate a pure residence-based tax system.

3) Capital Ownership Neutrality (CON)

This implies that taxation does not affect the incentive to transfer ownership of assets across countries.

It is achieved if all countries tax profits at source only.¹⁸

These neutrality principles entail a wider discussion of the corporate income tax system that goes beyond the choice of a common corporate tax base. It is well known that the attainment of all the neutrality principles at the same time requires not only a common tax base, but also a full harmonisation of the corporate income tax rates, a perspective which is at present rejected in the EC policy initiative.

Even if no fully neutral tax system is to be implemented, the guiding principle of neutrality can still be useful. It implies for example a certain degree of symmetry in the tax system, meaning that positive and negative components of the tax base should have a symmetrical treatment when they have a similar nature. For example, if capital gains are taxed at favourable rates, the same rate should apply when deducting losses on the same types of assets. A more extreme version of symmetry would imply that in case of losses, firms would receive a tax credit, representing a negative corporate income tax, from the government. Enforcement

¹⁷ See the recent survey by the European Commission (2004).

¹⁸ This is a sufficient, not a necessary, condition. See Desai & Hines (2003).

considerations (see below) would, however, probably rule out such an extreme application of symmetry.

Another implication of neutrality is that a tax system should be inflation-proof, as an otherwise efficient system might become inefficient if not indexed for inflation. The effect of inflation on most corporate income tax bases is ambiguous. On the one hand, depreciation allowances are reduced with inflation, as they are usually granted at historic cost. On the other, the value of deductible interest payments increases in inflation, as they are usually deductible at nominal value. Moreover the valuation of inventories will be affected differently by inflation, depending on the valuation method used.

While these distortions have attracted much attention in the past, the low level of inflation in the EU makes these issues less important at present. Economic policy in the Union is directed towards achieving and maintaining price stability. At the same time, inflation adjustments typically result in very complicated rules and do not promote simplicity and growth. The compliance and administrative costs of adjusting profits to take into account the effects of inflation are thus likely to be higher at present than the benefits this adjustment could provide. It appears appropriate, therefore, not to adopt indexation rules within a CCCTB. If inflation were to increase again, however, the importance of these issues might resurface.

2.3.2 Equity

The equity principle would imply that incomes to equally well-off individuals should be taxed at the same level (horizontal equity) and that individuals with higher incomes should pay tax at a higher rate (vertical equity). This principle cannot be easily used for corporate income taxes, as profits are normally taxed without regard to who are the owners of capital. In the case of distributions the additional personal income tax can follow such principles. In practice this is less often the case as there is a trend towards flat taxes on dividend income. In the case of retained earnings, equity considerations cannot be considered without a complicated imputation of profits to owners. The equity principle thus does not lead very far in the design of corporate income taxes (except as an argument for levying such taxes in the first place).

Moreover, there is a case for equal treatment of different companies in different sectors or firms using different legal forms. Such equity across firms would be called for by the neutrality principle, unless there are good

reasons for discrimination. For example, there do not seem to be good reasons for discrimination between multinationals operating at the EU level and purely domestic companies.

2.3.3 *Simplicity*

A simple tax system would promote efficiency and competitiveness within the European market. By contrast, the administrative burden of ever more detailed and complex tax rules constitutes a significant hurdle. The costs of the tax authorities of monitoring such systems are also very high. Simplicity is a matter of competitiveness in that it enables the businesses to direct their resources from administrative tasks to productive activities that promote growth. Simplicity is therefore a very important objective in the task of designing a CCCTB.

There is often a trade-off between improvements in neutrality and administrative simplicity.¹⁹ In theory, it could be suggested that the optimal amount of neutrality is reached when the benefit of making the tax law slightly more neutral equals the additional administrative and compliance costs caused by that improvement. In practice, however, these costs are difficult to measure because they include such diverse issues as the amount of time tax advisors need to understand tax rules, the actual cost of fulfilling any documentation/accounting requirements and the cost of revenue authorities, including their cost ensuring compliance.²⁰

2.3.4 *Enforceability*

A related principle is that the tax system should be easily enforceable and taxes should be difficult to avoid and evade. A tax system that cannot be enforced is unlikely to be equitable or neutral, as taxpayers will face different tax burdens depending on their scruples. In the extreme case, a non-enforceable tax may be illegal.²¹

¹⁹ Although some cash-flow taxes are both neutral and administratively very simple.

²⁰ According to a recent survey by the European Commission (2004), these costs are relevant, above all for SMEs (see Section 1.1).

²¹ E.g. Germany used to tax capital gains on shares if realised within six months. As there was no mechanism to check compliance, this was *de facto* a voluntary tax. The Constitutional Court declared this tax illegal, as it infringed on the principle of equal treatment.

An enforceable system has to define with certainty which items are included in the tax base and clearly limit the taxpayer discretion of implementing accounting techniques that will affect the taxable base.

2.3.5 Tax capacity

Under pure comprehensive income taxation, corporate and business income should include (deduct) any accrued gains (losses). In practice, however, this would raise unacceptable problems both for taxpayers and governments and infringe on the widely accepted principle of tax capacity. In a world with imperfect capital markets, taxpayers may have great difficulty in financing the payment of taxes on unrealised gains. As a result, they are likely to forgo some otherwise profitable investment and may in extreme cases go bankrupt, even if making profits. The government on the other hand, may see its ability to raise revenue impaired if accrued losses are deductible (see section 2.3.6).

In addition, in many cases, there would be very complex valuation problems and uncertainties. For all these considerations, taxable profits usually include capital gains and losses only at realisation.

In theory, it would be possible to devise a system that would seek to adjust the tax levied on eventual realisation to offset the benefit of deferral and in this way produce a system that approximates to accrual taxation. Such a system would, however, be extremely complex and few countries have attempted to adopt such systems. Accordingly tax is usually deferred until realisation without any adjustment.

2.3.6 Revenue provision

The reason for the existence of most taxes is the provision of revenues to the government. Therefore a tax must be able to provide the revenue expected with a sufficient degree of certainty.

It is also often argued that stability over time is important, although governments can in principle smooth irregular tax revenues through borrowing and saving. In practice this is often restricted, either by political restriction, such as the constitution, or in Europe, the Stability and Growth Pact, or because of political economy reasons. The higher the revenues from a tax and the more dependent a government is on these revenues, the more important it is that the tax can provide them regularly.

One implication of this principle is that the definition of the tax base should limit the scope for taxpayers to be able to allocate revenue and cost items to different fiscal years.

2.3.7 Public policy

In some countries, the corporate income tax is not only used as a convenient way of raising revenue but also as a policy tool. By permitting allowances or other benefits in the form of deductions from the tax base or tax credits, the tax system is used as an incentive to stimulate investments or certain types of investments, notably R&D. If and to the extent that these incentives correct some market imperfection (e.g. externalities, in the case of R&D), they may be an important ingredient of a neutral tax system. The definition of a corporate tax base should therefore be transparent as to the kinds of incentives that are to be granted, which should then be at a uniform level in the EU. It should be noted, however, that such incentives typically add to complexity and must therefore be fully justified as capable of achieving their particular objective before being adopted.

A parallel issue to be faced is whether to grant additional powers to each member state to set its own incentives. While the subsidiarity principle would call for such autonomy, it may result in distortions to the efficient allocation of capital and activities across the EU. In this respect the objective of a CCCTB is to produce a *common* tax system. One of the key benefits is for multinationals to face one set of rules within the EU rather than the domestic legislation of each member state. To achieve this, the same rules need to apply in all countries in a uniform manner. Otherwise there would be no common base.

Uniformity on some aspects of a common tax base – for example, depreciation and stock valuation rules – may be difficult to achieve given the basic difficulties of measurement involved. The common tax base may naturally have to accommodate more than one valuation method that must be accepted by all member states. There seems less justification, however, for granting member states explicit powers to deviate from the common base. If some autonomy is to be left to member states, it would better be granted by allowing them to offer tax credits, rather than additional deductions or other deviations from the common base, so as not to interfere with the definition of the common tax base. This also represents a more transparent solution that may, if necessary, be justified within existing state aid rules.

2.3.8 Cost of reform

A final concern is the cost of the reform itself. Even if a rule that is different from current ones can be shown to be preferable, a change in tax law can only be justified if the present discounted value of the benefit exceeds the present discounted value of the cost of implementing the change. Such costs include the cost of any transitional arrangements that may be needed for the change. This is a matter of concern for both governments and companies which, under self-assessment systems, may have to bear the immediate costs associated with reform.

2.3.9 Other constraints

Finally, apart from any principles derived from economics, there may be other constraints on the choice of the tax base. Some countries' constitutions, as well as international treaties, may well limit the possibilities of chosen tax systems. This is particularly true in the short run, as the cost of changing such legal obligations may be high.

2.4 General guidelines from tax principles for the design of the tax base

The different tax systems currently observed in member states are the result of historical and political developments. To some extent, differences between countries are the result of different choices about trade-offs between conflicting principles, but other differences are likely to be the result of historical accident. Particularly in the latter case, agreement on a new tax base may be very difficult, if countries try to minimise the changes required in replacing their current tax laws.

Precisely because of that, a discussion of basic principles can be helpful, as they may help convince member states of the need to replace a current rule, even if this implies short-term costs. This could also help to build up a better system for the EU, rather than focusing discussion on how to accommodate existing national tax practices in order to reach a sort of common average tax system.

A ranking of the various principles is difficult, if not impossible, to draw and could change depending on the specific item to be considered. Nonetheless, particular emphasis should be given to the objectives of neutrality and simplicity, in order to improve the efficiency of the system and reduce compliance and administrative costs. In line with the Lisbon

strategy, the main aim of a common tax base should be to develop a more competitive (simple and efficient) EU tax system.

In its proposal for a common tax base, the Commission does not consider possible alternatives to the traditional definition of profits usually adopted by member states; broadly speaking: revenue less costs, including depreciation and interest payments. In the following section we briefly discuss alternative schemes, such as the neutral cash flow tax or the allowance for corporate equity (ACE).²² However, as they do not appear to be part of the reform agenda, we suggest a number of guiding principles, based on the assumption that traditional measures of profit will continue to be taxed.

First, the tax base should be as broad as possible, in order to obtain a given revenue with lower rates. This will reduce tax evasion and avoidance (both at the domestic and international level). This will also lead to simplification of tax codes, as fewer rules are required for exceptions. Moreover, if the tax base is not neutral, as is the case with the traditional profits tax, low rates reduce distortions.

It is important to stress, however, that the aim of a broad tax base is to achieve the benefits above and not to increase the overall taxation. The broadening of the tax base should thus be accompanied by a corresponding reduction of the tax rate. Furthermore, the width of the tax base must not exceed a reasonable reflection of economic reality.

Second, the tax base should be as close as possible to accounting profits. A greater alignment of tax and accounting profits reduces both compliance and administrative costs: without adjustments, accounts need to be filed and checked only once. Any adjustment to the IFRS definition of profits in order to define the tax base should be carefully justified by invoking the priority of other principles, with respect to simplicity and compliance cost reductions.

Third, member states should be prevented from granting fiscal incentives, such as accelerated depreciation allowances, that reduce the tax base. If member states insist on some autonomy in using tax policy to achieve public policy aims, then fiscal incentives should take the form of tax credits, or cash grants, rather than deductions from the tax base. The same result could be achieved with credits or grants as with deductions but

²² See IFS Capital Taxes Group (1991 and 1994).

with the benefit that the tax base would be unaffected; the incentive would be more transparent and it would be easier and more straightforward to check for its compatibility with state aid provisions. The United States and Canada offer a similar lesson: to work properly, a common consolidated tax base with formula apportionment, as envisaged by the Commission, should aim to minimise differences in the tax base definition. This is the case in Canada, where tax credits are allowed but the tax base, in contrast to the US, is a true common tax base across all different provincial jurisdictions.

The latter consideration raises the issue of what kind of agreement should member states reach on the corporate tax base. Should it be a highly detailed common tax base or should only minimum requirements be set, while leaving member states to agree, through mutual recognition, whether or not to accept the diversities of each country? Home state taxation (HST) envisages agreement on the common parameters of a corporate tax system, to be set out in a convention or a directive, but leaves the detail to member states operating within those parameters. A CCCTB necessarily envisages a more detailed formulation within the framework of a directive or a regulation.

In considering the detail of and potential for deviations from a common base, however, it is important to distinguish between differences in measurement that arise from alternative but equally valid accounting methods for identifying and valuing assets and liabilities and differences that may arise from the freedom of governments to introduce special rules that depart from such generally accepted methods. To the extent that a common tax base recognises more than one valid method of measurement, such methods would be recognised and available in every member state. By contrast, the scope for each member state to depart from such generally accepted methods other than on a basis specified by the rules of the common consolidated tax base should be strictly limited as otherwise this would go against the very objective of the project and counteract the core benefits of a CCCTB.

On the assumption that it is found to be possible to base the common tax base on accounting measures of profit, the central definitional issue that arises for any directive or regulation giving effect to the common base, is the ease with which it can set out those occasions on which it allows departures from ordinary accounting rules and can state the principle that should apply in place of those rules to form the basis of detailed provision in each member state.

A related issue is whether the system should be reserved only to companies operating throughout the EU or should it be a choice open to all companies, whatever the extent of their operations? The criteria of efficiency, simplicity and enforceability would call for a true common base and for having a level playing field for all companies, operating abroad as well as within the domestic boundaries, and regardless of the size and legal form of the company.

2.5 An aside: Neutral tax systems

While the likelihood of major tax reform towards a fully neutral tax system is unlikely, there are a number of proposals for such systems. One influential study, the Meade Report (1978), summarised two types of cash flow taxes ('R-Base' and 'S-Base'), which achieve neutrality with respect to investment. The Capital Taxes Group of the Institute for Fiscal Studies also proposed for the UK in 1992 a neutral system that would give an allowance for the notional cost of equity capital (the 'ACE' system).

Two countries have tried such systems: Croatia used an allowance for corporate equity (ACE) system between 1994 and 2001.²³ Estonia introduced a system resembling an S-Base cash flow tax in 2000. Italy and Austria temporarily used lower tax rates on measures of 'normal profits', thus going some way in the direction of an ACE system. Belgium has introduced a system that closely resembles the ACE system, to take effect in 2006.

A disadvantage of neutral systems is that, because of the smaller tax base, the tax rate needs to be set at a higher level if revenues are to be kept at a constant level. This would not affect investment in a closed economy, because these tax systems are neutral. In open economies, however, the discrete investment decisions of multinationals will be affected by this, as such decisions are based on the after-tax rent that can be obtained in different locations. If there is competition for the location of such firms, it is therefore likely that countries would prefer to keep the tax base broad and the tax rate low.²⁴

In any event, as the Commission is not inclined to extend the debate between member states to discuss such broad issues of tax design, this

²³ See Keen & King (2002) for an evaluation.

²⁴ See Bond 2000.

report also limits its attention to how the principles listed above may be a guide to define a common corporate tax base in a traditional system of profit taxation.

3. Corporate tax and IAS/IFRS bases in the EU member states

3.1 Introduction

The purpose of chapter 3 is two-fold. First, selected provisions of the IFRS for the capitalisation and valuation of assets and liabilities are compared with the corresponding tax practice in the member states. Second, general, inherent principles of tax accounting that are common in member states are developed on the basis of this comparison.

In principle, the chapter deals with revenue recognition, the definition of assets and liabilities as well as with their initial measurement (acquisition costs, production costs and simplified valuation) and their subsequent measurement (regular depreciation and lower of cost or market principle). It also deals with the treatment of financial instruments and – since IFRS could be a starting point for a common consolidated tax base – with the various concepts of group taxation prevailing in member states.

With respect to current tax practice, data has been extracted from various contributions in the literature. The European Tax Handbook²⁵ has served as a valuable source. Detailed data on country-specific rules are provided in Appendix 1 to this survey.

3.2 Comparison of corporate tax and IAS/IFRS bases

3.2.1 Relationship between financial accounting and tax accounting

In most member states taxable income is based on financial profits or losses. Only two countries (Ireland and the Netherlands) make reference to distinct tax accounting rules. However, where income is based on financial profits or losses, the impact of relevant GAAP (Generally Accepted

²⁵ See IBFD (2005).

Accounting Principles) varies among member states. Country practice ranges from reference to International Accounting Standards (IAS) to adjustments to domestic GAAP (Table 3). Different techniques provide for strong dependency (authoritative principle) in Germany, Austria and Luxembourg, whereas there is no formal dependency in most other member states (e.g. UK), but linkage between accounting profits and taxable income.

Table 3. Relationship between financial accounting and tax accounting

| Characteristic | Member state |
|--|--|
| Reference to IFRS | Estonia |
| Adjustments to IFRS | UK, Cyprus, Malta |
| Reference to domestic GAAP | Belgium, Luxembourg, Slovenia |
| Adjustments to domestic GAAP | Austria, Denmark, Finland, France, Germany, Greece, Italy, Portugal, Sweden, Spain, Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia |
| Reference to distinct tax accounting rules | Ireland, Netherlands |

According to the German Income Tax Code, the recognition and measurement of assets and liabilities (net assets) have to be done in conformity with the principles of proper bookkeeping. These govern commercial accounts, unless a departure there from is expressly envisaged in the taxation provisions. Its most important effect is that the prudence principle, which dominates commercial accounting, also governs tax accounting unless explicitly stated otherwise. Over the years, however, the authoritative principle has been rolled back because, especially for the measurement of assets and liabilities, German tax law is increasingly providing separate tax rules. In these cases, the authoritative principle is breached (for example valuation of debts and provisions). In contrast, the UK tax accounting rules do not exhibit formal dependency. Nevertheless the general starting point for the tax base is that tax follows the accounts. Even solitary traders and professionals are required to calculate their profits in accordance with generally accepted accounting practice, even though such businesses are not subject to that practice.²⁶

²⁶ For an explanation and comparison of the relationship between accounting rules and the German, US and UK tax rules, see Schön (2004).

3.2.2 Realisation date of earnings

3.2.2.1 Sale of goods

According to IFRS, profits are realised if the following conditions are fulfilled (IAS 18). Sales or service revenue should be recognised at the time of performance, provided that the amount can be measured reliably and collection is reasonably assured. For the sale of goods, performance is when:

- the significant risks and rewards of ownership are transferred to the buyer; and
- no significant uncertainty exists regarding the consideration from the sale, the associated costs or the extent to which goods may be returned.

For service transactions, performance should be measured under the percentage-of-completion method.

In principle, in the field of the realisation date of earnings, there is no significant variation between IFRS and taxation practice in member states.²⁷ Although profit realisation depends on the individual circumstances, significant risks of a transaction must have been transferred to the contract partner. Subsequent payments are not relevant; income or profit is rather determined on an accrual basis. As a general rule, therefore, unrealised profits are not recognised either in financial accounts or in member states' tax bases.

3.2.2.2 Construction contracts

Construction contracts (IAS 11) should be accounted for under the general principles identified above. This means that performance should be measured under the percentage-of-completion method, i.e. when the outcome of a construction contract can be estimated reliably, contract revenue and contract costs should be recognised by reference to the stage of completion of the contract activity at the balance sheet date.

With regard to tax accounting (see Table 4), the completed-contract method has to be applied in many member states. There is, thus, considerable variation between IFRS and taxation practice in some member states. However, a considerable number of member states are in line with

²⁷ See Appendix 2 for member states' practices.

IFRS since they prescribe or optionally allow the application of the percentage-of-completion method.²⁸

Table 4. Construction contracts (taxation)

| Characteristic | Member state |
|--|--|
| Percentage-of-completion method (similar to IFRS) | Belgium, Denmark, France, , Spain, UK, Cyprus, Estonia, Malta |
| Completed-contract method | Austria, Germany, Greece, Ireland, Luxembourg, Sweden, Czech Republic, Lithuania |
| Option between the two alternatives (Fourth Council Directive) | Finland, Netherlands, Portugal, Italy |
| Under scrutiny | Hungary, Latvia, Poland, Slovakia, Slovenia |

3.2.3 Assets and liabilities

3.2.3.1 Assets (self-created intangibles)

The definition of assets may be taken as a good example for the accounting differences between a system that aims at providing useful information for investors and tax rules which are designed to calculate taxable profits. According to the international standards (Framework section 49) an asset is defined as being the source of probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. Whereas this definition focuses on future economic benefits, the ‘continental’ approach to the definition of an asset refers to civil law and other test criteria (i.e. distinctly valuable, having the potential to be subject to a market transfer) that prove the existence of an economic value. This concept is applied, however, in only eight member states, whereas there is no definition in four member states and similar definitions to IFRS are applied in further eight member states. Accordingly, it appears that the definition of an asset in IFRS may serve well in the task of determining taxable profits, which should be clear and can be reviewed by any third party.²⁹ However, since the notion of an asset strongly depends on criteria that specify under what circumstances intangibles may be qualified as

²⁸ See Appendix 3 for member states’ practices.

²⁹ For an in-depth analysis, see Schnorr (2004).

property, the definition of an intangible asset comes to the fore. An intangible asset is defined as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes. The asset is identifiable if a reliable measurement of acquisition costs or production costs is possible (IAS 38).

IFRS distinguish between five categories of intangibles. Their capitalisation is treated as follows (see Table 5): Development costs as well as the costs for the acquisition or creation of rights and intellectual property have to be capitalised. By contrast, research costs, establishment costs and self-created goodwill must not be capitalised and, thus, are expensed immediately.

Table 5. Recognition of self-created intangible assets (IFRS)

| Category | Provision – Capitalisation of production costs is ... |
|---|--|
| Research costs | Prohibited |
| Development costs | Mandatory |
| Establishment costs | Prohibited |
| Rights (e.g. patents), intellectual capital (e.g. know-how) | Mandatory |
| Goodwill (self-created) | Prohibited |

Although member states apply different definitions of intangible assets there are some similarities to IFRS. The most common and important aspects of these definitions are a common future economic benefit and the ability to identify related costs.³⁰ Consequently, the definitions of intangibles under IFRS and taxation are quite similar. With respect to the different categories of intangibles their costs are treated as follows for the purpose of taxation.

In accordance with IFRS, self-created goodwill must not be capitalised for tax purposes in any member state.

About half the member states (12) follow IFRS with respect to research costs and disallow their capitalisation (see Table 5).³¹ The great

³⁰ See Appendix 4 for member states' definitions.

³¹ See Appendix 3 for member states' practices.

majority of member states (21) allow the capitalisation of development costs on option. Member states' practices do not deviate therefore to a great extent from IFRS but, in contrast to IFRS, which do not grant any options in the field of intangibles, the options mean that tax practices are not absolute. This is attributable to the fact that the treatment of R&D costs for tax purposes is closely linked to various tax incentives granted by the member states.³² In particular the capitalisation of these costs enables investors to avoid reporting taxable losses which might not become effective since loss compensation is restricted in most member states (see Table 24 for loss compensation).

Table 6. Recognition of research and development (R&D) costs (taxation)

| Characteristic | Member state |
|--|---|
| Same as IFRS | Ireland, UK, Estonia, Slovakia |
| R&D costs cannot be capitalized | Austria, Germany, Latvia |
| R&D costs can be capitalised (Fourth Council Directive) | Belgium, Czech Republic, Denmark, Finland, Greece, Italy, Luxembourg, Netherlands, Portugal, Sweden, Spain, Hungary |
| Research costs cannot but development costs can be capitalised | Cyprus, France, Malta, Poland, Slovenia |
| No information available | Lithuania |

Table 7. Recognition of establishment costs (taxation)

| Characteristic | Member state |
|---|---|
| Same as IFRS | Austria, Germany, Ireland, UK, Cyprus, Estonia, Latvia, Malta, Poland |
| Establishment costs can be capitalised (Fourth Council Directive) | Belgium, Denmark, Finland, France, Greece, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, Slovenia, Hungary |
| Establishment costs have to be capitalised | Czech Republic, Slovakia |
| Under scrutiny | Lithuania |

³² See IBFD (2004).

Similar to the treatment of R&D costs, IFRS provide strict rules for the treatment of establishment costs. They do not constitute an asset and therefore must be expensed immediately. While nine member states follow IFRS practice, 15 deviate from IFRS and prescribe or allow capitalising establishment costs on option (see Table 7).³³ Again, these more liberal and less binding rules for tax purposes can be traced back to less liberal rules for loss compensation.

Table 8. Recognition of self-created rights and intellectual property (taxation)

| Characteristic | Member state |
|--|---|
| Same as IFRS | Belgium, France, Greece, Italy (only advertising costs), Sweden, Spain, Cyprus, Czech Republic, Estonia, Hungary, Malta |
| Capitalisation is not allowed | Austria, Denmark, Germany, Poland, Slovakia, Slovenia |
| Capitalisation is allowed (Fourth Council Directive) | Finland, Ireland, Luxembourg, the Netherlands, Portugal, UK, Latvia |
| Under scrutiny | Lithuania |

IFRS do not differentiate between self-created intangibles and intangibles acquired from third parties. In any event, intangibles such as self-created rights and intellectual property must be capitalised. Member states' tax practices (see Table 8) are less binding since seven of them grant an option to capitalise costs for these intangibles.³⁴ However, 19 member states follow IFRS insofar as they allow a capitalisation although it is only mandatory in 11 member states. Only six member states have as a precondition for capitalisation that intangibles must be acquired from third parties and therefore forbid a capitalisation of costs for self-created intangibles. In this respect, acquisition serves as an indicator for objectivity and provides evidence that the tax base follows the prudence principle. With respect to the capitalisation of costs for intangibles, the prudence principle, however, is questionable since it results in a quite narrow tax base (in particular for industries with very intensive research activities).

³³ See Appendix 4 for member states' practices.

³⁴ See Appendix 5 for member states' practices.

Moreover, immediate expensing of costs can be avoided by multinational groups by transferring these assets to other members of the same group.

3.2.3.2 Liabilities (provisions and bad debts)

According to IFRS (Framework Sec. 60), an essential characteristic of a liability is that the enterprise has a present obligation. These obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. They also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. The settlement of a present obligation usually involves the enterprise giving up resources embodying economic benefits. Examples are payment of cash, transfer of other assets, the provision of services or the replacement of the obligation with another obligation. It is, however, decisive that liabilities result from a past transaction or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables and the receipt of a bank loan results in an obligation to repay the loan. To this end, IFRS (IAS 37) define provisions as liabilities of uncertain timing or amount. A provision should be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event,
- it is probable that an outflow of economic benefits will be required to settle the obligation and
- a reliable estimate can be made of the amount of the obligation.

A past event is deemed to give rise to a present obligation if, taking into account all available evidence, it is more likely than not that a present obligation exists at the balance sheet date and the other recognition criteria described above are met.

According to IFRS, bad debts are not recognised as a provision. Assets generally have to be tested, however, for impairment and an impairment loss must be recognised in the income statement if an asset's carrying amount exceeds its recoverable amount.

With respect to the general definition of a liability the 'continental' approach refers to civil law (i.e. legal obligation and other test criteria), based on which the taxpayer can clearly demonstrate his liability. As a result, relevant countries also only allow the accounting for provisions if several recognition criteria are met. Some countries, however, do not allow for recognition of provisions at all. Therefore, with respect to the recognition of provisions and bad debts for taxation purposes one has to

differentiate between the old and the new member states (see Tables 9 and 10):³⁵

Table 9. Provisions (taxation)

| Characteristic | Member state |
|---|---|
| Comparable to IFRS | Austria, France, Germany, Ireland, Luxembourg, Netherlands, Spain, UK, Estonia |
| Permitted under certain conditions concerning reason and amount | Belgium, Italy, Portugal, Sweden, Slovakia, Slovenia, Cyprus, Latvia, Czech Republic, Malta, Denmark, Finland |
| Not allowed | Lithuania, Poland, Greece, Hungary |

Table 10. Provisions for bad debts (taxation)

| Characteristic | Member state |
|--|---|
| Comparable to IFRS | Estonia |
| Specific provisions are allowed | Austria, Belgium, Denmark, Finland, France, Ireland, Luxembourg, Netherlands, Sweden, UK, Czech Republic, Slovakia, Portugal, Poland, Cyprus, Spain |
| Both specific and general provisions are allowed | Netherlands (if in accordance with 'sound business practice'), Greece |
| General provisions are allowed within limits | Italy |
| Not allowed | Hungary, Latvia, Malta, Slovenia, Germany, Lithuania |

In the old member states, provisions are recognised for tax purposes in most countries if certain objective facts are fulfilled. For example, in Germany, a provision is recognised if it is more likely than not (i.e. probability more than 50%) that an obligation exists. This is similar to IFRS (IAS 37.23). However, the situation in the new member states is different. Most countries allow accounting of provisions for tax purposes only under certain conditions concerning reason and amount or abandon them entirely. Therefore, we should expect a tax base that is considerably broader in the new compared to the old member states. One has to be

³⁵ See Appendix 6 for member states' practices.

aware, however, that this broader tax base is normally accompanied by lower nominal tax rates.³⁶

3.2.4 Initial measurement

With respect to the initial measurement of assets, one can differentiate between acquisition costs, production costs, and simplified valuation standards. The following sections deal in detail with these rules.

3.2.4.1 Acquisition costs

According to IFRS (IAS 2, IAS 16), acquisition costs comprise the purchase price of the asset, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use. Any trade discounts and rebates are deducted in arriving at the purchase price. If the asset is a qualifying asset, interest costs may be included. Administration and other general overhead costs are not components of the acquisition costs unless they can be directly attributed. IFRS therefore follow a full cost approach.

Table 11. Acquisition costs (taxation)

| Characteristic | Member state |
|--|--|
| Acquisition costs (Fourth Council Directive and similar to IFRS) | Italy, Netherlands, Portugal, Spain, Cyprus, Estonia, Malta |
| Acquisition costs without an option to include interest cost | Austria, Denmark, France, Finland, Germany, Greece, Ireland, Luxembourg, Sweden, UK, Czech Republic, Latvia, Lithuania, Slovenia |
| Other variations to IFRS | Belgium (option to include direct ancillary costs), Hungary and Slovakia (no deduction of price reductions) |
| Under scrutiny | Poland |

This full-costs approach to acquisition costs as laid down in the Fourth Council Directive, is quite common amongst member states.³⁷ As a result, seven member states define acquisition costs in a similar manner to IFRS. A further 14 member states follow the full cost approach without an

³⁶ See Ernst & Young/ZEW (2004).

³⁷ See Appendix 8 for member states' practices.

option to include interest costs. This deviation from IFRS should, however, be of minor relevance since borrowing costs are included in the cost of inventories or property, plant and equipment only in limited circumstances. On this note, borrowing costs may only be included in the acquisition costs if it necessarily takes a substantial period of time to get the asset ready for its intended use or sale. Examples of qualifying assets are inventories that require a substantial period of time to bring them into a saleable condition, manufacturing plants, power generation facilities and investment properties. Three further countries provide for other variations to IFRS. Belgium has an option to include direct ancillary costs, and Hungary and Slovakia do not allow price reductions to be deducted from acquisition costs. Altogether, these deviations are secondary. Rather, all countries in principle define acquisition costs in such a way that reporting the acquisition of an asset does not affect net income.

3.2.4.2 Production costs

With respect to production costs IFRS follow a full cost approach. Accordingly, the production costs include costs directly related to the product and a systematic allocation of fixed and variable production overheads based on normal capacity. Other costs may only be included to the extent that they are incurred in bringing the products into their present location and condition. If the asset necessarily takes a substantial period of time to prepare for its intended use (qualifying asset), borrowing costs are included. Distribution costs, however, do not form a part of the production or conversion costs.

Table 12. Production costs (taxation)

| Characteristic | Member state |
|--|---|
| Full cost approach (similar to IFRS) | Austria, France, Germany, Ireland, Italy, Luxembourg, Portugal, Spain, Sweden, Cyprus, Estonia, Slovakia, Slovenia, Malta |
| Direct cost approach | Hungary, Latvia |
| Option between the two alternatives (Fourth Council Directive) | Belgium, Denmark, Finland, Netherlands, UK |
| Under scrutiny | Greece, Czech Republic, Lithuania, Poland |

In observing the tax practices of member states, we may note that 14 follow a full-costs approach, which is similar to IFRS. Only two member states (Hungary and Latvia) limit the costs of production or conversion to costs directly related to the units of production, such as direct labour or materials. Several other member states grant an option between the two alternatives so that a full cost approach may serve as a common accounting principle for the majority of member states.³⁸

3.2.4.3 Simplified valuation (inventories)

In order to meet their objectives, financial statements are prepared on an accrual basis. On this basis, the effects of transactions and other events are stated in the accounting records and reported in the financial statements on an item by item valuation principle. This holds true for both the IFRS and the tax accounting principles in member states. According to IFRS, the cost of inventories of items that are not ordinarily interchangeable and goods and services produced and segregated for specific projects should, therefore, be assigned by using specific identification of their individual costs (IAS 2). However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the costs of inventories that are held in stock or affect the net profit or loss for the period should be assigned by using the first-in, first-out (FIFO) or weighted average cost formulae. In contrast the last-in, first-out (LIFO) method is no longer allowed under IFRS.

Table 13. Simplified valuation of inventories (taxation)

| Characteristic | Member state |
|---|---|
| FIFO (similar to IFRS) | Denmark, Finland, Ireland, Sweden, UK, Cyprus, Czech Republic, Estonia, France, Hungary, Latvia, Lithuania, Malta, Slovakia |
| FIFO and LIFO (Fourth Council Directive) | Austria, Belgium, Greece, Italy, Luxembourg, Netherlands, Spain, Poland, Slovenia |
| LIFO | Germany |

³⁸See Appendix 9 for member states' practices.

Assigning the costs of inventories by applying specific formulae when there are large numbers of items of inventory that are ordinarily interchangeable is a prevalent measure for tax accounting in member states. To this end the first-in, first-out (FIFO) formula is accepted in 14 member states. Nine other member states, including e.g. Belgium and Italy, also allow for the last-in, first-out (LIFO) formula for calculating the costs of inventories. Most member states also accept the weighted cost formula according to which the cost of each item is determined from the weighted average of the costs of the similar items at the beginning of a period and the costs of similar items purchased or produced during the period.³⁹ Usually, the average may be calculated both on a periodic basis or as each additional shipment is received. However, the weighted average cost method is not allowed in nine member states.⁴⁰ The survey nevertheless indicates that the first-in, first-out formula could serve as a common method to simplify valuation of inventories for the purpose of a common European tax base.

3.2.5 Subsequent measurement

3.2.5.1 Fixed assets

According to IFRS (IAS 16), the depreciable amount of an asset (i.e. historical acquisition or production costs or the revalued amount) should be allocated on a systematic basis over the useful life of the asset. The useful lives of major depreciable assets or classes of depreciable assets, should be reviewed periodically and depreciation rates adjusted prospectively if expectations are significantly different from the previous estimates. The useful life is defined as the period over which an asset is expected to be used by the enterprise. The depreciation method selected should be applied consistently from period to period unless altered circumstances justify a change. There is no guidance, however, as to which particular methods of depreciation are permitted and which are not. Accordingly, the straight-line method, the declining-balance method and the unit-of-production method are all applicable. However, any method selected, besides meeting the criterion of being systematic, must also be appropriate to the economic profile of the asset being depreciated. Thus, depreciation seems to be an area of accounting that involves a great deal of subjectivity. If, however, the pattern in which the asset's economic benefits

³⁹ See Appendix 10 for member states' practices.

⁴⁰ See Appendix 10 for member states' practices.

are expected to be consumed by the enterprise cannot be reliably determined, the straight-line method should be used. This particularly holds for intangibles. In practice the straight-line method is the most common.

The following differentiates in line between regular depreciation on industrial buildings, intangibles, machinery and goodwill.

Table 14. Depreciation on industrial buildings (taxation)

| Characteristic | Member state |
|--|---|
| Comparable to IFRS (Fourth Council Directive) | Estonia |
| Method: straight-line Rate: specified | Austria, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Portugal, Spain, Sweden, UK, Cyprus, Hungary, Latvia, Malta, Poland, Slovakia, Slovenia |
| Method: declining balance Rate: specified | Finland, Latvia |
| Method: straight-line or declining balance Rate: specified | Czech Republic, Lithuania, Belgium, Netherlands |

The treatment of buildings for tax purposes closely follows IFRS with respect to the depreciation method (see Table 14).⁴¹ With the exception of six countries, all member states prescribe the straight-line method. In contrast to IFRS, due to certainty and the equal treatment of all taxpayers the depreciation period (or the rate derived there from) is either fixed by the tax codes or by administrative practice. Depending on the type of building, the country-specific periods may vary between seven (15% annually) and 50 years. This also reflects national differences between expected economic benefits for the enterprises (i.e. quality of a building), which can cause problems when harmonising depreciation rates.

⁴¹ See Appendix 11 for member states' practices. Note that depreciation on office buildings for tax purposes is disallowed in some member states (e.g. the UK).

The depreciation on intangibles (rights and intellectual property) for tax purposes (see Table 15)⁴² relative to IFRS is quite similar. The majority of member states call for the straight-line method. However, there are a considerable number of member states (6) that apply – mandatory or optional – the declining-balance method. The useful life of intangibles mostly is determined according to the period of their legal protection. These periods can vary from country to country.

Table 15. Depreciation on intangibles (taxation)

| Characteristic | Member state |
|--|---|
| Comparable to IFRS (Fourth Council Directive) | Estonia, UK |
| Method: straight-line Rate: specified | Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Portugal, Spain, Cyprus, Czech Republic, Hungary, Latvia, Malta, Poland, Slovenia, Slovakia |
| Method: declining balance Rate: specified | Sweden (on a pool basis) |
| Method: straight-line or declining balance Rate: specified | Luxembourg, Lithuania, Netherlands |

For tax purposes, in many countries depreciation on machinery is linked closely to investment incentives. This explains why more than half of all EU member states apply – mandatory or optional – the declining-balance method (see Table 16).⁴³ Three states also apply the declining-balance method on a pool basis. The pool method stands for simplification and objectivity. Besides the methods, the periods also vary to a great extent, in particular when investment incentives are available.

⁴² See Appendix 11 for member states' practices.

⁴³ See Appendix 11 for member states' practices.

Table 16. Depreciation on machinery (taxation)

| Characteristic | Member state |
|--|---|
| Comparable to IFRS (Fourth Council Directive) | Estonia |
| Method: straight-line Rate: specified | Ireland, Italy, Portugal, Cyprus, Hungary, Latvia, Malta, Poland, Slovenia |
| Method: declining balance (on a pool basis) Rate: specified | Denmark, Finland, UK, Latvia |
| Method: straight-line or declining balance Rate: specified | Belgium, France, Germany, Greece, Luxembourg, Spain, Sweden, Czech Republic, Lithuania, Slovakia, Netherlands |

According to IFRS, acquired goodwill must not be depreciated on a systematic basis. Depreciation is only due if the cash-generating unit to which goodwill is allocated loses value. To this end, the enterprise has to verify on a regular basis whether or not the discounted cash flow of each cash-generating unit justifies a devaluation (impairment test). This implies that goodwill that emerges from consolidation or results from an asset deal has initially been allocated to cash-generating units at the time of the purchase. As far as taxation is concerned (see Table 17),⁴⁴ most countries call for a regular depreciation on acquired goodwill on a straight-line basis. However, there is considerable variation in the depreciation periods (between five and 20 years). Moreover, seven countries refuse depreciation on acquired goodwill for tax purposes. This different treatment of goodwill will result in differing tax burdens in case of mergers and acquisitions. In case of a common tax base, an identical treatment of goodwill will be necessary. In this field, current practice of IFRS (impairment only approach) can hardly serve as a starting point. By contrast, since the majority of member states allow for regular depreciation of goodwill on a straight-line basis, the latter provision could serve as commonly accepted practice for tax purposes.

⁴⁴ See Appendix 12 for member states' practices.

Table 17. Depreciation on goodwill (taxation)

| Characteristic | Member state |
|--|--|
| Method: on a systematic basis (Fourth Council Directive) Rate: not specified | Estonia |
| Method: straight-line Rate: specified | Austria, Belgium, Denmark, Finland, Germany, Greece, Italy, Luxembourg, Netherlands, Spain, Czech Republic, Hungary, Lithuania, Poland, Slovakia, Slovenia, UK |
| Not depreciable | France, Ireland, Portugal, Cyprus, Latvia |
| Method: straight-line or declining balance Rate: specified | Sweden |

According to IFRS (IAS 16), regular depreciation should start when an asset is available for use. During an asset's life, a change of the depreciation method is possible. In principle, these rules are in line with current member states' practices for tax purposes. Some countries allow accelerated depreciation in the first year (e.g. first year allowance), which could not be upheld in case of a common tax base.

3.2.5.2 Inventories

The cost of inventories may not be recoverable for several reasons. Inventories may for example have become obsolete, the estimated costs of completion may have increased or their selling prices have declined. In order to avoid carrying assets in excess of amounts expected to be realised from their sales or use, IFRS provide that inventories have to be reported at lower of costs and net realisable value. Estimates of the net realisable values have to consider the amount which inventories are expected to realise. To this end, net realisable value is determined through the sales market and linked either to the contract prices of firm's sales or based on general selling prices. The amount of any write-down of inventories to net realisable value and all losses of inventories should be recognised as an expense in the period in which the write-down or loss occurs (IAS 2.31).

Table 18. Subsequent measurement (inventories)

| Characteristic | Member state |
|--|---|
| Lower of cost or market principle (Fourth Council Directive and similar to IFRS) | Austria, Belgium,* Finland, France (through a provision), Germany,* Greece, Ireland, Luxembourg, Netherlands,* Portugal (through a provision), Spain, Sweden, UK, Cyprus, Estonia, Latvia, Malta, Slovenia, Poland, Italy |
| To be reported at historical costs | Denmark, Czech Republic, Hungary, Lithuania, Slovakia |
| Option | Italy |
| Under scrutiny | Poland |

* Determination of the market value by the purchase market for certain inventories.

This principle of lower of costs and net realisable value also reflects the common practice for tax accounting across member states (see Table 18).⁴⁵ Accordingly, this principle can be traced back to the accounting rules of 20 member states. However, five member states provide that inventories have to be reported at historical costs. This different treatment indicates that there is no common understanding as to the treatment of expected losses. However, depending on common standards that are envisaged for the offsetting of realised losses, the lower of costs or market principle could serve as a collective means to subsequent measurement of inventories.

3.2.6 Financial assets

According to IFRS detailed rules have to be applied to financial instruments. These instruments are defined as contracts that simultaneously lead to a financial asset on the one hand and a financial liability or an equity instrument on the other hand. Financial assets include cash, shareholdings and various receivables. For the purpose of valuation, IFRS differentiate between four categories of financial assets (IAS 39). These categories include held-to-maturity investments, loans and receivables, financial assets 'at fair value through profit or loss' (i.e. financial assets held for trading and financial assets designated by the entity as at fair value through profit or loss) and available-for-sale financial assets. Financial assets have to be recognised in the balance sheet as soon as the enterprise enters into a contract regarding this asset. As a consequence, executory

⁴⁵ See Appendix 10 for member states' practices.

contracts (i.e. contracts establishing both rights and obligations for each of the contracting parties without necessarily being onerous) have to be recognised in the balance sheet. This is of special practical importance for derivatives. As far as initial measurement is concerned, financial assets have to be reported at fair value. This fair value is calculated on an expense basis, including the purchase price of the asset plus costs directly related to the acquisition unless the asset falls into the category 'at fair value through profit or loss'.

Table 19. Initial measurement of financial assets (taxation)

| Characteristic | Member state |
|--|---|
| Fair value | Estonia |
| To be reported at historic cost (Fourth Council Directive) | Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, Cyprus, Hungary, Lithuania, Malta, Poland, Slovakia, Slovenia, UK,* Latvia |
| Under scrutiny | Czech Republic |

* Except in the case of shares, the UK tax law generally follows the accounting treatment for most financial assets.

For tax purposes (see Table 19), initial measurement at fair value is only admissible in Estonia. In contrast almost all other member states provide that financial assets have to be reported at historic cost.⁴⁶ At initial measurement, however, this deviation is of minor importance since both values refer to the purchase price and acquisition costs. Moreover, it has to be taken into account that the definition of acquisition costs, as discussed in the context of a tangible or intangible assets, does not apply to loans and receivables. Rather, a similar concept is adopted (nominal value or contractual value).

As to the subsequent measurement of financial assets, IFRS provide for a different treatment for each category. The general concept of the IASB for the subsequent measurement of financial assets is fair value without regard to possible cost of selling the asset. Exceptions are made, however, for all held-to-maturity instrumentals as well as for loans and credits. These instruments have to be reported at an adjusted value which is calculated according to the effective yield method. Further exceptions apply to

⁴⁶ See Appendix 13 for member states' practices.

shareholdings and related derivatives for which there is no active market or other reliable means to arrive at a fair value.

Available-for-sale financial assets and financial assets designated by the entity 'as at fair value through profit or loss' have to be measured at the fair value of the effective balance sheet date. As to the available-for-sale financial assets, however, changes in market value have to be reported as equity not affecting net income unless these changes refer to currency translation adjustment, a permanent decrease in value or appreciation. Changes in value of a financial asset 'at fair value through profit or loss' on the other hand have to be accounted for in the profit and loss statement. A further difference relates to the fact that executory contracts are normally not recognised for tax purposes.

The concept of revaluation of financial assets due to an increase in value for tax purposes differs widely across member states (see Table 20).⁴⁷ This results from the fact that the revaluation of financial assets is not only a question of accounting principles but also linked to the taxation of capital gains. As to participations and securities, some member states stipulate valuation at fair market value. However, in three member states revaluation may not affect net (taxable) income. Only Denmark and the UK (which generally follows the accounting treatment) accept that changes in market value can affect tax on income. Three member states allow for an option to revalue, whereas revaluation shall not affect net income (as laid down in the Fourth Council Directive). The bulk of member states, however (18 countries), do not allow for a revaluation, thus applying the general principle that revenue is not recognised until the enterprise has transferred the significant risks and rewards of ownership. If taking into account that revaluation may not necessarily affect net or taxable income, other concepts may also prevail in order to account for taxable profit. It should, however, be clear that measurement 'at fair value through profit or loss' is not acceptable from a tax point of view.

In case the financial asset declines in value, IFRS provide for an impairment test and, if necessary, depreciation to the fair value as of the effective balance sheet date by debiting the profit and loss account. In this respect the fair value of held-to-maturity instruments, loans and receivables is calculated as the net present value of all future cash flows, whereas the fair value of an available-for-sale financial asset is derived from market value. Regarding these available-for-sale financial assets in the event of

⁴⁷ See Appendix 13 for member states' practices.

depreciation, amounts that have been allocated to reserves due to previous changes in market value have to be cancelled.

*Table 20. Revaluation of financial assets (taxation)**

| Characteristic | Member state |
|--|---|
| Not affecting the net income, not taxable | France, Estonia, Lithuania |
| Affecting the net income, taxable | UK** |
| Option to revalue, not affecting the net income (Fourth Council Directive) | Belgium, Finland, |
| No revaluation allowed | Austria, Denmark, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, Cyprus, Hungary, Malta, Poland, Slovakia, UK, Latvia |
| Under scrutiny | Czech Republic, Slovenia |

* A classification of financial assets in each of the four categories was not possible. Therefore the treatment of participations and securities was analysed.

** Derivatives (subject to hedging rules), assets and liabilities for trading or designated at fair value and assets in category of 'available-for-sale'. Shares are excepted unless held for trading.

The prevailing rules regarding the write-down of financial assets for tax purposes do not display a clear cut pattern (see Table 21).⁴⁸ Again, however, it has to be taken into account that there is some interaction with the taxation of capital gains. So, whether or not the write-down is deductible for tax purposes depends on whether connected capital gains are taxable. According to the EU tax rules, the write-down of financial assets is mandatory in 15 member states, however, in four countries with no effect on net income. On the other hand, the write-down of financial assets is not allowed in seven countries. Harmonisation of these rules appears not to be possible without harmonising the taxation of capital gains at the same time. In this respect it is also to be borne in mind that there is a need to achieve symmetrical treatment of any hedges of such financial assets.

⁴⁸ See Appendix 13 for member states' practices.

Table 21. Write-down of financial assets (taxation)

| Characteristic | Member state |
|---|---|
| Not affecting net income | Greece, Lithuania, Estonia, Malta |
| Affecting net income (Fourth Council Directive) | Austria, Finland, France (for treasury shares), Germany, Luxembourg, Netherlands Portugal, Spain, Hungary, Poland, Slovenia, UK** |
| Option | Belgium (not tax deductible) |
| Not allowed | Denmark, Ireland, Italy, Cyprus, Sweden, Slovakia (for securities), Latvia |
| Under scrutiny | Czech Republic |

* Whether or not the write-down is deductible for tax purposes depends on whether the capital gains are taxable (exception: Luxembourg).

** Not including shares unless held for trading

3.2.7 Group taxation

In the field of group taxation, IFRS do not provide any regulations for tax purposes. Consolidated financial statements (IAS 27) shall include all subsidiaries of the parent company based on the concept of the power to control. In general, the parent company must own directly or indirectly through subsidiaries more than one half of the voting power of an entity. Intra-group balances, transactions, income and expenses shall be eliminated in full.

The concepts of a group for tax purposes in the member states differ significantly from IFRS (see Table 22).⁴⁹ In general, for reasons of objectivity and certainty, member states applying group taxation require certain minimum holding quotas enabling the parent company to effectively control the subsidiaries.

In all countries, parent companies must hold at least more than 50% of shares in a subsidiary; in certain cases, direct and indirect participation might be added. Most member states require holding quotas of more than 90%. Therefore, the problem of the interests of minority shareholders is not so relevant for tax purposes in many countries. Only four member states allow foreign subsidiaries to become members of the fiscal group in respect of losses incurred outside the member state in question.

⁴⁹ See Appendix 14 for member states' practices.

Table 22. Definition of a group (taxation)

| Characteristic | Member state |
|------------------------------|---|
| Minimum holding quota > 50 % | Austria*, Germany, Italy*, Malta |
| Minimum holding quota > 75 % | Ireland, Spain, UK, Cyprus, |
| Minimum holding quota > 90 % | Finland, France* (95%), Luxembourg (95%), Netherlands (95%), Portugal, Sweden, Latvia, Poland (95%), Slovenia |
| Holding quota = 100 % | Denmark* |
| No group taxation | Belgium, Greece, Czech Republic, Estonia, Hungary, Lithuania, Slovakia |

* Under certain circumstances, non-resident subsidiaries may also be included.

With regard to the type of group relief for tax purposes (see Table 23), the pooling of profits and losses at the level of the parent company is the predominant concept. Consolidation and an elimination of intra-group transactions for tax purposes only prevail in two member states. States (e.g. the UK) may also adopt different group rules for different categories of losses, such as capital losses.

Table 23. Type of group relief (taxation)

| Characteristic | Member state |
|---|---|
| Consolidation with elimination of intra-group transfers | Netherlands, France |
| Consolidation, pooling/transfer of profit and loss at the level of the parent | Austria, Denmark, Germany, Italy, Luxembourg, Portugal, Spain, Poland, Slovenia |
| No consolidation but contributions to other members | Finland, Sweden |
| No group consolidation, but losses can be surrendered to other group members | Ireland, UK, Cyprus, Latvia, Malta |
| No group taxation | Belgium, Greece, Czech Republic, Estonia, Hungary, Lithuania, Slovakia |

3.3 Analysis of common and inherent accounting principles

3.3.1 Conceptual accounting principles

The framework for the preparation and presentation of financial statements was adopted by the International Accounting Standards Board (IASB) in April 2001 and provides the conceptual accounting principles that underlie IFRS. The framework deals, among other things, with the qualitative characteristics that determine the usefulness of information in financial statements and the definition, recognition and measurement of the elements from which financial statements are constructed. In principle, there is no significant conflict between the objectives of financial accounting as illustrated by the principles established in the framework and the principles of income taxation adopted in member states.

Even if the primary objective of IFRS is to provide participants in the capital markets with information that is useful in making decisions – this, however, primarily takes place outside of the balance sheet in the cash flow statement, segmental reporting and the preparation of a statement of shareholders' equity – IFRS do not appear to be too investor-orientated to prevent the tax administration from using them as a primary starting point for determining the tax base. IFRS provide a broad basis of objective rules that can be adopted for tax accounting.⁵⁰ The examples in section 3.2 illustrate that IFRS as compared to taxation practice are based on more objective rules in the areas of recognition of assets and liabilities, initial measurement (acquisition costs, production costs, simplified valuation of inventories) and subsequent measurement (regular depreciation).

3.3.2 Accrual principles

3.3.2.1 Realisation date of earnings

With respect to the realisation date of earnings, a comparison of IFRS and member states' tax practices for the sale of goods, long-term contracts, revaluation and inter-company transactions suggests the following conclusions:

- 1) *Sale of goods.* As far as the sale of goods is concerned, there exist, in principle, no variation between IFRS and taxation practice in member states (see above, 2.2.1). Sales or service revenue should be recognised at the time of performance.

⁵⁰ See Schön (2004); Spengel (2003); Oestreicher & Spengel (2001).

- 2) *Long-term contracts.* With respect to long-term contracts, member states' practices deviate from IFRS, which calls for the percentage-of-completion method (see above, 2.2.2). There is no clear evidence from an accounting perspective, however, whether the percentage-of-completion method or the completed-contract method better meets the requirements to represent performance. This becomes evident from the fact that the Fourth Council Directive grants an option between the two alternatives. On the one hand, the application of the completed-contract method for tax purposes in most member states is more prudent in tax accounting. On the other hand, if the percentage-of-completion method were applied for tax purposes instead, the impact on the tax base would be rather limited since only periodical income is affected while total income remains the same. An analysis of member states' practices indicates that there are different views on this subject.
- 3) *Revaluation.* According to IFRS, revaluation of financial assets – if available-for-sale and at fair value through profit or loss – is a general concept. However, income is only affected if financial assets are held for trading or have been designated by the entity as at fair value through profit or loss. Variations in fair value of available-for-sale financial assets are allocated to the company's equity capital (reserves). With regard to tax accounting, revaluation predominantly is not allowed in the member states. Consequently, variation between IFRS and taxation practice in most member states in the field of revaluation is limited to financial assets as at fair value through profit or loss.
- 4) *Inter-company transactions.* According to IFRS, inter-company profits and losses are eliminated until realisation with third parties on a consolidated basis. With regard to tax accounting, group taxation is applied in most member states. However, consolidation is only applied in France and in the Netherlands. Moreover, elimination of inter-company profits and losses is only applied by a minority of member states. There is, therefore, considerable variation between IFRS and the taxation practice of member states. The reason is that consolidation and an elimination of intra-group transactions for tax purposes has turned out to be very complex in practice.

It is doubtful whether consolidated accounts from IFRS can serve as a starting point for a common consolidated tax base in the EU. Individual

accounts seem to be a better starting point.⁵¹ In this event, which is beyond the purpose of this survey, rules for the definition of a fiscal group and the treatment of inter-company transactions have to be identified.

3.3.2.2 Matching principle

When goods are sold, the carrying amount of those goods should be recognised as an expense in the period in which the related revenue is realised. This principle holds true for both IFRS and taxation practice in member states. To this end, the costs for assets with a useful life of more than one period, for example, are capitalised and depreciated on a regular basis over the amortisation period in order to allocate the respective costs to stocks and work in progress.

Since, for the initial measurement, both IFRS and taxation practice in member states broadly follow the full cost approach, the matching principle is recognised as a general principle in financial and tax accounting. In principle, there is no variation between IFRS and taxation practice. However, in countries that follow the ‘continental’ approach to assets, i.e. the capitalisation requirements are based on civil law or other test criteria, complete matching of earnings and expenses does not result. The same applies due to capitalisation options (e.g. R&D costs or establishment costs in Belgium, Finland, France and Italy) and valuation options (e.g. capitalisation of production overhead costs in Belgium, Denmark, Finland and the Netherlands).

With respect to the subsequent measurement of depreciable assets, both IFRS and taxation practice recognise the historical costs as a base (starting point) for regular depreciation. With respect to the method and rate of depreciation, there is, however, also considerable variation between IFRS and taxation practice in member states. We deal with this issue in more detail below (see section 3.3.4.3).

3.3.3 Treatment of losses

Accounting for potential losses is a common principle of IFRS and taxation practice. The lower of cost or market valuation is accepted by both IFRS and taxation practice in most member states. However, considerable variation exists on the fields of provisions and the recognition of bad debts. While these items are recognised under IFRS and affect income as

⁵¹ See European Commission (2003). See also Spengel (2004b).

expenses, they are limited and restricted for tax purposes in most member states. In particular, this is true with respect to provisions (see above, 2.3.2).

The limitations and restrictions of the recognition of losses in tax accounting, however, are compensated by offsetting losses for tax purposes. Essentially, the carry back and carry forward of losses is an important element of the tax base since they link the tax bases of different periods. In all member states, in the field of inter-period loss compensation, different rules and various limitations exist (see Table 24).

Table 24. Loss treatment (taxation)

| Characteristic | Member state |
|--|---|
| Carry-forward (years): ∞ Carry-back (years): 3 | France, Ireland, Netherlands |
| Carry-forward (years): ∞ Carry-back (years): - | Austria, Belgium, Denmark, Luxembourg, Sweden, Cyprus, Hungary, Malta |
| Carry-forward (years): ∞ Carry-back (years): 1 | Germany, UK |
| Carry-forward (years): 15 Carry-back (years): - | Spain |
| Carry-forward (years): 10 Carry-back (years): - | Finland |
| Carry-forward (years): 6 Carry-back (years): - | Portugal |
| Carry-forward (years): 5 Carry-back (years): - | Italy, Czech Republic, Greece, Latvia, Lithuania, Poland, Slovakia, Slovenia |
| Carry-forward (years): - Carry-back (years): - | Estonia |

Whereas most member states allow for pooling, contribution or surrender of losses to other group members within a group of companies, on an individual basis, the carry back of losses is denied by the majority of member states. The carry forward of losses is restricted to a certain number of years (between five and 15 years) in 11 member states. From those member states that allow for an unlimited loss carry-forward, some have introduced a kind of minimum taxation which limits the amount of the

deducted losses in subsequent periods to a certain percentage of the profits of that period (e.g. Austria, Germany and Poland).⁵²

Consequently, the limitations of accounting for potential future losses in the tax base are only compensated to a certain extent by the compensation of realised losses. These limitations can be traced back to the aims of objective assessment in accounting and the stabilisation of member states' tax revenues. If a common consolidated tax base were introduced, however, it would also be appropriate to have common standards for the offsetting of losses.⁵³ As a general rule, relief for losses should be more liberal if greater limitations exist in the recognition of potential losses in tax accounting.

3.3.4 *Simplification, miscellaneous*

3.3.4.1 *Immediate write-off*

According to IFRS, the depreciation of an item should be on a systematic basis over its useful life. An immediate write-off of acquisition or production costs is not allowed.

Table 25. Immediate write-off of tangible assets in tax accounting (acquisition costs)

| Euro value | Member state | Euro value | Member state |
|----------------------|---------------------|-------------------|-------------------------|
| 199.52 | Portugal | 516.46 | Italy |
| 400.00 | Austria | 601,01 | Spain |
| 410.00 | Germany | (SKK 30,000) | 750.00 Slovakia |
| (DK 11,000) 1,161.61 | Denmark | 850.00 | Finland |
| 450.00 | Netherlands | 870.00 | Luxembourg |
| 500.00 | France | (CZK 40,000) | 1,265.00 Czech Republic |
| 1,200.00 | Greece | (PLN 3,500) | 837,83 Poland |

In most member states, immediate write-down on assets with low acquisition costs is available.⁵⁴ The relevant volume varies, but the

⁵² See Appendix 15 for member states' practices.

⁵³ See Schön (2004); Spengel (2004b).

⁵⁴ See

Appendix 16 for member states' practices.

maximum amount is less than €1,000 in most cases. In general, qualifying assets are tangible fixed assets acquired from third parties. Since the amount of immediate write-off is rather limited, these practices cannot be qualified as tax incentives. Rather, they can be traced back to simplification and materiality of tax accounting, which is also a common principle of IFRS. Again, however, a common tax base would need common standards for the treatment of these particular assets.

3.3.4.2 Simplified valuation of inventories

Both IFRS and taxation practice in member states allow for the use of simplified valuation methods for inventories (LIFO and FIFO). Again, this provides evidence that simplification is a general, commonly accepted accounting principle. Whereas IFRS calls for the FIFO method as a benchmark, some member states additionally allow the application of the LIFO method. Both from an accounting and from a tax perspective it is debatable whether the LIFO method can be justified systematically (i.e. by accounting objectives). Therefore, the common and binding application of the FIFO method for tax purposes and thus the use of IFRS as a starting point seem to be possible.

3.3.4.3 Depreciation

According to IFRS, depreciation has to be on a systematic basis over the asset's useful life. For tax purposes, tax law or administrative practices determine the method and the rate of depreciation depending on categories of assets. In many member states standardised depreciation is independent of the useful life of assets.

Whereas the general approach of IFRS is to allocate depreciation or capital allowances respectively to the economic profile of the asset, which involves a subjective judgment, tax accounting aims to allocate these expenses on a fixed pro rata temporis basis to subsequent periods. As far as tax accounting is concerned, this deviation can be traced back to reasons of simplification and the need for an objective determination. A good expression of these two objectives is the application of the pooling method in some member states (e.g. the UK). In addition, rather restricted rules for regular depreciation express a tax policy of 'tax rate cum base broadening' which seeks to attract direct investment. One has to bear in mind, however, that according to IFRS the straight-line method should be applied in case there exist no reliable estimates about the economic profile of the asset

being depreciated. Therefore, IFRS also include elements of objective determination in the area of regular depreciation and could be used as a starting point.

In the field of depreciation on fixed tangible assets (i.e. plant and machinery, see above 2.5.1), it becomes evident that a considerable number of member states adopt the declining-balance method. The underlying objective is to grant incentives for new investments. Many member states are concerned that with a common tax base they would lose the power to control their tax bases and thus the most important element for granting tax incentives. This is particularly true for continental European countries such as Germany. Nevertheless, under a common tax base there would still remain instruments for affording tax incentives other than through the tax base. Prominent examples are investment tax credits which are common in particular in Anglo-Saxon member states and in France.⁵⁵

3.3.4.4 Cash orientation

According to IFRS, as a general rule, profits are determined on an accrual basis (F. 22). Although the accrual principle is recognised as a principle for determining taxable profits, some member states allow the cash basis to be used (e.g. Germany and Lithuania). This kind of profit determination recognises certain income and expenses on receipt or payment rather than on accrual. There is, therefore, no obligation to keep books for tax accounting. The cash principle is limited to small companies with a turnover or profit beyond certain limits. Again, this can be traced back to simplification as a major objective of tax accounting.

⁵⁵ See IBFD (2004). Same opinion as Bravenec (2000, p. 455).

4. Scope of IAS/IFRS as a starting point for a common EU tax base

4.1 IAS/IFRS and tax principles

As mentioned earlier, the principle of simplicity would call for the greatest possible alignment between taxable and accounting profits. This would save compliance costs since companies would only have to use one set of accounts for both purposes.

It has also been frequently recognised (for example, Schön, 2004) that the IAS/IFRS accounting profits would in principle be well suited to represent taxable profits, if we follow the widely recognised Schanz-Haig-Simon (SHS) definition of income. According to this definition, taxable profits should be measured as accrued changes in net worth, plus net distributions of capital; a measure that is close to the IAS/IFRS definition of accounting profits. In principle, therefore, a tax system in which profits are aligned with IAS/IFRS accounting profits would be equitable and neutral. However, measurement problems and the violation of other tax principles require some adjustments to accounting profits.

In a world of uncertainty and, more importantly, of imperfect capital markets, two major problems make it difficult to implement a SHS definition of profits and, for similar reasons, prevent a full alignment of taxable and IAS/IFRS accounting profits.

First, it is not always possible to evaluate accrued income on accurate market values. In the real world there are situations in which it is impossible to determine the true amount of accrued gains and losses, or of accrued receipts and expenses, until the transactions take place (the asset is sold or the payment is made). The measurement of profits always entails the use of discretion, and the implementation of IAS/IFRS is bound to enhance this discretion. This would make taxable income difficult to assess, give scope for avoidance and manipulation and impair the equity and

efficiency of the tax system too. The latter calls for greater certainty and objectivity than is required in accounting.

Second, in imperfect capital markets, accrued income does not coincide with disposable income. The taxpayer might have liquidity problems and be forced to sell her/his assets, in order to pay the tax debt. The capacity to pay principle calls for taxation at realisation, even though this is an imperfect solution. Taxation at realisation confers benefits on the taxpayer that increase the longer realisation can be postponed, and provides opportunities to realise gains and losses in a manner and at a time designed to minimise the tax bill. Such behaviour clearly reduces the efficiency of the market.

The examples suggested in section 4.2 illustrate how the various tax principles could provide a guide for choosing whether or not to align to accounting standards and, if not, which solution could be envisaged and why. The examples have been divided into three groups, depending how close IAS provisions are to a tax system guided by the principles discussed above.

One should also distinguish between the problems that might arise in the transition to the new system and those concerning the structural definition of the tax base. Also, an alignment of the tax base with IAS/IFRS would give rise to difficulties with respect to the future coordination between the CCCTB and these accounting standards. In order to provide for simplicity and save compliance costs, it is not sufficient that the systems are aligned day one. As both systems will require ongoing improvements and updates, there is an issue of how to maintain the alignment (and thereby the simplicity), which needs to be addressed.⁵⁶ The analysis below, however, focuses on the difficulties concerning the structural definition of the tax base. The use of IAS/IFRS as a benchmark for common tax rules should provide for simplicity with respect to the process of establishing a CCCTB.

⁵⁶ This aspect of linkage may also raise the constitutional issue in some member states of how far it is appropriate to allow the tax base to depend upon the decisions of international accounting bodies. From the accounting bodies' perspective there is concern that a process that has to move by seeking consensus will be hampered if it is perceived that particular tax consequences may result from the consensus.

4.2 Some concrete examples

4.2.1 *Examples in which the overall balance between the different tax principles could make the IAS definition acceptable for tax purposes*

Inventories are principally defined by the valuation standards and the cost formula. According to IAS/IFRS, the valuation standard is the lower between cost and 'net realisable value'. It has been argued that market value may be too subjective and, hence, not suitable for tax purposes.⁵⁷ Moreover full alignment would allow deductions for unrealised losses and this could be questionable unless a symmetric treatment is reserved to unrealised gains. However, this valuation standard (lower of purchase/production cost or market value) is adopted in most EU tax systems and this discretion does not seem to create significant problems of tax stability. Concerning the cost formula, most member states adopt FIFO or the weighted average methods, which are both allowed by IAS/IFRS accounting. Only one (Italy) out of 25 member states allows an option for LIFO, which is not permitted as a cost formula for inventories under the new accounting standards. At the same time Italy offers an example of how alignment and simplicity have prevailed over other considerations (e.g. equal treatment of all companies). Under Italian rules companies adopting IAS/IFRS will not usually be allowed to opt for LIFO evaluation of inventories,⁵⁸ whereas other companies will continue to be able to do so.

Another example in which full alignment between tax and IAS/IFRS accounting seems possible is **(long-term) construction contracts**. According to IAS 11, when the outcome of a construction can be estimated reliably, contract revenues and contract cost are recognised as revenues and expenses, respectively, by reference to the stage of completion of the contract activity (percentage of completion method). Some European countries use the 'percentage of completion method' in their tax accounting rules (UK, France, Spain, etc.). Other countries, mainly Germany, adopt the 'completed contract method' for the imputation of costs and revenues to the taxable income. Italy allows companies to opt between the two methods.

⁵⁷ Nobes (2004).

⁵⁸ In fact, if a company used the LIFO system in the last three years, it can continue using it.

From a neutrality point of view, the 'percentage of completion method' suggested by IFRS seems more capable to give a real picture of the profits accruing to the company and would be suitable for tax purposes. Moreover by averaging profits over time it would smooth the tax payments too. However, companies may have to pay tax on profits that have not been cashed yet and may even be uncertain. This may raise liquidity problem. Despite this, the overall balance of the different tax principles seems to be in favour of full alignment of the tax base with the IFRS prescription, as long as the outcome of the contract can be assessed with reasonable certainty.

A more controversial choice might turn out to be **lease** treatment, particularly because of the high costs that adopting IFRS for tax purposes might have on the leasing sector. On the basis of tax principles, though, there may be arguments in favour of aligning tax and accounting treatment. IAS 17 differentiates between operating lease, if it does not transfer substantially all the risks and rewards incidental to ownership, and financial lease, if it transfers substantially all the risks and rewards incidental to ownership. For operating leases, lease payments of the lessee should be recognised as an expense for a sort of 'rental' of an asset that goes to the profits and losses account. For financial leases, the asset acquired through a lease is included in the 'tangible assets section' of the balance sheet of the lessee and depreciated according to its useful life. In the liabilities the lessee has to indicate a debt equal to the present value of the minimum leases payments. In the profits and losses account, the lessee deducts the depreciation of the asset and the interest paid on the lease operation. Under current tax arrangements, most European countries adopt the IAS definition of an operating lease. The application of the IAS 17 treatment of finance leases could lead to an increase in the taxable base since lease payments are often bigger than the sum of depreciation and interest paid (especially when the lease contract is shorter than the asset useful life). From a neutrality point of view the present favourable treatment of leasing activities is debatable. It may distort the firm choice between different forms of financing investment decisions, by favouring leasing as compared to ordinary debt financing. The IAS distinction between operating and finance leases offers a more neutral approach. It is questionable, however, whether the accounting definition is clear enough to distinguish correctly between the two types of leasing operation. If not, a special statutory definition would be needed for tax purposes.

A related problem that should be evaluated is the cost that this solution could impose on SMEs, particularly start-up companies, that

usually use finance leases in order to be able to take advantage, through the lessor, of depreciation allowances. But this problem would be better addressed through other instruments than by treating all leases as operating leases.

4.2.2 Examples in which adjustments to IAS accounting would be required to avoid excessive taxpayer discretion

This group comprises cases in which accounts leave too much discretion to taxpayers. Adjustments are mainly called for in order to satisfy the principles of certainty and enforceability of the tax system.

Depreciation of **tangible assets** is one of the most important issues in this group. Current treatment in member states ranges from allowing firms to make their own (reasonable) judgement, to prescribing rates for detailed asset categories (e.g. Italy) to prescribing a few rates that treat most assets the same (e.g. the UK). The methods adopted are the straight line and/or the declining balance. The base is always the historical cost. According to IAS 16, the base for depreciation is historical costs or re-valued amounts, the method should reflect the pattern in which the asset's benefits are consumed. As a systematic basis the straight line method is suggested at a rate that reflects each asset's useful life.

Based on the principle of economic neutrality, particularly neutrality across firms and asset types, the optimal approach would be to estimate as precisely as possible actual economic depreciation and prescribe this. The IAS definition would in principle be acceptable and even more adequate than a fixed generalised rate, since it tailors economic depreciation for each asset and business activity, taking into account individual circumstances. Full alignment would pass the test of simplicity and reduce compliance costs too. It could, however, leave too much discretion to taxpayers and require difficult and costly monitoring to prevent taxpayers from accelerating depreciation to defer taxation. The principles of certainty, revenue stability and enforceability call for a tighter definition of tax depreciation and the application of specific rules, concerning the valuation of the depreciable basis, the method and coefficients of depreciation.

As far as the depreciable basis is concerned, the use of historical cost would be in line with accounting principles and also with the practice used in member states, minimising the costs of reform. Revaluation should not be recognised, as long as tax is not paid on accrued capital gains. The loss

in value should be recognised through specific capital allowances, with a balancing charge when the asset is finally sold or scrapped.

The straight line (SL) method suggested by the IAS/IFRS principles is adopted in many member states, particularly with reference to buildings. For machinery and equipment the declining balance (DB) method is widespread. Agreeing on a common method could be a difficult process, and an option between the two methods could eventually be allowed. However, the argument should not be overemphasised, since DB and SL can be made equivalent in present-value terms, depending on the relationship between the depreciation coefficients used under the two methods.⁵⁹

According to the principles of simplicity and enforceability it would be preferable to have fixed depreciation rates, rather than boundaries or a maximum amount. Moreover, assets should be grouped into easily distinguishable groups, to avoid costly disagreements between firms and revenue authorities as to which assets class a particular asset belongs to. A further advantage is that in the case of few categories, tax accounting is simplified as different assets can be pooled and only additions and sales need to be monitored. The benefits of pooling seem to be particularly relevant if the DB method is used.

Overall, the cost of reform principle is unlikely to be decisive in this case, as whatever approach is chosen, some countries will need to change their current policy. Particular problems might arise in those countries where accelerated depreciation is allowed as a generalised incentive to investment. As anticipated before, investment incentives, if desired, should only take the form of tax credits (or cash grants); accelerated depreciation or other types of incentives that reduce the corporate tax base should not be allowed under a common EU tax base.

R&D is a particular and important expenditure for two major reasons. First, there are good motives to provide a favourable tax treatment, in order to promote R&D. Second, the tax treatment differs greatly across member states: some of them do not capitalise these expenses, and among those that do, rates differ widely. IAS 38 draws a

⁵⁹ For a given and constant discount rate, the net present value of depreciation allowances is approximately the same if the rate of the declining balance depreciation is twice the rate of straight line depreciation.

distinction between research (non-capitalised) and development costs⁶⁰ (capitalised under certain conditions).

According to the neutrality principle, IFRS could be acceptable for tax purposes. However, when costs are capitalised under IFRS, revenue stability and certainty would call for a clear definition of the timing, method and rates of tax depreciation, as is the case for a tangible asset. Timing is more difficult to define, in this case, but could be aligned with the IAS 38 definition. The distinction between different types of R&D costs is not easy to draw. Moreover, there are good economic reasons to provide incentives for all types of R&D, to the extent that they generate positive externalities. Simplicity, enforceability and public policy objectives would therefore suggest allowing companies to opt for full deduction from the tax base or capitalisation and depreciation, in this case according to a common set of rules (e.g. from one to five years), independently of any distinction between R&D costs, and irrespective of any capitalisation for financial reporting.

A particular intangible asset is **goodwill**. According to IAS, self-created goodwill is not capitalised, whereas acquired goodwill is. In neither case is depreciation allowed. However, acquired goodwill is subject to impairment. The major problems in adopting IAS for tax purposes concern acquired goodwill, which is depreciable in most member states for tax purposes.

Based on the neutrality principle, goodwill should be depreciated at a rate that is close to its actual loss in value, if any. As this is likely to be very different across companies, even more so than for physical assets, and as goodwill may even be increasing in value (although this is not recognised in accounts), a statutory given rate is unlikely to be close to true depreciation. Simplicity and enforceability however mean that a case-by-case calculation would be problematic. Overall the case for allowing any tax depreciation is then debatable, unless goodwill is acquired in a business combination (not considered here). However the widespread use in the EU of a regular depreciation of goodwill on a straight-line basis, could suggest the adoption of this common practice, in order to minimise the costs of reform. Adjustments to IAS would be required to exclude from tax purposes any devaluation due to impairment. The treatment should be

⁶⁰ They include ‘applied research costs’ under certain strictly defined conditions.

symmetric with gains: as the latter are postponed until realisation, losses should bear a similar treatment (see below).

Contingent liabilities represent another case in which some adjustment to accounting seems to be necessary. On the one hand, IAS/IFRS tends to recognise a provision for contingent liabilities at an early stage when i) a firm has a present obligation (legal or constructive) as a result of past events, ii) it is probable that an outflow of economic benefits will be required to settle the obligation and iii) reliable estimates can be made of the amount of the obligation. European tax systems, on the other hand, differ widely across countries when it comes to recognition of contingent liabilities. For example, while UK courts have accepted the inclusion of provisions based on accounting, Germany has in recent years increasingly restricted the recognition of provisions for contingent liabilities in tax rules.⁶¹

The main concern associated with the tax treatment of contingent liabilities is related to the certainty and the enforceability of the tax system. While for accounting systems, and particularly for IFRS, there is an explicit acceptance of the accrual principle, for the tax system the realization principle is more relevant. If we accept the IFRS provision for contingent liabilities, a taxpayer in similar circumstances could face a different tax burden depending on his estimation of contingent liabilities. However, the problem remains that adopting a stricter rule for the tax base than for accounting could excessively restrict the possibility of deducting a loss. To compensate, a carry-back provision could be introduced to provide immediate relief to companies without taxable profits in the year in which the loss is recognised and possibly in subsequent years too. At present very few countries allow loss carry-back and also the carry-forward of losses differs widely (see below). As emphasised earlier, if a carry-back provision turned out to be unrealisable, it might be better to recognise contingent liabilities at an early stage.⁶²

4.2.3 Examples in which adjustments to IAS accounting would be required for other reasons

This group of items requires adjustment to IAS for additional reasons, beyond certainty and enforceability, particularly to preserve the company's capacity to pay, that is to say, for liquidity reasons. The crucial problem

⁶¹ Schön (2004).

⁶² Schön (2004).

here is how to treat capital gains and losses. To the extent that the taxation of gains is postponed until realisation, a symmetric treatment should be provided for losses (hence, impairment should not be allowed).

This group includes one of the most discussed IAS: IAS 39, on **financial assets/liabilities**. According to IAS/IFRS, assets held for trading and available for sale have to be valued at fair value, in the balance sheet account. Changes in value affect the profit and loss account if they accrue on assets held for trading.

Fair value evaluation widely differs from current tax arrangements, under which all financial assets are valued at the purchase price. In some countries (e.g. Spain and Luxemburg), de-valuation of financial assets is allowed, in certain circumstances, with effect on the profit and loss account and the tax base. Under current tax arrangements capital gains on financial assets (as well as tangible assets) are usually taxed when they are realised.

In principle, from an equity and neutrality point of view, the full fair value accounting measurement would be adequate for tax purposes and coherent with a SHS concept of income. Nevertheless full fair value accounting does not meet several principles that are important when defining a tax base. First, the fair value accounting gives room to a great uncertainty and discretion both for the taxpayer and the tax authorities that may affect the stability of revenues provision (increasing the volatility of profits and losses) and the equity principle (in the case of abuses in the discretionary evaluation). Discretion by the taxpayer, along with different IAS valuation methods for the different financial assets, would stimulate avoidance behaviour and increase the costs of monitoring, and legal disputes. Moreover, fair value accounting would show in the taxable income gains that have not been realised yet, so that there not may be a corresponding capacity to pay on the part of the taxpayer, who could be forced to sell assets to pay the tax liability. Overall, the principles of certainty, revenue stability, enforceability and capacity to pay seem to call for an adjustment to IAS 39 principles, in order to restate the historical cost method and taxation at realisation, despite the costs in terms of neutrality.

The possible tax implications of fair value accounting have been widely discussed. The most important effect of fair value accounting would be on the banking and financial sector. In Italy, for example, the banking sector has progressively moved to mark-to-market accounting since 1993. Hence, the introduction of IAS 39, as it is now, is not inducing relevant changes to current accounting rules in the banking system. In this respect

the issues of IAS 39 should not be over-emphasised. However, it may also present difficulties for manufacturing and industrial sectors that use derivative contracts to hedge a variety of assets and positions. The implementation of IAS 39 in the tax sphere has proved particularly problematic in the UK following the decision to adopt IAS/IFRS as the basis for business taxation from 1 January 2005, and its application under those rules is currently subject to a variety of qualifications.

Investment property is another example of adjustment mainly explained by the necessity to avoid liquidity problems for the taxpayer. According to IAS 40, investment property is initially recognised at cost. Subsequent to initial recognition, investment property is carried either at historical cost (less accumulated depreciation and any accumulated impairment losses) or at fair value, that is, the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. Changes in fair value are recognised immediately in profits and losses account. The measurement model has to be applied consistently to all investment property. Transfer to or from the investment property classification are made only when there is evidence of a change in use.

Under most member states' tax rules, subsequent evaluation of investment property are carried at cost less accumulated depreciation.

From a neutrality point of view, the IAS option for valuation at the historical cost or at the fair value in principle provides a correct comprehensive measure of the income produced in a company. On the other hand, if a company opts for the fair value method, in the case of an increase of the market value (without realisation) it may encounter liquidity constraints and be forced to sell the property or take a loan to pay the tax. It would be better, therefore, for tax purposes, to limit valuation of investment properties to historical costs.

A final example in this group is **post-employment benefits** (defined benefit plans). For a defined benefit plan, according to IAS 19, an entity recognises a net defined benefit, including the present value of the defined benefit obligations at the balance sheet date, based on actuarial assumptions.⁶³ Actuarial gains or losses (including experience adjustments and the effects of changes in actuarial assumptions) are recognised as income or expense to the extent that they exceed 10% of the defined benefit

⁶³ IAS 19 encourages the involvement of a qualified actuary in measuring defined benefit obligations, which are valued using the projected unit credit method.

obligation or 10% of the fair value of plan assets. The actuarial gains or losses are recognised over the average remaining working lives of employees participating in the plan. An entity can recognise all actuarial gains and losses immediately.

Most member states' tax systems do not impose an actuarial valuation of these assets and liabilities and consequently do not accord significance to actuarial gains or losses in taxable income.

From a neutrality point of view the IAS standard could be acceptable in principle as it would give a real picture of all assets and liabilities of a company. But the actuarial evaluation of defined benefit plans could give rise to uncertainty and discretion in the definition of taxable income. It would also increase legal disputes between firms and tax authorities. Since actuarial gains and losses are recognised (under certain conditions) taxable income, this would affect a firm's capacity to pay, in case of capital gains. Therefore, following all the principles of certainty, stability, enforceability and capacity to pay, it would be better not to consider actuarial gains and losses related to these benefit plans in the taxable income.

Even though **loss treatment** for tax purposes has nothing to do with IAS principles, it is an essential ingredient of a corporate tax base, and should be carefully discussed along with the other components, explicitly considering possible interactions between the different provisions of the tax base, and with the major aim to harmonise the existing legislation. Current treatment of carrying losses is very different across countries: carry-forward is always allowed but over widely different periods; carry-back is allowed only in few countries (Germany, France, Ireland and the Netherlands) and is limited to a maximum of three years.

Based on the principle of neutrality, a symmetric tax system would be preferable, i.e. a tax system that paid out taxes on losses in the year they occur. However, concerns about the reliable provision of revenues suggest that tax relief on losses should be restricted. Otherwise corporate tax revenues could even become negative in recessions, when the corporate sector as a whole might be loss-making. To avoid this, while maintaining neutrality, losses could be carried forward with an adequate interest rate. However, for reasons of simplicity and fear about possible tax evasion schemes, involving artificially loss-making companies that subsequently go out of business means that for the sake of enforceability as well, perfect symmetry or total recognition of losses might not be commendable.

The major issues here will be to decide how long losses could be carried forward and if it would be worthwhile to allow a carry-back provision too. Both carry-back and carry-forward provisions should moreover consider the costs of the reform, which might be relevant in this case, as current treatment for losses varies significantly across countries: moving towards a different approach may significantly affect tax revenues in some countries.

5. Conclusions

The comparative analysis presented in this report is based on selected accounting standards and the corresponding treatment for tax purposes. To draw more universally valid conclusions whether and – above all – to what extent IFRS could serve as a starting point for a common tax base needs further in-depth research. Nevertheless, from the survey made, some general conclusions are possible:

- 1) In principle, there is no general conflict between IFRS and current rules for tax accounting in member states. Both in financial and tax accounting, profits are determined on an accrual basis.
- 2) Although the primary objective of IFRS is to provide useful information for decision-making, they offer a broad basis of objective accounting rules, which are in accordance with the taxation principles (e.g. conceptual principles, accrual principles and valuation standards).
- 3) Referring to current practice, ‘reliability’ and ‘materiality’ as general rules for financial accounting do not violate taxation principles either.
- 4) However, fair-value accounting is not in line with tax accounting since historical costs (acquisition and production costs) are the general valuation standard and taxable profits are not recognised before realisation. Moreover, with respect to the treatment of goodwill, the impairment-only approach under IFRS does not correspond to tax practice commonly adopted by member states.
- 5) With respect to the definition of assets and liabilities, the recognition of revenues and the treatment of (future) losses, member states’ practice for tax purposes deviates from IFRS (and from domestic GAAP). In addition, potential changes to IFRS may create further departure from current tax accounting practice in member states. On this note, the IASB, for example, contemplates modernising its standards on revenue recognition taking into account that the existence of a signed contract is a valuable asset (connected to the liability to perform) for every entity

and therefore useful information for investors. If the fair value approach was considered for the valuation of these assets and liabilities, the modernised approach to revenue recognition would hardly be acceptable for tax purposes. Thus, the further evolution of the international standards may increasingly render reference to IAS/IFRS useless and, therefore, should be watched closely.

- 6) On the one hand, these deviations result from different underlying principles of taxation (e.g. simplification, objectification, stabilisation of the tax base and the tax revenue and granting of investment incentives). On the other hand, member states following the 'continental' approach base the capitalisation of assets and liabilities as well as revenue recognition on civil law or other test criteria. Since civil law is not yet harmonised across the EU, these deviations could only be overcome by common economic criteria.
- 7) The adoption of IFRS and/or their modifications for tax purposes can only be decided upon on the basis of clearly defined and commonly accepted principles of taxation.
- 8) IFRS therefore offers a starting point for tax accounting in certain areas. Following this study, these areas could cover the recognition of assets and liabilities, initial measurement (acquisition costs, production costs, and simplified valuation of inventories) and subsequent measurement (regular depreciation). The results of this study also suggest that a common tax base would require common standards for loss compensation and that tax incentives would need to be removed from the tax base.

REFERENCES

- Bond, S.R. (2000), "Levelling up or levelling down? Some reflections on the ACE and CBIT proposals, and the future of the corporate tax base", in S. Cnossen (ed.), *Taxing Capital Income in the European Union*, Oxford: Oxford University Press.
- Bravenec, L.L. (2000), "International Corporate Income Tax Coordination in the 21st Century", *European Taxation*, pp. 450-465.
- CEPS (2001), *EU Corporate Tax Reform*, Report of a CEPS Working Party, Centre for European Policy Studies, Brussels.
- Desai, M.A. and J.R. Hines (2003), "Evaluating International Tax Reform", *National Tax Journal* 56(3), pp. 487-502.
- Ernst & Young/ZEW (2004), *Company taxation in the new EU member states*, Frankfurt.
- European Commission (2001), *Company taxation in the internal market*, SEC2001, Luxembourg.
- European Commission (2003), *An Internal Market without tax obstacles - Achievements, ongoing initiatives and remaining challenges*, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, COM(2003) 726 final, 24.11.2003, Brussels.
- European Commission (2004), *European Tax Survey*, Commission Staff Working Paper, SEC(2004) 1128/2, Brussels.
- IBFD (International Bureau of Fiscal Documentation) (2004), *Tax Treatment of Research & Development Expenses*, Amsterdam.
- IBFD (International Bureau of Fiscal Documentation) (2005), *European Tax Handbook*, Amsterdam.
- IFS Capital Taxes Group (1991), *Equity for Companies: A Corporation Tax for the 1990s*, IFS Commentary No. 26, Institute for Fiscal Studies, London.
- IFS Capital Taxes Group (1994), *Setting Savings Free, Proposals for the Taxation of Savings and Profits*, Institute for Fiscal Studies, London.
- Keen, M. and J. King (2002), "The Croatian profit tax: An ACE in practice", *Fiscal Studies* 23(3), pp. 401-118.

- Meade Report (1978), *The Structure and Reform of Direct Taxation*, Institute for Fiscal Studies, London.
- Mennel/Förster (2005), *Steuern in Europa, Amerika und Asien*, Stand: Januar 2005 Herne/Berlin.
- Nobes, C. (2004), *A Conceptual Framework for the Taxable Income of Business, and How to Apply it under IFRS*, Association of Chartered Certified Accountants, London, January.
- Oestreicher, A./Spengel, C. (2001), "Anwendung der IAS in der EU", *Zukunft des Maßgeblichkeitsprinzips und Steuerbelastung*, *Recht der Internationalen Wirtschaft*, pp. 889-902.
- PricewaterhouseCoopers (1998), *Understanding IAS. Analysis and Interpretation of International Accounting Standards*, 2nd edition, The Bath Press.
- Schnorr, R. (2004), "Nationale und internationale Aktivierungsgrundsätze der Rechnungslegung in Handels- und Steuerbilanz", in *StuW*, pp. 305-317.
- Schön, W. (2004), "International Accounting Standards - A Starting Point for a Common European Tax Base?", *European Taxation*, pp. 426-440.
- Schon, W (2004), "The Odd Couple: A Common Future for Financial and Tax Accounting?", *Tax Law Review*, Vol. 58, pp. 111-148.
- Spengel, C. (2003), "International Accounting Standards, Tax Accounting and Effective Levels of Company Tax Burdens in the EU", *European Taxation*, pp. 253-266.
- Spengel, C. (2004a), "Rechnungslegung nach IFRS - Konsequenzen für die Besteuerung", in *Zeitschrift für Controlling und Management, Sonderheft 2*, pp. 130-140.
- Spengel, C. (2004b), "Einheitliche Bemessungsgrundlage für die laufende Besteuerung der Europäischen Aktiengesellschaft", in Norbert Herzig (ed.), *Besteuerung der Europäischen Aktiengesellschaft (Societas Europaea - SE)*, Köln, pp. 101-117.

APPENDICES

Appendix 1. Relationship between financial accounting and tax accounting

| Country | Relationship between tax accounting & financial accounting |
|----------------|--|
| Austria | If a business entity is subject to financial reporting requirements under commercial law, then the financial statements constitute the basis of assessment for tax purposes. The Personal Income Tax Act contains several valuation rules, which are distinct from the corresponding rules in the Commercial Code. If an entity must prepare financial statements, both the two sets of rules must be obeyed (authoritativeness principle). Generally, if a company must prepare financial statements under the Commercial Code, their contents will be relevant to the assessment of income tax. If the items contained in the financial statements are admissible under tax law, they must not be changed for tax purposes. This implies that the way the financial statements are prepared, particularly the valuation of the items, has a direct effect on the tax burden, except for cases where tax law lays down a strict rule. |
| Belgium | In 1976, the parliament permitted fiscal rules to differ from accounting rules only in exceptional cases. On this basis, accounting law overrides fiscal law except as far as concerns some special issues. Because of the principle of fiscal neutrality, the starting point for the calculation of corporate income tax is the accounting profit shown in the individual company accounts. |
| Denmark | Since the Fourth Directive was established in 1981, the financial statements and tax accounts are completely separate. In practice, taxable income is calculated on the basis of the result before tax as it appears from financial statements. Any necessary adjustments are then made. In Denmark there seem to be no examples of accounting legislation having had any impact on the formulation of tax legislation rules. Accounting profits and tax profits are separate units. |
| Finland | The tax computation is based on the company's profit and loss account submitted to the tax office, together with the tax declaration. Taxable income is the profit shown in the audited annual profit and loss account adjusted as accepted or required by the tax laws. |
| France | Tax and accounting results are closely linked since numerous tax-generated items are included in the accounting records and accounts. In certain circumstances, tax law takes precedence over accounting law. Companies wishing to take advantage of certain tax concessions are obliged to make purely fiscal entries in their accounting records and hence include them in their financial statements. Tax law set out separate rules for the deductibility of certain expenses and the taxation of certain revenues. |

| | |
|------------------------|--|
| Germany | <p>Commercial and tax accounting are interrelated. The determination of profit by tax law based on a net worth comparison. The recognition and valuation of the items have to be done in conformity with the principles of proper bookkeeping which govern commercial accounts, unless the tax law provides otherwise.</p> <p>This rule is called the authoritativeness principle. Its most important effect is that the prudence concept (prudence principle combined with the realisation principle and the imparity principle), which dominates commercial accounts, also governs tax accounting unless the tax law stated otherwise.</p> |
| Greece | <p>Taxable income for corporate income tax purposes is determined annually on the basis of the profit and loss account prepared from the official accounting books maintained in accordance with the regulations in the Code of Books and Records. This is adjusted for certain items, e.g. non-deductible expenses or tax-free income.</p> |
| Ireland | <p>The accounting profit and loss account is the starting point for the computation of taxable trading profits. The tax treatment will usually respect any generally accepted accounting practice adopted by the taxpayer unless these conflict with case law principle or they are expressly overridden by tax statute.</p> <p>The Irish courts have reserved the right to determine the correct principles of accounting. On this basis, they have treated inflation accounting as unacceptable for tax purposes.</p> <p>In general, the financial accounting and the tax accounting are independent.</p> |
| Italy | <p>The influence of the tax laws on the financial statements is significantly less, but is still present. Thus for example, some possible tax advantages cannot be taken if they are not recorded in the financial statements.</p> <p>Taxable income is derived from the company's statutory balance sheet and profit and loss account by way of off-book adjustments. These adjustments intend to correct situations mainly where the fiscal prescription for the recognition of revenues and expenses diverge from the statutory-commercial rules.</p> |
| Luxembourg | <p>The specification of the sometimes subtle relationship between these two bodies of law is defined in the rule known as the 'authoritativeness principle'. Generally, if a company must prepare financial statements under the Commercial Code, their contents will be relevant to the assessment of income tax.</p> |
| The Netherlands | <p>Financial reporting and tax accounting are two different activities, although both are based on the same underlying information system.</p> <p>Basically, the tax rules for the calculation of profits are, unless tax legislation specifies otherwise, based on 'sound business practice'. However, the determination of profit for financial reporting purposes is based on the principles that are generally considered acceptable in commercial practice.</p> <p>Tax law does not define the principle of sound business practice. The Supreme Court has developed the main rule that a system of computing the annual business profits is in accordance with the</p> |

| | |
|-----------------------|---|
| | <p>principle of sound business practice if it is based on generally accepted accounting principles. Some of these principles are laid down in the Civil Code.</p> <p>In addition, the Supreme Court has decided that a system is deemed not to be in accordance with sound business practice if the principles employed are incompatible with any tax regulation or basic principles of the tax law.</p> |
| Portugal | <p>Tax and accounting results are closely linked since numerous tax-generated items are included in the accounted records and accounts. In addition, the tax return actually includes the balance sheet and income statement approved by the company's directors. Sometimes tax law has specific rules.</p> <p>Companies that wish to take advantage of certain benefits are obliged to make some purely fiscal entries in their accounting records and hence to include these results in their financial statements.</p> |
| Spain | <p>Corporate income tax does not involve a radical separation between the taxable income and book income. The tax is linked with the accounting, as manifested fundamentally in the principle of recording in the accounts. This principle establishes that an essential requirement for expenses to be deductible is that they must have been recorded previously for accounting purposes; with regard to revenues, it establishes that they may not be computed for tax purposes at a date subsequent to that on which they were recorded for accounting purposes, without prejudice to the exceptions which the law may allow.</p> |
| Sweden | <p>There is a strong link between financial reporting (in individual account) and tax accounting. According to the major tax code, tax should be assessed on reported profits unless there are specific provisions in the Tax Code that state otherwise. A normal tax return from a company starts with the reported net profit. To this figure are added back those items in the income statement that are not taxable/deductible. Finally, an adjustment is made for items that are taxable/deductible even though they do not appear in the income statement for the purposes of arriving at taxable income.</p> |
| United Kingdom | <p>In the United Kingdom there is a clear distinction between the tax accounts and the financial statements. Even if the underlying concepts and principles in both sets of accounts are identical, the basis for arriving at profits in the financial accounts is not the same as the basis used for tax purposes. However, trading and property business profits now take UK GAAP or IFRS as the starting point for computing taxable profits subject to adjustment under specific tax rules.</p> |
| Cyprus | <p>There is no explicit general rule in the law providing how the income is to be determined. However, if no tax rule provides otherwise, tax accounting follows legal accounting based on International Accounting Standards.</p> |
| Czech Republic | <p>The taxable income is the difference between the income and the expenses incurred in earning the income. The taxable base is the</p> |

| | |
|------------------|--|
| | accounting profits, which must be adjusted for several items as set out in the tax law. |
| Estonia | Under scrutiny |
| Hungary | The taxable base is computed from the accounting results by adjusting for certain items. |
| Latvia | The taxable base is computed from the accounting profits by adjusting them for certain items. Adjustments are made for exempt income, non-deductible expenses and depreciation. |
| Lithuania | The taxable base is determined on the basis of the profit and loss account. It has to be adjusted for certain items that are regulated by tax law. As a result of these adjustments, the taxable income differs considerably from the accounting income. |
| Malta | Taxable profits (or losses) of each year are the profits (or losses) reported in the company's audited financial statements after adjustment for non-deductible expenses and non-taxable income. |
| Poland | Corporate income is the net profit shown on the yearly balance sheet computed in accordance with statutory accounting rules after adjustment for deductions and additions provided under the tax law. |
| Slovakia | The taxable income is computed on the basis of the accounting profits and is adjusted for several items as described in the tax law. |
| Slovenia | The starting point for the computation of the taxable base is the profit shown in the profit and loss account. Taxable income includes the receipts, which are determined according to the regulations or accounting standards, unless the tax law provides otherwise. Expenditures of the taxpayer include the expenses allowed by regulations or accounting standards, except those that are determined in a different manner under the Profits Tax Law. Allowable expenditures include only the expenses that represent a direct expense for the performance of an activity for the production of income or that were incurred as a consequence of the activity. |

Appendix 2. Realisation date (Sales of goods)

| Adopted in | Date of contract conclusion | Date of receiving the payments | Transfer of the goods and thus transfer of significant risks |
|-----------------------|-----------------------------|--------------------------------|--|
| IAS/IFRS | | | X |
| 4th Council Directive | | | X |
| All member states | | | X |

Appendix 3. Construction contracts

| Adopted in | Percentage-of-completion method | Completed-contract method | Option between the two alternatives |
|------------------------------|--|----------------------------------|--|
| IAS/IFRS | X | | |
| 4th Council Directive | | | X |
| Austria | | X | |
| Belgium | X | | |
| Denmark | X | | |
| Finland | | | X |
| France | X | | |
| Germany | | X | |
| Greece | | X | |
| Ireland | | X | |
| Italy | X | X | |
| Luxembourg | | X | |
| Netherlands | | | X |
| Portugal | | | X |
| Spain | X | | |
| Sweden | | X | |
| UK | X | | |
| Cyprus | X | | |
| Czech Republic | | X | |
| Estonia | X | | |
| Hungary | Under scrutiny | | |
| Latvia | No special rules apply! | | |
| Lithuania | | X | |
| Malta | X | | |
| Poland | Under scrutiny | | |
| Slovakia | No special rules apply | | |
| Slovenia | Under scrutiny | | |

Appendix 4. Definition of capital assets/ intangible assets

| Adopted in | Definition |
|------------------------------|--|
| IAS/IFRS | In general assets are defined as probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events (IAS 49(a)). An intangible asset is defined as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. |
| 4th Council Directive | Not defined. Capital assets are defined according to national accounting principles. On the one hand there is the definition used in Anglo-Saxon member states (emphasis on an ascertainable future benefit) and on the other hand there is the definition used in central European member states (emphasis on identifiability). In each case it has to be separated from goodwill. |
| Austria | Assets are separately identifiable goods of every kind. An asset is identifiable if a potential purchaser would pay a separate amount for this asset, even if it is acquired in a basket purchase of several assets. Assets comprise especially cash, inventory, valuable rights and debt. |
| Belgium | Intangible assets are non-physical, non-monetary separately identifiable assets, which are controlled and used by the entity and from which future economic benefit may be obtained. |
| Denmark | An asset is defined as a resource controlled by a particular entity as a result of past transactions or events and from which probable future economic benefits are expected. The value of the asset must be estimated reliably. Intangible assets may be defined as rights and economic benefits, as e.g., licences, patents, trademarks or copyrights. Intangible assets are non-material and non-financial assets. |
| Finland | Under scrutiny |
| France | Intangible assets comprise rights for inventions, other valuable rights such as patents, licenses, copyrights, software and the so-called 'fonds de commerce'. Their production costs are capitalized, provided they fulfil two conditions: <ul style="list-style-type: none"> - Constancy: This implies a benefit which exists for more than one period. - The asset obtained must be distinctly valuable, i.e. the future flow of funds must be sufficiently concrete. |
| Germany | Assets are defined as things and rights defined by civil law and other economic resources which are acquired for consideration and are separately identifiable and from which future benefits may be obtained. Intangible assets are valuable rights and purely economic values. An asset is identifiable if a potential purchaser would pay a separate amount for this asset, even if it is acquired in a basket purchase of several assets. Intangible assets are non-material non- |

| | |
|-----------------------|--|
| | financial assets. |
| Greece | Intangible are the goods that can be valued and can be subject to a transaction either alone or with the enterprise. Intangible assets are acquired with purpose to be used productively for a time period greater than one year. They are divided to the following categories: <ul style="list-style-type: none"> - Goodwill - Copyrights, trade-marks, know-how, patents, mining rights - Asset usage and other rights. |
| Ireland | Intangible fixed asset, in relation to a company, means an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities. Intangible assets are non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity through custody or legal rights. Moreover, the self-developed intangible asset has to have a readily ascertainable market value. |
| Italy | Not defined |
| Luxembourg | Under scrutiny |
| Netherlands | Capital assets are defined as goods used for carrying on a business. Case law defines capital assets as goods belonging to the fixed capital of the company, of which the acquisition or manufacture expenses are capitalized, and which are used for carrying on an enterprise and which fulfil an independent function within the company. Intangible assets are generally understood as rights and purely economic benefits, e.g. concessions, licenses, patents, trademarks or copy rights. Intangible assets are non-material and non-financial assets. |
| Portugal | Under scrutiny |
| Spain | Assets are things and rights as well as other economic resources which are acquired for consideration and from which future benefits may be obtained. Intangible assets are defined as property or rights (i.e. licenses, trademarks, copyrights) which are able to generate income or reduce the expenses of the company in the future. |
| Sweden | Under scrutiny |
| United Kingdom | Intangible fixed asset, in relation to a company, means an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities. Intangible assets are non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity through custody or legal rights. |
| Cyprus | Comparable to IAS/IFRS |
| Czech Republic | Intangible assets include: <ul style="list-style-type: none"> - incorporation expenses, - results of development and similar activity, |

| | |
|------------------|---|
| | <ul style="list-style-type: none"> - computer software and - valuable rights. |
| Estonia | Comparable to IAS/IFRS |
| Hungary | Intangible assets are defined as non-material assets (valuable rights, goodwill, R&D and intellectual property) which serve the entrepreneurial activity directly and on a permanent basis during the expected lifetime. |
| Latvia | Comparable to IAS/IFRS |
| Lithuania | Not defined |
| Malta | <p>„An item of property, plant and equipment should be recognized as an asset when:</p> <ul style="list-style-type: none"> a) it is probable that future economic benefit or service potential associated with the asset will flow to the entity; and b) the cost of fair value of the asset to the entity can be measured reliably |
| Poland | <p>Intangible assets are:</p> <ul style="list-style-type: none"> - property rights whose expected useful life is more than one year, designed to be used by the entity or rented to others, - start up costs or costs of extension of a company, - goodwill, - costs of completed development work. |
| Slovakia | General basic definition is missing. Specific definitions are available for incorporation expenses, R&D, computer software and valuable rights. |
| Slovenia | Under scrutiny |

Appendix 5. Recognition of self-developed intangible assets

| Adopted in | Categories of intangible assets | Mandatory | Prohibited | Electoral |
|------------------------------|---|------------------|-------------------|----------------------|
| IAS/IFRS | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X | |
| 4th Council Directive | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | | | X X X X |
| Austria | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights and intellectual property (fixed assets) • Valuable rights and intellectual property (current assets) • Self-created goodwill | X | X X X X | |
| Belgium | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | | X X X |
| Denmark | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights and intellectual property (fixed assets) • Valuable rights and intellectual property (current assets) • Self-created goodwill | X | X | X X X |
| Finland | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | | | X X X X |

| | | | | |
|--------------------|---|---|-----------------------|------------------|
| France | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X | X X |
| Germany | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights and intellectual property (fixed assets) • Valuable rights and intellectual property (current assets) • Self-created goodwill | X | X X X X X | |
| Greece | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X | X X X |
| Ireland | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X X X | X |
| Italy | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (only advertisement) • Self-created goodwill | X | X | X X X |
| Luxembourg | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | | X | X X X X |
| Netherlands | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | | X | X X X X |

| | | | | |
|-----------------------|---|--------|-------------|------------------|
| Portugal | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | | X | X X X X |
| Spain | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X | X X X |
| Sweden | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X | X X X |
| United Kingdom | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X X X | X |
| Cyprus | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X X X | X |
| Czech Republic | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X X | X | X X |
| Estonia | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X X | X X X | |

| | | | | |
|------------------|---|--------|-------------|-------------|
| Hungary | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | | X X X |
| Latvia | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | | X X X | X |
| Lithuania | Under scrutiny | | | |
| Malta | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) • Self-created goodwill | X | X X | X |
| Poland | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights and intellectual property (fixed assets) • Valuable rights and intellectual property (current assets) • Self-created goodwill | X | X X X | X |
| Slovakia | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights (e.g. patents) and intellectual property (e.g. know-how) except for software • Valuable rights and intellectual property (current assets) • Self-created goodwill | X X | X X | |
| Slovenia | <ul style="list-style-type: none"> • Research costs • Development costs • Establishment costs • Valuable rights and intellectual property (fixed assets) • Valuable rights and intellectual property (current assets) • Self-created goodwill | X | X X | X X |

Appendix 6. Provisions

| Adopted in | Regulation for tax accounting |
|------------------------------|--|
| IAS/IFRS | In general provisions are allowed for present obligations resulting from a past event when it is probable that an outflow of resources will be required and the amount can be reliably estimated (IAS 37.14). |
| 4th Council Directive | Provisions are allowed for pensions and other comparable liabilities. Therefore, provisions for contingent liabilities are allowed. |
| Austria | Provisions have to be based on objective facts and especially on business experience. |
| Belgium | Permitted under certain conditions concerning the reason and the amount. |
| Denmark | Provisions for guarantee obligations are deductible under narrow and strict conditions and provided they are not immaterial. |
| Finland | Not available except for guarantees, for aircraft and shipping or in construction industry for buildings. |
| France | May be made in order to cover future losses, liabilities or the depreciation of certain assets under the condition that: <ul style="list-style-type: none"> - the contingency to be covered is itself tax-deductible and - the expense of liability is precisely identified, highly probable and related to events that are in progress at the time the provision is booked. |
| Germany | Comparable to IFRS. |
| Greece | Not allowed. |
| Ireland | Provisions are deductible as long as they are in respect of a specific liability. |
| Italy | Tax law specifically states which reserves and provisions are recognised for tax purposes: <ul style="list-style-type: none"> - provisions to cover the risks from foreign exchange, and expenses resulting from lotteries and other prizes are available. |
| Luxembourg | Allowed for, inter alia, guarantees and warranties, damage claims, litigation expenses. Deferred repair and maintenance provisions as well as self-insurance provisions are not available. |
| Netherlands | A provision may be made for future expenses, the cause of which exists on the balance sheet date. |
| Portugal | Generally not available; exception for liabilities and charges arising on court procedures and for companies engaged in exploration and exploitation of petroleum sources, which may set up provisions for the replacement of petroleum deposits. |
| Spain | Provisions are allowed for liabilities the amount of which has not been definitely fixed. |

| | |
|-----------------------|---|
| Sweden | Provisions for guarantee obligations are deductible to a certain amount. 25% of taxable income can be allocated to a tax-exempt profit periodisation reserve, which has to be dissolved within six years after the year the allocation has been made. |
| United Kingdom | FRS 12 (UK GAAP) or IAS 37 are followed for tax purposes |
| Cyprus | Reserves that are an appropriation of profit, such as a reserve for future dividends, are not deductible; nor may general contingency reserves, such as a reserve for deferred repairs and maintenance, which might be charged in the profit and loss account, be deducted. Provisions are deductible as long as they are in respect of a specific liability whose exact amount cannot currently be determined. |
| Czech Republic | Allocations to reserves whose establishment and scope is stipulated by a special legislative act on reserves are tax deductible. Allocations to reserves for obsolete inventory are not deductible for tax purposes. |
| Estonia | IFRS |
| Hungary | Generally not available (exception: provisions created to cover specific statutory environmental obligations). |
| Latvia | Credit institutions may deduct contributions to provisions for doubtful debts. |
| Lithuania | Not allowed for tax purpose (except for banks and insurance). |
| Malta | Generally not available. Provisions for expenditure that is known to have been incurred, normally referred to as accrued charges, are allowed as deductions. |
| Poland | Not allowed |
| Slovakia | Reserves are allowed for maintenance and repair of tangible property with an expected useful life exceeding eight years may be deducted up to 80% of their value. |
| Slovenia | Long-term reserves for future material or non-material expenses are deductible up to 50% of their actual amount. |

Appendix 7. Provisions for bad debts

| Adopted in | Regulation for tax accounting |
|------------------------------|---|
| IAS/IFRS | An impairment loss must be recognised in the income statement if a receivable's carrying amount exceeds its recoverable amount. |
| 4th Council Directive | No provisions but value adjustments shall be made in respect of current assets with a view to showing them at the lower market value or, in particular circumstances, another lower value to be attributed to them at the balance sheet date. |
| Austria | Specific provisions are allowed. |
| Belgium | Specific provisions are allowed. |
| Denmark | Specific provisions are allowable. There is a limited allowance for general provisions. |
| Finland | Specific provisions are allowable if they are in accordance with generally accepted accounting principles. General provisions are not available but there are exceptions in the case of financial traders. |
| France | Are allowed taking into account the probability of payment and must be estimated with sufficient approximation. |
| Germany | Provisions are not available but an irregular depreciation may be claimed for current assets if the fair market value is lower than the book value. |
| Greece | A provision for bad debts may be deducted up to 0.5% of turnover from the supply of goods or services or 1% of sales on credit of certain commonly consumed goods. The bad debt provision may not exceed 30% of trade receivables and must be used within five years, or otherwise it is taxed. The law also allows the deduction of additional provisions if all legal measures to pursue a specific claim have been exhausted. |
| Ireland | A general provision for doubtful debts is not deductible, but a provision based on specific doubtful debts is. |
| Italy | Tax law specifically states which reserves and provisions are recognised for tax purposes: - 0.5% of trade receivables may be set aside until the provision reaches 5% of the total. To the extent that they are not covered within the general reserve, losses arising through debtor insolvency are also allowed. |
| Luxembourg | Allowed by a 'sufficient approximation'. |
| Netherlands | Allowed, if they are in accordance with 'sound business practice'. |
| Portugal | Provisions are allowed for debts that are more than six months overdue. The provision amount depends on the overdue period. |
| Spain | Provisions for doubtful debts are allowed if: - the debts are more than six months overdue, - the debtor is declared legally bankrupt or - the payment depends on a judicial dispute or an arbitration process. |

| | |
|-----------------------|---|
| Sweden | Specific provisions are allowed. Provision for doubtful debts if the debts are more than six months overdue. |
| United Kingdom | Specific proven bad debts are deductible, whereas general provisions for bad debts are not allowed. |
| Cyprus | A general provision for doubtful debts such as one based on a percentage of total debts is not deductible, but a specific provision for doubtful debts is deductible. |
| Czech Republic | Allocations to provisions for bad debts are deductible for tax purposes if certain conditions are met. Bad debts incurred before 1 January 1995 may be written off at 20% annually. |
| Estonia | IFRS |
| Hungary | Not allowed |
| Latvia | Not allowed |
| Lithuania | Not allowed |
| Malta | Provisions such as those for doubtful debts are not deductible. |
| Poland | Certain contributions to a provision for bad debts may be deducted for tax purposes. |
| Slovakia | Provisions for bad debts in respect of receivables are deductible, based on percentage of outstanding balances. |
| Slovenia | Allocations to bad debt reserves are not deductible. |

Appendix 8. Acquisition costs

| Adopted in | Elements of production costs | Mandatory | Prohibited | Electoral |
|------------------------------|---|--|-------------------|------------------|
| IAS/IFRS | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | X |
| 4th Council Directive | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | X |
| Austria | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | |
| Belgium | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X | X X | X |
| Denmark | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X X | |
| Finland | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X X (if they are material) | X | |
| France | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X X | |

| | | | | |
|--------------------|---|-------------|--------|---|
| Germany | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X X | |
| Greece | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X X | |
| Ireland | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X X | |
| Italy | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | X |
| Luxembourg | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X X | |
| Netherlands | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | X |
| Portugal | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | X |
| Spain | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X X X | X | X |

| | | | | | |
|-----------------------|---|---|---|--|---|
| Sweden | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | X | | |
| United Kingdom | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | X | | |
| Cyprus | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | | | X |
| Czech Republic | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | X | | |
| Estonia | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | | | X |
| Hungary | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | | X | | |
| | | | X | | |
| | | X | | | |
| Latvia | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | X | | |
| Lithuania | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | X | | |
| Malta | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | | |
| | | X | | | |
| | | X | | | |
| | | | X | | |
| | | | | | X |

| | | | | |
|-----------------|---|----------------|---|--|
| Poland | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | Under scrutiny | | |
| Slovakia | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | |
| | | X | | |
| | | | X | |
| | | | X | |
| Slovenia | <ul style="list-style-type: none"> • Purchase price • Direct ancillary costs • Deduction of any reduction of price • Overhead costs • Interest | X | | |
| | | X | | |
| | | X | | |
| | | | X | |
| | | | X | |

Appendix 9. Production costs

| Adopted in | Full cost approach | Direct cost approach | Option between the two alternatives |
|------------------------------|---------------------------|-----------------------------|--|
| IAS/IFRS | X | | |
| 4th Council Directive | | | X |
| Austria | X | | |
| Belgium | | | X |
| Denmark | | | X |
| Finland | | | X |
| France | X | | |
| Germany | X | | |
| Greece | Under scrutiny | | |
| Ireland | X | | |
| Italy | X | | |
| Luxembourg | X | | |
| Netherlands | | | X |
| Portugal | X | | |
| Spain | X | | |
| Sweden | X | | |
| UK | | | X |
| Cyprus | X | | |
| Czech Republic | Under scrutiny | | |
| Estonia | X | | |
| Hungary | | X | |
| Latvia | | X | |
| Lithuania | Under scrutiny | | |
| Malta | X | | |
| Poland | Under scrutiny | | |
| Slovakia | X | | |
| Slovenia | X | | |

Appendix 10. Measurement of inventories

| Adopted in | Regulation for tax accounting | |
|------------------------------|--|--|
| IAS/IFRS | Valuation standard Cost formula | Lower of cost or net realisable value - FIFO - Weighted average method |
| 4th Council Directive | Valuation standard Cost formula | In general, lower of purchase/production cost or market value However, the member states may declare to permit or require in respect of all companies or any classes of companies valuation by the replacement value method for tangible assets with limited useful economic lives and for stocks. <u>Write-up:</u> Valuation at the lower value may not be continued if the reasons for which the value adjustments were made have ceased to apply. - FIFO - LIFO - Weighted average method - Some similar methods |
| Austria | Valuation standard Cost formula | Lower of acquisition/production cost or going-concern value <u>Write-up:</u> Write-up is possible, if the value increased, but the new book value may never exceed the original cost. - Weighted average cost - FIFO - LIFO, but only if it accords with the taxpayer's actual practice |
| Belgium | Valuation standard Cost formula | Lower of acquisition or production cost or fair market value - FIFO - LIFO - Weighted Average cost |
| Denmark | Valuation standard Cost formula | Inventory may be valued at cost, depreciations are not allowed - FIFO |
| Finland | Valuation standard Cost formula | Lowest of direct acquisition cost, replacement cost or net sales values at the last day of the accounting year - FIFO |

| | | |
|--------------------|--------------------|--|
| France | Valuation standard | Lower of acquisition / production cost or market value at year-end. On the balance sheet, inventory is shown at cost; if the market value is lower, a provision for depreciation of the inventory must be noted separately as a deduction from cost. Price increases of 10% may be taken into account if the price increase will be booked in a reserve. The reserve is not taxable. It must release within six years at the latest and will increase the profit at the point of the release. |
| | Cost formula | - FIFO - Average cost |
| Germany | Valuation standard | Lower of acquisition or manufacturing cost or fair market value |
| | Cost formula: | - LIFO - Base stock value |
| Greece | Valuation standard | Lower of acquisition cost/production cost and market price/production price |
| | Cost formula | - FIFO - LIFO |
| Ireland | Valuation standard | Lower of cost and net realisable value |
| | Cost formula | - FIFO - Weighted average method |
| Italy | Valuation standard | Lower of cost or market value principle |
| | Cost formula | - LIFO - FIFO - Average weighted cost |
| Luxembourg | Valuation standard | Lower of the cost of acquisition (or production) or the going concern value The taxpayer has an option to revalue the item, if the value increases. The maximum is the original cost. |
| | Cost formula | - FIFO - LIFO - HIFO - Average cost |
| Netherlands | Valuation standard | The method used to value must be in accordance with sound business practice. In according to the general accounting treatment inventories are valued at the lower of historical cost or market value. |
| | Cost formula | - LIFO - FIFO - HiFo - Base-stock method |

| | | |
|-----------------------|--------------------|--|
| Portugal | Valuation standard | Generally, inventory must be valued at historical cost. A deductible provision for written down inventory may be set up if, at the end of a financial period, the market value is less than the historic cost. The provision is deductible only in the financial period in which the loss is incurred. |
| | Cost formula | - Standard cost method - Sale price method |
| Spain | Valuation standard | Lower of the cost of acquisition (or production) or market value |
| | Cost formula | - Average cost method - FIFO - LIFO |
| Sweden | Valuation standard | Lower of cost or market value at the date of the balance sheet. Alternatively, inventory (excluding real property and securities) may be valued at not lower than 97% of the inventory's total acquisition value. This provision implies a standard deduction for obsolescence of 3%.. |
| | Cost formula | - FIFO |
| United Kingdom | Valuation standard | Lower of cost or net realizable value |
| | Cost formula | - FIFO |
| Cyprus | Valuation standard | According to accepted accounting standards (IAS); lower of cost and net realisable value |
| | Cost formula | - FIFO - LIFO only under specific circumstances |
| Czech Republic | Valuation standard | Inventories are valued at cost, depreciations are not allowed |
| | Cost formula | - Average cost - FIFO |
| Estonia | Valuation standard | According to IFRS |
| | Cost formula | - According to IFRS |
| Hungary | Valuation standard | Purchased inventories have to be valued at their cost or weighted average cost; manufactured inventories must be valued at their production cost or recalculated or standard direct cost. |
| | Cost formula | - FIFO |
| Latvia | Valuation standard | Lower of production/ acquisition cost or market value at the end of the tax year |
| | Cost formula | - Weighted average method - FIFO |
| Lithuania | Valuation standard | Inventory is recorded in the books at the acquisition cost. |
| | Cost formula | - FIFO |

| | | |
|-----------------|------------------------------------|---|
| Malta | Valuation standard Cost formula | Lower of cost or net realisable value - FIFO - Weighted average cost |
| Poland | Valuation standard Cost formula | Inventory is valued according to its historic cost. This may not lower than the net realisable value of the asset. The market value, however, may not be lower than the cost of acquisition or production. - Weighted average cost - LIFO - FIFO |
| Slovakia | Valuation standard Cost formula | Inventories are valued at purchase price or production cost. Allowances for any risks, losses or deterioration are not deductible for tax purposes. - FIFO - Weighted average cost |
| Slovenia | Valuation standard Cost formula | Inventories are valued at the lower of cost and net realisable value, the valuation of inventory are solely based on accounting rules. - FIFO - Weighted average cost - LIFO |

Appendix 11. Regular depreciation

| Adopted in | Regulation for tax accounting | | |
|--|--------------------------------------|--|--|
| IAS/IFRS (IAS 16, IAS 38, IAS 40) (New : IAS 38R, IFRS 3) | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or revalued amount On a systematic; must reflect the pattern in which the asset's benefits are consumed Over the useful life of the asset |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or revalued amount On a systematic; must reflect the pattern in which the asset's benefits are consumed Over the useful life of the asset |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or revalued amount On a systematic; must reflect the pattern in which the asset's benefits are consumed Over the useful life of the asset |
| | Investment property | Depreciation base: Depreciation method: Depreciation rate: | Historical cost or fair value On a systematic basis in case of historical cost, no amortisation in case of fair value but annual impairment In case of historical cost over the useful life of the asset |
| 4th Council Directive | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or revalued amount On a systematic (straight-line method) Over the useful life of the asset |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or revalued amount On a systematic (straight-line method) Over the useful life of the asset |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or revalued amount On a systematic (straight-line method) 5% or more (no longer than 20 years) |
| Austria | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method 3% (buildings of business companies), 2.5% (buildings of bank or insurance companies) or 2% (other buildings) |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method 10-20% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical costs or production cost Straight-line method Time of useful life |

| | | | |
|----------------|-------------|--|---|
| Belgium | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Cost price Straight-line method, declining balance method 3-5% (depending on the type of building) |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Cost price Straight-line method, declining-balance method 10-33% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Cost price Straight-line method 10-33.3% |
| Denmark | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method 5 % |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Declining-balance method (on a pool basis) 25% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method 14.3% (7 years) |
| Finland | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Declining-balance method 7-20% (depending on the main building material and the type of the building) |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Declining-balance method (on a pool basis) Maximum 30% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost (only patents and other transferable rights) Straight-line method Maximum 10% |
| France | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical cost Straight-line method Depending on the useful life |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical cost Straight-line method, declining-balance method Depending on the useful life |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical cost Straight-line method Depending on the useful life |

| | | | |
|----------------|-------------|--|---|
| Germany | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method, declining-balance method Industrial and commercial buildings (excluding those used for living accommodation): (straight-line rates) 2.5% for buildings before 1925, 2% for buildings between 1925-31/03/1985, 4% for buildings after 31/03/1985, 3% for buildings after 31/12/2000. Living accommodation (acquired or built up after 31/03/2003): (declining-balance rates) 4% for the first 10 years, 2.5% for the following 8 years, 1.25% for the remaining 32 years. |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method, declining-balance method. The only change in method allowed is from declining balance to straight-line method. Straight-line rates: 6-10% (machinery), 12.5% (office equipment), 8-10% (office furniture), 33.3% (computers), 11-16% (cars, etc.) the declining-balance rate is limited to twice the allowable straight-line rate, with a maximum of 20%. |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method Time of useful life |
| Greece | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs (revaluation of fixed assets every four years) Straight-line method 3-12% |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method (alternatively declining-balance for new machinery and technical production equipment acquired after 1.1.1998) Varies according to the kind of business (rates of the declining-balance method are those which apply to straight-line method multiplied by the factor of three) |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 33.3% for R&D; 10% for trademarks; 5% for patents |

| | | | |
|--------------------|--|--|---|
| Ireland | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Acquisition costs Straight-line method 4% (industrial buildings) |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Acquisition costs Straight-line method 12.5% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Acquisition costs Straight-line method Minimum 5.9% (17 years) for patents |
| Italy | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method Rates of depreciation are fixed by ministerial decree (rates vary between 3 and 7%) |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method Rates of depreciation are fixed by ministerial decree (rates vary between 20 and 25%) |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method 33.3% |
| | More intensive use may justify more rapid depreciation. If depreciation taken in a taxable period is less than the maximum allowed, the difference is deductible in subsequent years under certain restrictions. | | |
| Luxembourg | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Acquisition cost / production cost Straight-line method 2-5% |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Acquisition cost / production cost Straight-line method, declining-balance method 10-20% (for declining method multiply by factor 3; not more than 30%) |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Acquisition cost / production cost Straight-line method, declining-balance method 10-20% |
| Netherlands | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost All kinds of depreciation (e.g. straight-line method, declining-balance method), provided the method is in accordance with 'sound business practice' and is applied consistently Depending on useful life of the asset (in general: 1.5-4%) |

| | | | |
|-----------------|-------------|--|---|
| | Machinery | Depreciation base: Depreciation method: | Historical acquisition or production cost All kinds of depreciation (e.g. straight-line method, declining-balance method), provided the method is in accordance with 'sound business practice' and is applied consistently |
| | | Depreciation rate: | Depending on useful life of the asset (in general: 10-30%) |
| | Intangibles | Depreciation base: Depreciation method: | Historical acquisition or production cost (only intangibles if purchased) All kinds of depreciation (e.g. straight-line method, declining-balance method), provided the method is in accordance with 'sound business practice' and is applied consistently |
| | | Depreciation rate: | Depending on useful life of the asset (patents and concessions: 20%) |
| Portugal | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Adjusted purchase cost or production cost Straight-line method 2% for office buildings, 5% for industrial buildings |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Adjusted purchase cost or production cost Straight-line method 12.5-25% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Adjusted purchase cost or production cost Straight-line method 33.3% for software and start-up expenses; rate is determined with respect to the time frame of exclusive use for patents, trademarks, licenses, models and similar rights. |
| | | | |
| Spain | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 1-3% |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method, declining-balance method 5-12% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 20% |
| Sweden | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Historical acquisition or production cost Straight-line method 1.5-5% |

| | | | |
|-----------------------|----------------------|---|---|
| | Machinery | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Straight-line method, declining-balance method (shift to straight-line method with a 20% rate, if it results in a lower book value) |
| | | Depreciation rate: | 30% (of the aggregate book value of all assets) |
| | Intangibles | Depreciation base: | Historical acquisition or production cost (only intellectual property, trademarks and leasing rights) |
| | | Depreciation method: | Declining-balance method (shift to straight-line method with a 20% rate, if it results in a lower book value) |
| | | Depreciation rate: | 30% |
| United Kingdom | Buildings | Depreciation base: | Acquisition or production costs |
| | | Depreciation method: | Straight-line method |
| | | Depreciation rate: | 4% |
| | Machinery | Depreciation base: | Acquisition or production costs |
| | | Depreciation method: | Declining-balance method (on a pool basis) |
| | | Depreciation rate: | 25% |
| Intangibles | Depreciation base: | Acquisition or production costs | |
| | Depreciation method: | Accounting depreciation or straight line method | |
| | Depreciation rate: | As depreciated in accounts with election for 4% straight line | |
| Cyprus | Buildings | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Straight-line method, accelerated method The accelerated method is, in effect, a declining-balance method as it uses the same period as the linear method. |
| | | Depreciation rate: | 3-4% |
| | Machinery | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Straight-line method, accelerated method The accelerated method is, in effect, a declining-balance method as it uses the same period as the linear method. |
| | | Depreciation rate: | 10% |
| Intangibles | Depreciation base: | Historical acquisition or production cost | |
| | Depreciation method: | Straight-line method | |
| | Depreciation rate: | 8%, useful time of life (patents and patent rights), 20% (research expenditure) | |

| | | | |
|-----------------------|----------------------|--|--|
| Czech Republic | Buildings | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Straight-line method, declining-balance method |
| | | Depreciation rate: | 3.33% (buildings and constructions etc.), 2% (office buildings hotels, shopping malls) |
| Machinery | Depreciation base: | Historical acquisition or production cost | |
| | Depreciation method: | Straight-line method, declining-balance method | |
| | Depreciation rate: | 25% (cars, computers etc.), 8.33% (machinery and equipment used in specified industrial processes), 5% (machinery and equipment providing energy), | |
| Intangibles | Depreciation base: | Historical acquisition cost | |
| | Depreciation method: | Straight-line method | |
| | Depreciation rate: | 8.33% (patents) | |
| Estonia | Buildings | Depreciation base: | According to IFRS |
| | | Depreciation method: | According to IFRS |
| | | Depreciation rate: | According to IFRS |
| Machinery | Depreciation base: | According to IFRS | |
| | Depreciation method: | According to IFRS | |
| | Depreciation rate: | According to IFRS | |
| Intangibles | Depreciation base: | According to IFRS | |
| | Depreciation method: | According to IFRS | |
| | Depreciation rate: | According to IFRS | |
| Hungary | Buildings | Depreciation base: | Acquisition costs |
| | | Depreciation method: | Straight-line method |
| | | Depreciation rate: | 2-15% (special rates for certain kinds of immovable property) |
| Machinery | Depreciation base: | Acquisition costs | |
| | Depreciation method: | Straight-line method | |
| | Depreciation rate: | 14.5% (special rate for certain assets) | |
| Intangibles | Depreciation base: | Acquisition costs (according to the accounting rules) | |
| | Depreciation method: | Straight-line method | |
| | Depreciation rate: | 20% (R&D, costs for forming a company and reorganisations), 50% (intellectual property) | |
| Latvia | Buildings | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Declining method (on a single base) |
| | | Depreciation rate: | 10% |
| Machinery | Depreciation base: | Historical acquisition or production cost | |
| | Depreciation method: | Declining method (single or pool base) | |
| | Depreciation rate: | 15-70% | |

| | | | |
|------------------|-------------|----------------------|---|
| Lithuania | Intangibles | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Straight-line method |
| | | Depreciation rate: | 10% (concessions) 20% (patents, licences and trademarks) |
| | Buildings | Depreciation base: | Historical acquisition or production cost |
| Malta | Buildings | Depreciation method: | Straight-line method, alternatively declining-balance method |
| | | Depreciation rate: | 15%, 12.5% (for new buildings) |
| | | Depreciation base: | Historical acquisition or production cost |
| | Machinery | Depreciation method: | Straight-line method, alternatively declining-balance method |
| Poland | Machinery | Depreciation rate: | 20% |
| | | Depreciation base: | Historical acquisition or production cost |
| | | Depreciation method: | Straight-line method, alternatively declining-balance method |
| | Intangibles | Depreciation rate: | 3% (software and acquired rights) |
| Slovakia | Buildings | Depreciation base: | Acquisition costs / production costs |
| | | Depreciation method: | Straight-line method |
| | | Depreciation rate: | 2% (additional 10% deduction in the first year) |
| | Machinery | Depreciation base: | Acquisition costs / production costs |
| Slovenia | Machinery | Depreciation method: | Straight-line method |
| | | Depreciation rate: | 6.67-25% depending on capital asset |
| | | Depreciation base: | Acquisition cost |
| | Intangibles | Depreciation method: | Straight-line method |
| Slovenia | Intangibles | Depreciation rate: | 8% |
| | | Depreciation base: | Acquisition or production costs |
| | | Depreciation method: | Straight-line method |
| | Buildings | Depreciation rate: | 1.5-4.5% |
| Slovakia | Buildings | Depreciation base: | Acquisition or production costs |
| | | Depreciation method: | Straight-line method |
| | | Depreciation rate: | 5% |
| | Machinery | Depreciation base: | Acquisition or production costs |
| Slovakia | Machinery | Depreciation method: | Straight-line method (also specified accelerated depreciation method) |
| | | Depreciation rate: | 16,6% |

| | | | |
|-----------------|-------------|--|--|
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 20% |
| Slovenia | Buildings | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 5% |
| | Machinery | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 25% |
| | Intangibles | Depreciation base: Depreciation method: Depreciation rate: | Acquisition or production costs Straight-line method 20% |

Appendix 12. Depreciation of goodwill

| Adopted in | Regulation for tax accounting |
|------------------------------|--|
| IAS/IFRS | IFRS 3.54f. (impairment-only approach): Goodwill can be only subject to an impairment test according to IAS 36, which has to be conducted at least annually. |
| 4th Council Directive | Depreciation method: Amortisation on a systematic basis Depreciation rate: Maximum 5 years |
| Austria | Depreciation method: Straight-line method Depreciation rate: 6.67% (15 years) |
| Belgium | Depreciation method: Straight-line method Depreciation rate: 20% (5 years) |
| Denmark | Depreciation method: Straight-line method Depreciation rate: 14,28% (7 years) |
| Finland | Depreciation method: Straight-line method Depreciation rate: 10% (10 years) |
| France | not depreciable |
| Germany | Depreciation method: Straight-line method Depreciation rate: 6.67% (15 years) |
| Greece | Depreciation method: Straight-line method Depreciation rate: 100% or 20% (up to 5 years) |
| Ireland | not depreciable |
| Italy | Depreciation method: Straight-line method Depreciation rate: 10% (10 years) |
| Luxembourg | Depreciation method: Straight-line method Depreciation rate: 10-20% (5 to 10 years) |
| Netherlands | Depreciation method: All kinds of depreciation (e.g. straight-line method, declining-balance method), provided the method is in accordance with 'sound business practice' and is applied consistently. Depreciation rate: Depending on useful life of the asset (in general: 20%) |
| Portugal | Not depreciable |
| Spain | Depreciation method: Straight-line method Depreciation rate: 5% (20 Years) |
| Sweden | Depreciation method: Declining-balance method (shift to straight-line method with a 20% rate, if it results in a lower book value) Depreciation rate: 30% |
| United Kingdom | Accounting depreciation or 4% straight line |
| Cyprus | not depreciable |
| Czech Republic | Depreciation method: Straight-line method Depreciation rate: 6.67% (15 years) |

| | |
|------------------|---|
| Estonia | Depreciation method: Straight-line method Depreciation rate: 20% (5 years) |
| Hungary | Depreciation method: Straight-line method Depreciation rate: Maximum 20% (minimum 5 years) |
| Latvia | not depreciable |
| Lithuania | Depreciation method: Straight-line method Depreciation rate: 15% (6.67 years) |
| Malta | no regulation |
| Poland | Depreciation method: Straight-line method Depreciation rate: 20% (5 years) |
| Slovakia | Depreciation method: Straight-line method Depreciation rate: 6.67% (15 years) |
| Slovenia | Depreciation method: Straight-line method Depreciation rate: 10% (10 years) |

Appendix 13. Measurement of financial assets

| Adopted in | Regulation for tax accounting | |
|------------------------------|--|--|
| IAS/IFRS | <p>Initial measurement:</p> <p>Revaluation:</p> <p>Write-down:</p> | <p>Fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset</p> <ul style="list-style-type: none"> - Financial assets 'at fair value through profit or loss': a revaluation beyond the acquisition costs is allowed. A gain does increase the profit. - Financial assets 'available-for-sale': a revaluation beyond the acquisition costs is allowed if the fair value at balance sheet date is higher than the carrying amount. However, a gain does not increase the profit, it must be booked directly in equity. - Financial assets 'held-to maturity': a revaluation beyond the acquisition cost is not allowed. <p>If an impairment loss is recognised:</p> <ul style="list-style-type: none"> - Financial assets 'held-to-maturity': Recognition in profit or loss - Financial assets 'available-for-sale': Recognition in profit or loss - Reversing of the impairment loss: recognition in profit or loss. |
| 4th Council Directive | <p>Initial measurement:</p> <p>Revaluation:</p> <p>Write-down:</p> | <p>Purchase price and production price</p> <p>Option for revaluation of tangible assets and financial fixed assets</p> <p>Difference between the revaluation amount and the book value must be entered in the revaluation reserve under 'liabilities'.</p> <p>The treatment of this item for taxation purposes must be explained either in the balance sheet or in the notes of the accounts.</p> <p>Value adjustments may be made in respect of financial fixed assets, so that they are valued at the lower value to be attributable to them at the balance sheet date. The value adjustments must be charged to the profit and loss account.</p> |

| | | |
|----------------|---|---|
| Austria | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed Financial assets may be written down to a lower going-concern value even if the reduction of value is not expected to be permanent. In the case of financial assets write-back is mandatory if the reasons for the decrease in value no longer apply. |
| Belgium | Initial measurement: Revaluation: Write-down: | Historical costs Option for revaluation if the increase in value is permanent and certain The revaluation must be booked in a revaluation reserve, but it will not be taxed until the reverse is maintained. <ul style="list-style-type: none"> • <i>Participations</i>: Write-down is optional if the decrease in the value is permanent, but it is not deductible for tax purposes. Capital losses are deductible in the case of liquidation. • <i>Portfolio investments</i> are booked at the lower of the historical cost or fair market value. But write-downs are not deductible for tax purposes unless the share is liquidated. • <i>Other securities</i> are valued at the lower of the historical cost and fair market value. |
| Denmark | Initial measurement: Revaluation: Write-down: | Historic costs In general, not Exemption for banks of other financial institutions: Financial assets have to be valued at their market value at the end of each tax year. Unrealised gains affect the net income and are taxed at the end of each tax year. In general, not Exemption for banks of other financial institutions: Financial assets have to be valued at their market value at the end of each tax year. Unrealised losses affect the net income and are taxed at the end of each tax year. |

| | | |
|----------------|----------------------|---|
| Finland | Initial measurement: | Purchased price |
| | Revaluation: | Option for revaluation if the increase in value is permanent. The revaluation must be booked in a revaluation reserve, but it will not be taxed until the reverse is maintained. If the amount of the revaluation item is too high, it must be revoked. This is not a taxable event. |
| | Write-down: | Write-down is allowed for tax purpose only if the taxpayer can prove that the market value of the financial asset is considerably lower than its book value. To be deductible for tax purposes, the depreciated amounts must also be recorded in the accounts of the company. |
| France | Initial measurement: | Historical costs |
| | Revaluation: | Revaluation for fixed financial assets is allowed. The capital gains resulting from a revaluation do not have to be accounted for. |
| | Write-down: | <ul style="list-style-type: none"> • Participating shares (securities giving their owner a degree of control or influence over the owned company. They establish a durable link between the holding company and the owned company): The provision for recognition the decrease in value (mandatory for financial purpose) does not decrease the taxable income. The decrease in value is treated as a long-term capital loss that can only be offset against long-term capital gain. • Portfolio shares (shares to be held over a short period of time for a quick return on investment): The provision decreases the taxable income. |
| Germany | Initial measurement: | Historical costs |
| | Revaluation: | Not allowed |
| | Write-down: | A write-down of shares in resident or non-resident companies is not tax deductible. The write-down is denied regardless of the level of participation, the holding period and whether the decrease is temporary or not. |

| | | |
|----------------|---|---|
| Greece | <p>Initial measurement: Acquisition costs</p> <p>Revaluation: Not allowed</p> <p>Write-down:</p> <ul style="list-style-type: none"> • <i>Listed companies</i>: valuation at the lower of the acquisition cost and the current price. The current price is defined as the average current price for the last month of the company's financial year. • <i>Not-listed companies</i>: in general, valuation at the lower of their acquisition cost and their current value. The current value is determined on the basis of the book value. <p>The write-down does not affect the net income. Any loss resulting from the valuation of shares and bonds at the year-end is debited to the account 'Reserves from securities'. This account is shown in the accounts of the company and results from the sale of securities, from the sale of listed shares or from the receipt of shares free of charge on the basis of revaluation of immovable property. If the amount of the reserves is not sufficient to cover the loss, the differences are not deductible; it is transferred to a special account to set off against future gains from the sale of securities.</p> | |
| Ireland | <p>Initial measurement: Acquisition costs</p> <p>Revaluation: Not allowed</p> <p>Write-down:</p> | <p>Deductions of expenses including extraordinary depreciations are not allowed.</p> |
| Italy | <p>Initial measurement: Acquisition costs</p> <p>Revaluation: Not allowed</p> <p>Write-down:</p> | <p>Since January 2004, capital gains from the disposal of participations in resident and non-resident companies are generally fully tax-exempt regardless of the level of shareholding (if the shares have been owned from the beginning of the twelfth month prior to the date of disposal). Therefore any write-downs of qualifying investments are not tax-deductible.</p> |

| | | |
|--------------------|---|--|
| Luxembourg | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed <ul style="list-style-type: none"> • <i>Participations</i>: If the going-concern value is lower than their acquisition costs, the assets must be written-down at the lower going-concern value. The write-down affects the net income and is tax-deductible. • <i>Securities</i>: If the going-concern value is lower than their acquisition costs, the assets must be written-down at the lower going-concern value. The write-down affects the net income and is tax-deductible. • Expenses in relation to participation qualifying for the participation exemption (write-down of the value) are only deductible to the extent that they exceed the exempt income arising from such a participation in a given year. |
| Netherlands | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed <ul style="list-style-type: none"> • Investments qualifying for the participations exemption (capital gains from the disposal of shares are exempt from corporate tax, condition: Holding of at least 5% of the nominal paid-in capital not as inventory): Devaluations of qualifying participations do not decrease the taxable income. If the reasons for the decrease in value cease to apply, the value may not be write-back. • <i>Investments not qualifying for the participations exemption</i>: The write-down is also mandatory for tax purpose. If the going-concern value increases after the write-down of the assets, the asset must be revaluated to (at the maximum) the original cost. The write-back increases the taxable income. |
| Portugal | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed In accordance with the general accounting principles, financial fixed assets must be valued at lower of cost or market value. |

| | | |
|-----------------------|---|--|
| Spain | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed At the end of every financial year, participations and securities (listed and not listed) must be valued at market value; if necessary, a provision is set aside for their decrease in value. Any loss in value of securities (including participations) must be recorded at the end of the book year through an adjusting provision and carried over to the next year. The provision is tax deductible. |
| Sweden | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed <ul style="list-style-type: none"> • <i>Participations</i>: They are valued at the cost of acquisition. • <i>Securities</i>: Shares, bonds and other securities will normally be valued at the cost of acquisition. |
| United Kingdom | Initial measurement: Revaluation: Write-down: | Acquisition costs Changes in fair value of equity are realised and taxable only at time of realisation (unless an exempt participation). Derivatives and debt securities generally in accordance with accounting treatment. Not generally for equity. Derivatives and debt securities generally in accordance with accounting treatment. |
| Cyprus | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed Depreciations are not allowed for tax purpose. Capital losses have to be accounted if they are realised. |
| Czech Republic | Initial measurement: Revaluation: Write-down: | Under scrutiny Under scrutiny Under scrutiny |
| Estonia | Initial measurement: Revaluation: Write-down: | According to IFRS According to IFRS According to IFRS |

| | | |
|------------------|---|---|
| Hungary | Initial measurement: Revaluation: Write-down: | Costs Not allowed For participations (irrespective of whether recorded as fixed assets or current assets) and creditor securities, devaluation to the market value is obligatory if their book value is permanently and substantially lower than their fair market value at the balance-sheet closing date. Write-back is also obligatory if their fair market price is permanently and substantially higher than their book value. |
| Latvia | Initial measurement: Revaluation: Write-down: | Cost Not allowed Not allowed |
| Lithuania | Initial measurement: Revaluation: Write-down: | Costs At the end of the year, long-term securities are valued at fair market value. The valuation difference is treated for tax purposes as a revaluation reserve (not affecting the net income). Upon disposal of the assets, the reserve is included in the taxable income. At the end of the year, long-term securities are valued at fair market value. The valuation difference is treated for tax purposes as a revaluation reserve (not affecting the net income). Upon disposal of the assets, the reserve is included in the taxable income. |
| Malta | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed Changes in the fair value of assets are not allowed to affect the taxable income. Any write-down must be added back to the accounting profit when computing the taxable income. |
| Poland | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed If the market value is lower than the book value, the value of the participation or securities have to be written down to the lower market value. The write-down affects the net income. |
| Slovakia | Initial measurement: Revaluation: Write-down: | Acquisition costs Not allowed Securities are valued at purchase price. A write-down at the lower fair market value is not allowed. |

| | | |
|-----------------|---|--|
| Slovenia | Initial measurement: Revaluation: Write-down: | Acquisition costs Under scrutiny Securities that have a lower market value on the date of balance sheet than their purchase value must be shown at market value. The difference is treated as an expense. However, if the market value of the securities increases, there is no requirement to reflect the market value. |
|-----------------|---|--|

Appendix 14. Group taxation

| Adopted in | Regulation for tax accounting |
|-------------------|--|
| IAS/IFRS | No regulations for tax purposes. Consolidated financial statement including all subsidiaries based on the concept of the power to control. |
| Austria | Group: Resident companies and their resident and non-resident subsidiaries Conditions: - Minimum share participation of 50% - Group treatment must be concluded for a minimum period three 3 years Type of relief: Consolidation: pooling of all income and taxation in the hands of the controlling parent. If the subsidiaries are non-resident, only the attributable loss can be transferred to the parent company. |
| Belgium | No fiscal consolidation |
| Denmark | Group: In general resident companies. May be extended to non-resident subsidiaries Condition: 100% direct or indirect interest in the other company Type of relief: Consolidation: Pooling of all profits and losses and taxation in the hands of the controlling company. |
| Finland | Group: Resident companies and their resident subsidiaries Conditions: - Minimum share participation of 90% - Involved companies carry on business and are not financial, insurance or pension institutions Type of relief: No consolidation. However, members of the group may make contributions to other members that are tax deductible from the taxable income of the contributing company and added to the taxable income of the recipient company. |
| France | Group: Resident companies and their resident subsidiaries Condition: Minimum share participation of 95% Type of relief: Aggregation of incomes and losses; the tax effect of intragroup transfers will be neutralised at the parent company level. |

| | |
|----------------|--|
| | <p>There is a second regime of group treatment which allows consolidation of domestic and foreign operations and subsidiaries under certain conditions.</p> <p>A tax-free provision equal to 100% of the losses incurred by a foreign subsidiary or permanent establishment abroad during the first four years following the acquisition or creation may be set up (provision for investment abroad). The subsidiary must be at least one-third owned by the resident company and serve for marketing and related operations of products manufactured in France by the parent company. The provision must be added back in amounts proportional to profits realised by the foreign subsidiary or establishment within a maximum period of 10 years.</p> |
| Germany | <p>Group: Resident companies and their resident subsidiaries</p> <p>Conditions: - A profit-and-loss pooling agreement - The controlled company must be financially integrated into the controlling parent</p> <p>Type of relief: Group taxation: Taxation in the hands of the parent company, as one fiscal unit: pooling of all profits and losses</p> |
| Greece | No group taxation |
| Ireland | <p>Group: Resident companies and their resident subsidiaries</p> <p>Condition: 51%, 75% or 90% subsidiaries, depending on the group treatment</p> <p>Type of relief: No group consolidation for tax purposes but a number of provisions allowing the surrender of losses between companies of a group</p> |
| Italy | <p>Group: National consolidated taxation: Resident companies and their resident subsidiaries International consolidated taxation: Resident companies and their non-resident subsidiaries Provisions do not apply for Italian permanent establishments of non-resident companies</p> <p>Condition: National consolidated taxation: <ul style="list-style-type: none"> - Majority of voting rights, participation of more than 50% of subsidiaries' capital and entitlement to 50% of the balance sheet profit - Same financial year - Option applies for at least three years International consolidated taxation: <ul style="list-style-type: none"> - Parent company must be listed at a stock exchange and dominated by the Italian government or by resident individuals - Participation of more than 50% of subsidiaries' capital and entitlement to 50% of the balance sheet profit </p> |

| | | |
|-----------------------|--|---|
| | Type of relief: | National consolidated taxation: - Pooling of profits and losses at the level of the parent company ('cherry picking' allowed) - Transfer of fixed assets between the group members is possible without release of hidden reserves International consolidated taxation: - Profits are transferred to the parent company only proportional to the amount of holding ('all in, all out' principle) |
| Luxembourg | Group: Conditions: Type of relief: | Resident companies - Minimum share participation of 95% (in special cases 75%) - Consolidation must be continued for at least five years Full consideration of losses |
| Netherlands | Group: Condition: Type of relief: | Resident companies. In certain cases, a fiscal unity may also include a non-resident company Minimum share participation of 95% Consolidation: Taxation in the hands of the parent company as one fiscal unit. Full transfer of losses. Transactions between group members are disregarded for tax purposes. |
| Portugal | Group: Conditions: Type of relief: | Companies with their legal seat and place of management in Portugal - Companies must have certain legal forms - The group is valid for five years and may be extended indefinitely - Minimum share participation of 90% Pooling of all profits and losses (excluding intra-group dividends), as determined in the tax return of each member of the group |
| Spain | Group: Conditions: Type of relief: | Resident companies and their resident subsidiaries - Optional for qualifying companies and mandatory for banks - Only for certain legal forms - 75% or more owned subsidiaries Consolidation to the net income of the group |
| Sweden | Group: Condition: Type of relief: | Resident companies and their resident subsidiaries The parent company must hold more than 90% of shares No consolidation. However, losses of one company can be set off against profits of another company of the group by group contributions |
| United Kingdom | Group: | Resident group companies and UK branches of non-resident group companies irrespective of parent company location |

| | |
|-----------------------|---|
| | <p>Conditions: - A group consists of a parent company and its 51% or 75% subsidiaries</p> <p>- A consortium consists of 20 or fewer UK resident companies that each own 5% or more and together own 75% of a company</p> <p>Type of relief: No consolidation, but a number of provisions covering the transfer of losses and the transfer of assets within a group or a consortium.</p> |
| Cyprus | <p>Group: Resident companies and their resident subsidiaries</p> <p>Condition: Minimum share participation of 75%</p> <p>Type of relief: No consolidation. However pooling of losses and profits within the group is allowed</p> |
| Czech Republic | No group taxation |
| Estonia | No group taxation |
| Hungary | No group taxation |
| Latvia | <p>Group: Resident companies and their resident subsidiaries</p> <p>Conditions: - Minimum shareholding of 90%</p> <p>- Principal company may also be an individual</p> <p>Type of relief: No consolidation, but companies of the same group are allowed to transfer losses amongst them</p> |
| Lithuania | No group taxation |
| Malta | <p>Group: Resident companies and their resident subsidiaries</p> <p>Condition: Minimum shareholding of 51%</p> <p>Type of relief: Surrender of losses to other corporate members of a group. The companies must be resident in Malta and belong to a 51% group</p> |
| Poland | <p>Group: Resident companies and their resident subsidiaries</p> <p>Conditions: A tax group may consist of companies with a share capital of at least PLN 1 million and must be formed for a period of at least three years. Further requirements are:</p> <p>- The parent company must own 95% of the shares of the subsidiary</p> <p>- The companies may not be exempt from income tax or VAT</p> <p>- The total net income of the tax group must be at least 6% of the total</p> <p>- Gross income of all companies forming the tax group</p> <p>Type of relief: The taxable base of a tax group is computed as the difference between the aggregated profits and losses of all group companies.</p> |
| Slovakia | No group taxation |
| Slovenia | <p>Group: Resident companies and their resident subsidiaries</p> <p>Condition: The parent company must hold at least 90% of the capital in each subsidiary</p> <p>Type of relief: Income consolidation: The taxable income of the group is the difference between the aggregate income and the aggregate losses of all group companies.</p> |

Appendix 15. Loss treatment

| Adopted in | Regulation for tax accounting |
|------------------------------|--|
| IAS/IFRS | No regulations |
| 4th Council Directive | No regulations |
| Austria | Carry-forward: No limitation in time Carry-back: Not available |
| Belgium | Carry-forward: Unlimited Carry-back: Not available (limited if the company is involved in certain tax-exempt reorganisation and if there is a change in ownership) |
| Denmark | Carry-forward: No limitation in time Carry-back: Not available |
| Finland | Carry-forward: 10 years Carry-back: Not available |
| France | Carry-forward: Indefinitely Carry-back: 3 years (tax credit) |
| Germany | Carry-forward: No limitation in time, restricted to 60% of taxable profits if loss exceeds €1 million, limited for corporation in case of certain changes in ownership Carry-back: 1 year |
| Greece | Carry-forward: Up to 5 years Carry-back: Not allowed |
| Ireland | Carry-forward: Indefinitely in the same and continuing trade with restriction where there has been a substantial change in the nature and ownership of the company Carry-back: 3 years |
| Italy | Carry-forward: 5 years (no limitation for losses incurred in the first three years of the business activity) Carry-back: Not available |
| Luxembourg | Carry-forward: Unlimited with restriction for statutory mergers, consolidation and reorganisations Carry-back: Not allowed |
| Netherlands | Carry-forward: No limitation in time Carry-back: 3 years |

| | |
|-----------------------|--|
| Portugal | Carry-forward: 6 years with some restrictions Carry-back: Not allowed |
| Spain | Carry-forward: 15 years Carry-back: Not allowed |
| Sweden | Carry-forward: No limitation in time Carry-back: By means of a profit periodisation reserve |
| United Kingdom | Carry-forward: No limitation in time Carry-back: 1 year |
| Cyprus | Carry-forward: No limitation in time Carry-back: Not available |
| Czech Republic | Carry-forward: 5 years Carry-back: Not available |
| Estonia | Carry-forward: Not available Carry-back: Not available (retained profits are tax-exempt) |
| Hungary | Carry-forward: No limitation in time Carry-back: Not allowed |
| Latvia | Carry-forward: 5 years Carry-back: Not available |
| Lithuania | Carry-forward: 5 years Carry-back: Not available |
| Malta | Carry-forward: Unlimited Carry-back: Not allowed |
| Poland | Carry-forward: 5 years up to 50% in each year Carry-back: Not allowed |
| Slovakia | Carry-forward: 5 years under very restrictive conditions. Carry-back: Not allowed |
| Slovenia | Carry-forward: 5 years Carry-back: Not allowed |

Appendix 16. Immediate write-off of assets

| Adopted in | Regulation for tax accounting |
|------------------------------|---|
| IAS/IFRS | Not allowed |
| 4th Council Directive | Not allowed |
| Austria | Write-off is immediately allowed for assets whose net value does not exceed €400. |
| Belgium | Under scrutiny |
| Denmark | Danish tax law allows certain assets to be fully depreciated in the year of acquisition. This applies for: <ul style="list-style-type: none"> - Machinery with acquisition cost of DKK 11,000 or less - Machinery with a physical – not technical or economic – lifetime of three years or less - Machinery acquired for experiment or research activities - Software |
| Finland | Items of machinery and equipment whose estimated useful life does not exceed three years may be fully written off in the year of acquisition. Such assets with a value of less than €850 may be written off immediately even though the economic life exceeds three years; the total value of assets so written off may not exceed €2,500 per tax year. |
| France | Write-off is immediately allowed for equipment, office equipment, tools and software if their net value (excluding VAT) does not exceed €500. |
| Germany | Immediately write-off is allowed for assets whose net value does not exceed €410. |
| Greece | Assets whose acquisition cost is up to €1,200 may be expensed in the year they were purchased or put into use. |
| Ireland | Under scrutiny |
| Italy | Write-off is immediately allowed for assets whose net value does not exceed €516.46. |
| Luxembourg | Write-off is immediately allowed for assets whose net value does not exceed €870. |
| Netherlands | Write-off is immediately allowed for assets whose net value does not exceed €450. |
| Portugal | Write-off is immediately allowed for assets whose net value does not exceed €199.52. |
| Spain | Small-size companies are nevertheless allowed to freely depreciate assets whose individual value does not exceed €601.01. The total value of assets so written off may not exceed €12,020.24 per tax year. |

| | |
|-----------------------|---|
| Sweden | Assets with a useful life not exceeding three years and assets of minor value may be fully depreciated in the year of acquisition. |
| United Kingdom | Not allowed |
| Cyprus | Under scrutiny |
| Czech Republic | Immediately write-off is allowed for movable, tangible assets if their net value (excluding VAT) does not exceed CZK 40,000. Immediately write-off is allowed for intangible assets if their net value (excluding VAT) does not exceed CZK 60,000. |
| Estonia | Under scrutiny |
| Hungary | Under scrutiny |
| Latvia | Under scrutiny |
| Lithuania | Under scrutiny |
| Malta | Not allowed |
| Poland | Write-off is immediately allowed assets if their net value (excluding VAT) does not exceed PLN 3,500. |
| Slovakia | Write-off is immediately allowed for tangible assets if their net value (excluding VAT) does not exceed SKK 30,000. Immediately write-off is allowed for intangible assets if their net value (excluding VAT) does not exceed SKK 50,000. |
| Slovenia | Under scrutiny |

MEMBERS OF THE CEPS TASK FORCE AND INVITED GUESTS AND SPEAKERS

Chairman of the Expert Group: Malcolm Gammie CBE QC
Chambers of Lord Gribner QC

Rapporteurs: Silvia Giannini
Professor
University of Bologna
& Assonime

Alexander Klemm
Economist
Institute for Fiscal Studies

Andreas Oestreicher
Professor
University of Goettingen

Paola Parascandolo
Senior Economist
Assonime

Christoph Spengel
Professor
Justus-Liebig-Universität

MEMBERS OF THE CEPS TASK FORCE

Krister Andersson
Director Tax Policy
for Swedish Business and
Commerce
Confederation of Swedish
Enterprise

Jesper Barenfeld
Confederation of Swedish
Enterprise

Claus Beckenhub
Global Tax Department
Deutsche Bank AG

Bianca Boehringer
Public Affairs Assistant
Volkswagen AG

Loredana Carpentieri
Assonime

Alessandra Casale
Head of Representative Office
Assonime

Jean-Pierre Casey
Research Fellow
CEPS

Jurgen de Moor
National Tax Manager
BP

Karel Lannoo
Chief Executive
CEPS

Vincent Delva
Director Tax & Legal Department
Volkswagen AG

Mattias Levin
Bureau of European Policy Advisors
European Commission

Christopher Dent
Director
European Taxation
Ford Motor Company, EU Affairs

Filippo Mancuso
Assonime

Rolf Diemer
Administrator
DG Taxation and Customs Union
European Commission

Stefano Marchese
Chairman
Direct Tax Working Party
Fédération des Experts Comptables
Européens (FEE)

Staffan Jerneck
Director & Director of Corporate
Relations
CEPS

Helmuth Martin
Senior Vice President
Commerzbank EU-Liaison Office
Brussels

Christian Kaeser
Deputy Director Taxes
Siemens AG

Yuji Miyaki
Administrator
Organisation for Economic
Co-operation and Development
(OECD) CTP/TTP

Patrick Kehm
Commerzbank AG

John Neighbour
Head of Transfer Pricing
Financial Transactions Unit
Organisation for Economic
Co-operation and Development
(OECD)

Michael Kröner
Global Head of Taxation
Deutsche Bank AG

Yasmin Kunisch
Citigroup

Gaëtan Nicodème
Administrator

Karin Lagerkvist
Vice President Taxes
StoraEnso

DG Economic and Financial Policy
European Commission

Lena Niels
Project Manager
European Commission

Lene Nielsen
Legal Adviser, Lawyer
Confederation of Danish Industries
(DI)

Geoff Pennells
European Tax Director
Schröder Salomon Smith Barney

Chiara Pisano
Project Manager
Fédération des Experts Comptables
Européens (FEE)

H. Onno Ruding
Chairman of the CEPS Board of
Directors
Retired Vice Chairman of Citibank
Former Minister of Finance of the
Netherlands

Julian Schaub
Executive Assistant
Commerzbank EU-Liaison Office
Brussels

Caroline Silberztein
Head of Transfer & Pricing Unit
Organisation for Economic
Co-operation and Development
(OECD)

Stephen Stacey
General Manager
Government Affairs
Toyota Motor Europe

Benoni Talahatu
Vice-President
Corporate Tax Department
ABN Amro Bank N.V.

Invited Speakers and Guests

Michel Aujean
Director
DG Taxation & Policy
European Commission

Paolo Ciocca
Direttore Dipartimento per le
Politiche Fiscali
Ufficio Relazioni Internazionali
Ministero dell'Economia e delle
Finanze

Philip Gillett
Group Tax Controller
Imperial Chemical Industries plc.

James Hines
Visiting Professor
London School of Economics

Michael Hölzl
CF Taxes
Siemens AG

Jan Inghelram
Référéndaire
European Court of Justice

Yasuyuki Kawabata
Professor
Yokohama National University

Theo Keijzer
Head of Shell Tax Policy
Shell International B.V.

Philip Martin
Taxation Advisor
Dorsey & Whitney LLP

Stefano Micossi
Director General, Assonime
Member of the CEPS Board of
Directors

Gert Müller-Gatermann
Director
International Tax Affairs
German Federal Ministry of Finance

Anne Murrath
Managing Partner
Belgian Tax Practice
PricewaterhouseCoopers

Will Morris
Tax Counsel - International
General Electric

Tom Neale
Administrator
DG Taxation & Customs Union
European Commission

Andreas Rutteman
Secretary General
European Financial Reporting
Advisory Group (EFRAG)

Alastair Sutton
Partner
White & Case LLP

Jan Van der Bijl
Secretary-General
Tax Department
Unilever NV

Robert Van der Have
Head of European Taxation
Dutch Ministry of Finance

Robert Verrue
Director General
DG Taxation & Customs
European Commission