Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

EBF comments on the proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)

GENERAL COMMENTS

In principle the EBF welcomes any initiative that will make the task of compliance with taxation requirements easier and remove the tax obstacles to cross-border activities of European companies within the EU. In this respect the EBF would welcome the development of common rules for company taxation only if the rules would reduce administrative and compliance costs. Any new regime should be practical to administer.

The EBF has noticed that – since the proposal was published – a number of Member States have expressed opposition to the CCCTB for various political reasons. If the proposal is rejected EBF suggest that the Commission should reconsider the old proposal for a directive concerning cross-border loss-offset (COM (90) 595 final). This proposal was withdrawn when the commission began consultations on CCCTB in 2001. Since then the decision of the ECJ in the “Cadbury-Schweppes case” has resulted in introduction of different legal measures in the member states to align national tax law with the decision. A directive on cross-border loss utilisation would help to harmonise this situation.

CORPORATE TAX BASE

Common tax base

Computing the tax base should be as simple as possible and it is a precondition that the CCCTB contains a common starting point. The ideal position would be that the taxable income was equal to the net profit as presented in the consolidated profit/loss account. This simplifies business decisions and makes it easier both for the tax payer and the tax administration to verify the corporate tax.

The proposal does not define a starting point for calculating the tax base. The CCCTB will be less effective if it is necessary to create separate tax accounts in addition to the accounts prepared for statutory purposes. It is therefore strongly recommended that the proposal considers this. In
EBF's view it would be appropriate to link the tax base to the IFRS principles that are compulsory for groups of companies.

If there still are member states disallowing statutory accounts based on IFRS it should anyway be possible to establish a link between the financial statements and the IFRS conform tax base. As the last resort it should be considered to amend EU accounting law in order to have an instrument to which the CCCTB can relate.

The technical format of the CCCTB is flow-based as the difference between taxable income, deductible expenses and other items. Even though the CCCTB stands for rules for calculating profits independently for tax purposes, it is assumed that the tax base is derived from open roll-over of already existing computation of profits. No concrete reference basis, e.g. the IFRS commercial accounting rules, is to be found in the draft directive. However, the IFRS principles, which have evolved further since the launch of the long-term CCCTB project, are reflected in individual provisions. In addition, it is intended that the directive may be supplemented by further rules in a special procedure (Article 127 et seq.), with the Commission taking the initiative on the rules and Member States approving them by majority decision in the review process. Should the CCCTB regime display any gaps, it would be advisable to establish a concrete reference basis to close these (provisionally or finally) from the outset if and as long as the procedure under Article 127 et seq. is not adopted – which, in view of flagging political interest in further shaping the CCCTB process, appears quite possible. Given the existing heterogeneity of concepts for computing profits under national tax law in the EU, the reference basis cannot be these themselves. Instead, reference could be made to EU accounting law. This would also have the advantage that computation of profits for tax purposes and recognised accounting rules would not completely drift apart.

The CCCTB's technical format as reconciliation of book and taxable income would appear to make sense only if few modifications are required. If a large number of corrections need to be made – which will usually be the case where businesses operating across borders are involved – we would prefer an accounting-based solution comprising a balance sheet and P&L account which, in addition to computing profits on an ongoing basis, documents positions and supports joining and exiting the system, particularly as in the case of the CCCTB additional information besides reconciliation of book and taxable income already has to be documented across periods (cf. fixed asset register, Article 32 of the draft directive; rollover relief for replacement assets, Article 38 of the draft directive; development of the asset pool, Article 39 of the draft directive).

The draft directive is based on the concept of “economic ownership” (substance over form) and adopts an approach based on risks and opportunities (Article 4(20) and Article 34 of the draft directive). This is in line with IAS 17, which in turn (because it is possible in practice to make choices about allocation) is subject to criticism and is about to undergo a thorough revision. Economic ownership needs to be better defined, and this should be done in the draft directive itself. Delegation to the Commission, as provided for in Article 34 of the draft directive, is not appropriate.
Financial instruments

The four general principles for computing the tax base referred to in Article 9 of the draft directive – recognition of profits and losses only when realised, individual measurement of transactions and taxable events, consistency and periodicity – are incomplete and need to be supplemented to ensure objective computation of profits. If, for example, Article 31 of the fourth EC Annual Accounts Directive (Directive 78/660/EEC of 16 July 2009) is held against it by way of comparison, this shows that the going concern principle, the prudence principle and the formal (accounting) continuity principle are missing. The question is also raised of how potential target conflicts could be resolved by target hierarchies. If the rules for computation of profits are supplemented, the system would be more coherent and better suited for the purpose of interpretation and closing gaps.

For example, the imparity principle is recognised in measurement of stocks at the (lower) fair value, in the admissibility of exceptional depreciation of fixed assets not subject to wear and tear and in the definition of provisions, which also covers anticipated losses, while write-downs on bad debt are not explicitly allowed. The admissibility of bad debt charges, particularly also of general bad debt charges, should not actually be allowed to be questioned in our view and ought therefore to be expressly regulated.

The realisation principle, which is based on the timing of the delivery or service and not on the timing of the payment transaction (no cash realisation principle) is breached (Article 9 of the draft directive) in the case of

- financial assets and liabilities held for trading, the differences between whose fair value are included in the tax base (Article 23(2) of the draft directive)

- partial realisation of profits from long-term contracts (Article 24 of the draft directive); and

- hedging instruments (Article 28 of the draft directive).

This leads to the taxation of unrealised profits. Breaching the realisation principle would only be justified if it went hand in hand with immediate loss compensation or interest on the excess tax that was temporarily due. However, the carry-forward of losses provided for in the proposed directive falls short of immediate loss compensation. It contains only a time-unlimited, non-interest-bearing carry-forward of losses (Article 43(1) of the draft directive). The use of the carry-forward of losses must not result in a negative amount in a given period (Article 43(2) of the draft directive). This, together with the absence of loss carry-back, will certainly worsen businesses’ cash flow problems. The realisation principle is interpreted in the case of deductible expenses to mean that these expenses arise in connection with both legal and actual events. A purely economic approach that is in principle called for under income tax law is thus rejected.

The individual measurement principle laid down in Article 9(2) of the draft directive contains no additional rules regulating the creation of valuation units that is possible under commercial law.
As valuation units are widely used in the banking sector to hedge financial risk, we suggest adding a corresponding provision to the draft directive.

**Fixed assets**

The distinction between tangible fixed assets that must be capitalised (where they can be valued independently and are to be used for more than 12 months) and low-value assets (less than EUR 1 000) excluded from capitalisation (Article 4(14) of the draft directive) is a welcome simplification (Article 4(14) of the draft directive).

Acquisition costs are to include only direct costs, with construction costs including indirect costs as well, insofar as these are not otherwise deductible (Article 33 of the draft directive; production-based total cost approach). Computation of costs is not specified further, however.

Capitalisation of intangible fixed assets (where these can be valued independently and are to be used for more than 12 months) is only permitted where they are acquired for value (Article 4(14) of the draft directive). This excludes capitalisation of research and development costs, thus leading to deductible expense. In view of the many intractable problems with measuring such things objectively and the goal of supporting research and development in the EU (page 1 of the draft directive), this should be supported.

When valuing assets, a distinction is made, depending on the type of transaction, between monetary consideration (for goods and services), market value (in the case of non-monetary consideration), fair value (for financial assets and financial liabilities held for trading) and value for tax purposes (in the case of non-monetary gifts to charitable bodies) (Article 22 of the draft directive). However, there is no clear definition of fair value.

For the purpose of subsequently measuring assets, a distinction is made between individually depreciable assets (buildings, aircraft, ships, long-life tangible assets with a useful life of 15 years or more and intangible assets; Article 36 of the draft directive) and depreciable assets to be put together in an asset pool (Article 39 of the draft directive).

In principle, entitlement to depreciate lies with the economic owner (Article 34 of the draft directive), whose identity, however, is not adequately defined.

The proposed depreciation rules are much simpler than the tax law in several jurisdictions.

In the case of individually depreciable assets, only linear depreciation is permitted. The timing of depreciation is stipulated.

The draft directive allows, in addition, pool depreciation based on the declining balance method instead of individual, linear depreciation. The pool depreciation method provides businesses with self-financing opportunities. At a depreciation rate of 25%, most of the depreciation would be offset when the time comes for replacement investment (around 90% after eight years). The depreciation rate for pool depreciation should therefore be raised appropriately.
Limiting exceptional deductions to non-depreciable fixed assets where a permanent decrease in value can be demonstrated places excessive limits on what losses can be taken into account. There is also a lack of clarity as to what constitutes a "permanent decrease in value". No exceptional deductions may be made in respect of assets whose disposal proceeds are tax-exempt, e.g. shares in companies. This could put holding companies and venture capital businesses at a disadvantage.

Subsequent reversals of losses are to be taken into account by including them in profits up to the maximum threshold of acquisition or construction costs (Article 41 of the draft directive). The reversal of losses is thus limited to the level of the previous exceptional deduction – which *per se* makes sense.

In general terms, the restriction on what losses can be taken into account when computing revenue would only be justified on condition that there is immediate loss compensation or interest-bearing carry-forward and carry-back of losses. However, no such provision is made in the draft directive. The need for clarification of a "permanent decrease in value" raises (long-standing) questions. This should be avoided at the outset of any restructuring of how profits are computed for tax purposes.

The evaluation of asset transfers from the EU to a third country and vice versa is deemed to be a disposal of that asset (Article 31 of the draft directive), which is in line with standard international practice. The same applies to provision for a reinvestment reserve (Article 38 of the draft directive), which is to be welcomed.

**Provisions**

The possibility of creating provisions (Article 25 of the draft directive) is excessively curtailed.

Provisions may be created only for activities and transactions relating to legal obligations. This rules out obligations arising from purely business activities. This is not economically justified, since business performance, and hence taxable profits, are also constrained by purely business obligations.

The creation of provisions under the CCCTB is justified by the fact that no immediate compensation for losses or interest-bearing carry-forward or carry-back of losses is provided. Otherwise, losses would in fact be taxed. If a decision in principle on the admissibility of provisions has been taken, it is not appropriate to limit the obligations taken into account to legal obligations, as taxable profits are also constrained by purely business obligations.

With regard to provisions for legal obligations, the requirements as to the minimum probability that these will be used need to be clarified. Similarly, the criteria for a reliable estimate are not adequately specified.

Though they are not specifically mentioned, contingent losses are (indeed) included, since an excess of obligations (the value of the contractual obligation exceeding that of the entitlement to consideration) fulfils the condition of a legal obligation. For want of specifics, however, the detail of how provisions for contingent losses are treated remains unclear. Provisions for
pensions are not mentioned in the rules either, but should be taken into account, as otherwise the specific assessment rule would be without effect.

While provisions may be created only if they relate to legal obligations but not if they relate to business obligations, this formal legal approach is not adhered to under the valuation rule. Instead of a provision in line with this approach covering the amount of the legal obligation (full provisioning), only accumulation is permitted in valuation. It is also unclear whether accumulation is carried out on a turnover or time-proportional basis. An explanation of the valuation of contingent losses is also missing.

The fact that the valuation rule for provisions generally takes into account that all relevant factors, including the empirical data of the business, group or sector, must be included in the estimate that has to be made appears appropriate.

However, the draft directive contains no specific information, nor delegation of implementing powers to the Commission, regarding the risks specific to certain sectors that are recognised by EU law. There is only a special rule on the deductibility of technical provisions of insurance undertakings, where Member States are given the option of whether to allow deduction of equalisation provisions.

Detailed rules are needed for the banking sector in particular in order to take proper account of risk-specific peculiarities against the background of the financial crisis. Like insurance undertakings, the business model of banks – in contrast to that of industrial, commercial and service undertakings – is based on taking on risks on the basis of legal obligations.

Specifically, there is a lack of detailed rules for the treatment of derivatives and leasing. In addition, we consider it necessary that rules be adopted that provide for


- the depreciation of financial assets in accordance with the Expected Loss Model (based on the IASB's ED/2009/12 on financial instruments).

CONSOLIDATION

It is obvious that CCCTB only works if it is based on the consolidated income of a group of companies. Any decisions of Member States to advocate for non-consolidation basis will make the system inapplicable. It will only add a 28th tax regime to the 27 already in place.

One of the advantages of CCCTB is the absence of transfer pricing regulations which is an administrative relief for most groups. However, the proposal introduces the arm's length principle to transactions between associated enterprises, where association is defines as 20% ownership or voting rights. For several reasons this is an exaggeration.
• It is outside the scope of transfer pricing regulations outside the CCCTP regime.

• Associated companies are not controlled in legal terms so transactions are deemed as independent.

• The proof of arm’s length would require transfer pricing documentation which would be difficult to share between non-controlled companies.

The EBF will suggest that the proposal should be in line with the internationally accepted OECD guidelines in this matter.

Aggregating the total profit and losses of the eligible members of the group ("consolidation") constitutes the key to eliminating tax obstacles within the single market and underlies the main benefits of the CCCTB. It therefore deserves unequivocal support. Consolidation makes possible automatic cross-border loss compensation, avoids transfer pricing issues, allows tax-neutral restructuring and enables the equal treatment of EU subsidiaries with EU permanent establishments. It also ensures that double taxation is avoided. Losses are offset during aggregation. Internal transactions within CCCTB groups, where costs and revenue over a given period are equal to one another, e.g. in the case of interest paid within the organisation, cease to have an impact on profits. Hidden reserves are realised only through transactions with third parties and not through internal transactions within CCCTB groups. The book value of service relationships within a CCCTB does not change the total profit to be apportioned under the formula. The problems of setting and documenting transfer prices are thus resolved within the EU. As the cross-border transfer of assets within a CCCTB group no longer has any impact on taxation, cross-border restructuring can also take place without any impact on profit. Consolidation also means equal treatment of subsidiaries and permanent establishments, as results are aggregated and dividends eliminated.

Consolidation also constitutes a “big” solution and is thus certainly preferable to the “small” solution of a common corporate tax base without consolidation (and apportionment of profits), as the major advantages of the draft directive, particularly automatic cross-border loss compensation and the elimination of transfer pricing in the case of internal transactions within groups would otherwise be lost. As consolidation is the essential economic benefit of the CCCTB, the tax base should include this element from the outset.

OPTIONALITY

When a tax payer has decided to opt for CCCTB this decision is binding for five years and then consequently for three year periods.

EBF understands that making the opt-in decision on a year-by-year basis would not be feasible. However, the first period of five years should be shortened. After adopting CCCTB a tax payer may realise that it was a wrong decision and want to leave the scheme again. Therefore it is suggested that the initial period is fixed at three years like the following periods.
**ONE-STOP-SHOP**

The EBF welcomes the introduction of the "principal tax authority". For the companies as taxpayers it is a great advantage that all communication with the tax authorities is intended to take place solely between a so-called principal taxpayer of the group and the principal tax authority to which it is assigned. This makes coordination with various national tax authorities unnecessary.

We unequivocally welcome the associated reduction in red tape for taxpayers and tax authorities.

A tax credit is granted in relation to withholding tax paid to recipients in other member states or third countries. Application of withholding tax is usually governed through bilateral double tax treaties and therefore tax authorities in the member state where a subsidiary is incorporated will have the power to consider questions in such matters. For clarity this should be stressed in the directive.

It is also anticipated that the application of rules governing "place of effective management" are unaffected by CCCTB and the "principal tax authority" principle.

**APPORTIONMENT OF THE CONSOLIDATED TAX BASE**

The administrative relief gained from having one common set of tax rules to calculate the tax base are offset by new administrative burdens in relation to the apportionment method. Apportionment on the basis of several added value factors (labour, assets, turnover by destination) is a complicated arrangement.

Apportionment of the tax base in accordance with a formula has the effect of taxing the factors that make up the formula, creating new opportunities of (undesired) tax planning. The member states' may introduce legal measures to prevent tax avoidance which will increase compliance burden. Such measures have proved costly for taxpayers when complying with such "ring-fencing".

As regards the sharing mechanism the proposal introduces special provisions for financial institutions in connection with determining the assets and sales factors.

**Assets**

The asset factor to be used includes financial assets recognised in the balance sheet only. It must be borne in mind that it is common for banks to have a number of off balance-sheet items. These are income-generating and should be added to the asset factor.

**Sales factor**

It is the view of EBF that a sales factor is unworkable and that it does not add to the clarity of the apportionment. Fee income etc. from other financial services than loans shall be attributed to the MS of the customer. This is in contrast to the registrations in the accounts where the group entity
does not distinguish between domestic and foreign customers. Even though there may be registrations of the customers' residence state a computation of this factor would be difficult and give rise to relocation of profit compared to present principles — and compared to institutions which have not opted for CCCTB. Furthermore EBF recognises that is it a burdensome task to create an apportionment formula that is both fair and relatively easy to apply. If it is in the interest of the Commission EBF will offer to assist with establishing principles for a sharing mechanism that eases administration and reflects the underlying income generation in the member states where the tax payer is situated.