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Global international taxation, from national tax systems towards global tax systems:
The calculation of the tax base
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The calculation of the tax base

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List of abbreviations

CCCTB – Common Consolidated Corporate Tax Base
CITA – Corporate Income Tax Act 1969 (“Wet op de vennootschapsbelasting”)
DASB – Dutch Accounting Standards Board (“Raad voor de Jaarverslaggeving”)
Dutch GAAP – Dutch Generally Accepted Accounting Principles
EC – European Commission
ECJ – European Court of Justice
EU – European Union
EUCOTAX - European Universities Cooperating on taxes
HR – Hoge Raad der Nederlanden (Dutch Supreme Court)
IAS – International Accounting Standards
IASB – International Accounting Standards Board
IFRS – International Financial Reporting Standards
OECD - Organisation for Economic Co-operation and Development
PITA – Personal Income Tax Act 2001 (“Wet op de inkomstenbelasting”)
Preface

This thesis is written as part of the EUCOTAX Wintercourse 2012. Participation in this project has given me the opportunity to write my master thesis on the subject of taxation from an international perspective. The Wintercourse week in Łódź, Poland was a great opportunity to not only learn about the differences in tax systems of different countries but also to meet and cooperate with students from across the world. The Wintercourse was a great and unforgettable experience.

I would like to thank my supervisor, Prof. Stevens for his helpful advice and comments. Furthermore, I would like to thank everyone that has helped me throughout this project and has made this into a great learning experience.
# Table of contents

## Chapter 1: Introduction

- § 2.1: Globalization ................................................................. 11
- § 2.2: The influence of globalization on taxation ..................... 11
- § 2.3: The influence of EU law .................................................. 12
- § 2.4: A possible starting point for a calculation of the tax base ... 13
  - § 2.4.1: The introduction of IFRS .......................................... 14
  - § 2.4.2: The CCCTB proposal .............................................. 14

## Chapter 2: The Dutch commercial accounting standards and the introduction of IFRS

- § 3.1: The legislation on financial reporting for legal entities in the Netherlands ................. 16
- § 3.2: The role of important Dutch institutions in the financial reporting process .................. 17
- § 3.3: The main objective of financial reporting in the Netherlands ...................................... 18
- § 3.4: The influence of the introduction of IFRS on financial reporting in the Netherlands ...... 19

## Chapter 3: The relationship between commercial and tax accounting in the Netherlands

- § 4.1: No formal link between commercial and tax accounting .............................................. 21
- § 4.2: The indirect relationship between commercial and tax accounting ............................... 22
- § 4.3: Applying tax accounting in commercial financial statements ......................................... 24
  - § 4.4.1: Natural persons subject to tax in the PITA 2001 ...................................................... 25
  - § 4.4.2: Important other legislation on tax accounting in the PITA 2001 ............................ 26
- § 4.5: The Corporate Income Tax Act 1969 .......................................................................... 27
  - § 4.5.1: Entities subject to tax in the CITA 1969 ................................................................. 27
  - § 4.5.2: Important other legislation on tax accounting in the CITA 1969 ............................. 28
- § 4.6: The classical system in the Dutch tax acts ................................................................... 29

## Chapter 5: A comparison between the Dutch system of tax accounting and the Common Consolidated Corporate Tax Base

- § 5.1: The concept of taxable profit .................................................................................... 31
  - § 5.1.1: The total profit and annual profit in the Dutch tax law ........................................... 31
  - § 5.1.2: The concept of profit in CCCTB .......................................................................... 32
- § 5.2: The general principles of taxation .............................................................................. 32
  - § 5.2.1: The general principles of sound business practice .................................................. 33
  - § 5.2.2: The general principles of article 9, CCCTB proposal .............................................. 34
- § 5.3: Taxable revenue ......................................................................................................... 36
  - § 5.3.1: Taxable revenue in the Dutch tax law ................................................................. 36
  - § 5.3.2: A comparison with revenue according to CCCTB .............................................. 38
§ 5.4: The definition of an expense ................................................................................................... 40
§ 5.4.1: Deductible expenses in the Dutch tax law ................................................................. 40
§ 5.4.2: A comparison with expenses in CCCTB ................................................................. 41
§ 5.5: General non-deductible expenses ......................................................................................... 42
§ 5.5.1: Limitations on the deductibility of expenses in the Dutch law ......................... 42
§ 5.5.2: A comparison with the non-deductible expenses of article 14 CCCTB .......... 44
§ 5.6: The treatment of losses ........................................................................................................ 46
§ 5.6.1: Loss offsetting in the Dutch tax law ................................................................. 46
§ 5.6.2: A comparison with losses according to CCCTB ................................................ 48
§ 5.7: The valuation of stock and inventory ............................................................................. 49
§ 5.7.1: The valuation of stock and inventory according to sound business practice .... 49
§ 5.7.2: A comparison with the valuation of stock according to CCCTB ....................... 51
§ 5.8: Work-in-progress ............................................................................................................... 52
§ 5.8.1: The valuation and profit determination of work-in-progress according to sound business practice ................................................................. 52
§ 5.8.2: A comparison with long-term contracts according to CCCTB ......................... 53
§ 5.9: Hedge accounting ........................................................................................................... 53
§ 5.9.1: Hedge accounting according to sound business practice ........................................ 53
§ 5.9.2: A comparison with the hedge accounting according to CCCTB ....................... 54
§ 5.10 Fixed assets ...................................................................................................................... 55
§ 5.10.1: The depreciation of fixed assets according to sound business practice ............. 55
§ 5.10.2: A comparison with the depreciation of fixed assets according to CCCTB .......... 59
§ 5.11: Bad debt deductions ...................................................................................................... 62
§ 5.11.1: The valuation of bad debt claims according to sound business practice .......... 62
§ 5.11.2: A comparison to bad debt deductions according to CCCTB ......................... 63
§ 5.12: Provisions ....................................................................................................................... 63
§ 5.12.1: Provisions according to sound business practice ................................................ 63
§ 5.12.2: A comparison with provisions according to CCCTB ....................................... 64
§ 5.13: Pension obligations ........................................................................................................ 65
§ 5.13.1: Pension obligations according to sound business practice .............................. 65
§ 5.13.2: Pension obligations according to CCCTB ......................................................... 66
§ 5.14: Rollover relief for replacement assets ........................................................................... 66
§ 5.14.1: The reinvestment reserve in the Netherlands ....................................................... 66
§ 5.14.2: A comparison with the rollover relief for replacement assets in CCCTB ...... 67

Chapter 6: Legal comparison between the EUCOTAX countries ........................................ 69
§ 6.1: The relationship between tax accounting and commercial accounting ............... 69
§ 6.2: The relevance of IFRS on individual commercial accounts and tax accounting................. 71
§ 6.4: The countries views about CCCTB .................................................................................. 74
  § 6.5.2: Intangible assets ........................................................................................................... 76
  § 6.5.3: Treatment of losses .................................................................................................... 78
  § 6.5.3.1: Carry-back and carry-forward schemes ................................................................. 78
  § 6.5.3.2: Treatment of losses of Permanent Establishments ................................................. 80
  § 6.5.4: Gifts and donations ..................................................................................................... 82
§ 6.6: The Dutch tax system compared to the EUCOTAX countries ...................................... 83

Chapter 7: The calculation of the tax base in a global tax system .............................................. 84
§ 7.1: Introduction ...................................................................................................................... 84
§ 7.2: Benchmark ...................................................................................................................... 85
  § 7.2.1: The principle of liquidity ........................................................................................... 85
  § 7.2.2: The principle of legal certainty .................................................................................. 86
  § 7.2.3: The principle of legality ............................................................................................. 87
§ 7.3: The international financial reporting standards as starting point for the calculation of the tax base ...................................................................................................................... 87
  § 7.3.1: Fair value accounting in IFRS .................................................................................... 87
  § 7.3.2: Improved legal certainty for taxpayers ...................................................................... 90
  § 7.3.3: The tax base is influenced by private-law bodies ...................................................... 92
§ 7.4: The Common Consolidated Corporate Tax Base as starting point for the calculation of the tax base ...................................................................................................................... 94
  § 7.4.1: Fair value accounting also used in CCCTB .............................................................. 94
  § 7.4.2: A rule-based calculation of the tax base ................................................................. 95
  § 7.4.3: Instrumental use of the tax law ................................................................................ 97
§ 7.5: A proposed calculation of the tax base in a global tax system ....................................... 97

Chapter 8: Conclusion ................................................................................................................ 100
Bibliography .............................................................................................................................. 104
Chapter 1: Introduction

The technological and economical developments of the past decades have increased the importance of the global market. Globalization and liberalization have made the world into a “global marketplace”. Next to that, the internet has made it easier for companies to do business all around the globe with a single click. In Europe, even more important developments are observable. The importance of the European Union has increased because of the “internal market” approach. This is making it easier for companies to access a bigger group of consumers in Europe. These developments give multinational companies many opportunities to expand their business. However, for companies it is not that easy to access this bigger market because of the difficulties they face.

These developments also show the need for a global tax system. At the present moment, the tax systems used in the countries around the world contain limitations that allow tax arbitrage: The practice of profiting from differences between the way transactions are treated for tax purposes. Another problem is the so called tax race to the bottom. Countries reduce their company tax rate to become attractive for companies to settle. Other countries follow by lowering their rates as well. To keep the tax revenue at roughly the same level, countries try to increase the taxable base.

For the EU a global tax system is even more important. The EU is trying to achieve an internal market by opening borders and introducing a shared currency. The legislation of Member States is already heavily influenced by EU law. The freedoms in the treaty for the functioning of the European Union are enforced by the Court of Justice in Luxembourg. The Court acts against discriminative legislation, including tax measures, in member states. You could say that as a result of this case law, there is negative integration in the EU on the level of the tax system. But there are 27 individual member states with their own sovereignty to make their own set of rules. The result is that there are 27 different tax systems. With respect to an internal market this is not really efficient. It is easier to do business across the border but companies still face the burden of complying with all the different tax laws.

Until now, at the level of direct taxation there has not been a lot of harmonisation in the EU. But in an area, related to taxation, there have been important changes in Europe: the accounting legislation. Since 2005, listed companies in the EU have to report on the basis of IFRS. This was introduced by a directive concluded in 2002. Before this directive, every country had its own accounting standards. In the Netherlands for example, listed companies had to report on the basis of the civil code, book 2, title 9: the Dutch Generally Accepted Accounting Standards (Dutch GAAP). This group is getting bigger by the years as new countries are joining the EU. Although legislation should not violate the EU freedoms: the free movement of persons for example. Directive (EG) nr. 1606/2002, 19th of June 2002

Listed companies still have to report on the basis of this title but article 362 refers to IFRS, making most of the articles not applicable.
Small and non-listed companies still have to use the rules set out in this law or they can choose to use IFRS as well. Commercial accounting standards provide a framework for calculating the profit of a company. Traditionally the goal of the accounting standards in the Netherlands was to give a true and fair view of the profitability of a company. Stakeholders should be able to know the threats and risks the company is facing. Countries as the United Kingdom and the United States had the same view. In other European countries such as Germany, France, and Italy accounting standards had other goals: for example the protection of the creditors.

The difference in the fundamental objectives of financial reporting also had its impact on tax accounting. Tax rules for calculating the tax base have the purpose of providing the government a taxable profit. It is important that this number resembles the ability of a company to pay taxes. The continental systems in Germany etc. had a very conservative way of calculating the commercial profit of a company. Therefore, the commercial accounting standards were very suitable to be used for tax purposes. In the Netherlands this was not really the case as the standards were focused on informing the stakeholders of the company. The profit figure thus could also include cash not yet received. To impose a corporate income tax in the Netherlands another approach was needed. As a result, the calculation of the tax base developed itself independent of the commercial accounting.

In many countries, there is a strong relationship between commercial accounting and tax accounting, the introduction of IFRS might provide a good starting point for the tax base in a global tax system. However, it is also possible to harmonise the tax base independently from commercial accounting. This harmonisation has been proposed in EU by the European Commission.

The European commission desired a solution for the problems resulting from the different systems and at the 16th of March 2011 the commission proposed a common system for calculating the tax base of companies operating in the EU. This is known as the Common Consolidated Corporate Tax Base (CCCTB). When the proposal is implemented, there will be a common tax base which can be used by companies operating across the EU. As expected the commission wants to reduce the administrative burden, compliance costs and legal uncertainties companies face. This tax base will be optional so companies who think they can benefit from the common tax base can use this. As this system will be optional, the current tax systems of the member states will remain in place. True harmonization is not the case here. The introduction of yet another system brings its own problems

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5 The Dutch accounting standards also include guidelines published by the DASB. More information about this process can be found in chapter 3.
7 Also known as the Anglo-Saxon system.
8 P.H.J. Essers, 2005, page 4
with it. With a common tax bases, companies still have to comply with for example administrative legislation of the different member states. Next to that, there could be budgetary consequences as profits could be taxed in a different country. These problems will make it a challenge to get the resolution approved by the council.

In this thesis, the process of national tax systems developing towards global tax systems plays a central role. This is the main topic of the EUCOTAX Wintercourse program. This thesis will discuss one of the topics of the Wintercourse: the calculation of the tax base. Therefore, it will describe how the Dutch system is developing towards a global tax system but also how the Dutch tax system should, with respect to the calculation of the tax base, develop. We have seen that the commercial accounting standards have been harmonised to a certain extent in the EU. Many countries have a link between commercial and tax accounting. Should the calculation of the tax base in a global tax system become in line with commercial accounting? Or, should we harmonise the tax base independently from commercial accounting: a CCCTB. In this thesis these questions will be addressed and with the help of the EUCOTAX legal comparison, an answer will be tried to be formulated. Taking this all into account, this results in the following central research question:

*How is the Dutch tax system, with respect to the calculation of the tax base, in the Netherlands developing towards a global tax system and how should it develop taking into account important principles underlying the current calculation of the tax base?*

This thesis is organized in two parts. The first part shows how the Dutch system is developing towards a global tax system: Chapter 2 will first provide an introduction about the drivers of the development of national tax systems towards global tax systems. And more specific, it will look at two important developments that provide a possible starting point for the calculation of the tax base in a global tax system. After this chapter, we can look at the current system of the commercial accounting environment in the Netherlands in chapter 3. Chapter 4 follows by investigating the current relationship between commercial and tax accounting. It will also outline the important components of the current calculation of the tax base. In chapter 5 we will go into much more detail by making an extensive comparison between sound business practice and the CCCTB proposal. It is possible to observe the differences and similarities of the two systems.

The second part of this thesis starts will try to find an answer to the second part of the research question: how should the Dutch tax system develop? In other words, how should the calculation of the tax base look like in a global tax system? Therefore, chapter 6 will first contain the EUCOTAX comparison of tax systems between countries. With the help of important principles of taxation and the results of the legal comparison, chapter 7 answers this second part of the research question. This thesis ends with a conclusion in chapter 8.
Chapter 2: Drivers of the development of national tax systems towards global tax systems.

In this chapter we will look at some developments that have increased the need for a global tax system. Factors such as globalization but also the influence of EU law create the necessity for countries to change their legislation. After looking at these factors, we will discuss two important developments that provide opportunities for the calculation of a tax base in a global tax system: The introduction of IFRS and the Proposal for a Common Consolidated Corporate Tax Base.

§ 2.1: Globalization

Political and economical processes have increased the importance of the global market in the last decade. Previously closed and autarkic economies have opened up and are taking part in the global economy. Next to the traditional major economies such as the United States and Japan for example, more and more countries are developing towards becoming important players in the international market. A world trade organization was formed to supervise and liberalize this international trade. But also the internet is making it possible to do business around the globe while the goods sold are easily transported by large carriers which have decreased the shipping costs dramatically. These processes of globalization have allowed capital markets to grow to a point of an almost global capital market. Therefore, capital is becoming a very mobile production factor. Companies profit from this as they can access new markets more easily. But next to that, it also allows companies to transfer their residence more easily when they feel like. It can be said that globalization has a big impact on national legislation as national policies have their effect beyond a country’s border. Of course, this legislation also includes the national tax system. It can become inevitable

§ 2.2: The influence of globalization on taxation

The globalization process does not only provide an increase in welfare but also has negative consequences. The increased mobility of capital has lead to more tax competition between states.

12 The World Trade Organization replaced the General Agreement on Tariffs and Trade in 1995.
17 This also includes for example social and environmental problems but this is beyond the scope of this thesis.
You could argue that increased competition is not necessarily a bad thing. It can increase the efficiency of a tax system: to get rid of discriminating rules for example.\textsuperscript{18} Tax competition becomes harmful when certain countries decide to enact fiscal-friendly legislation that only attracts companies while it does not create extra economic substance. Such countries have a friendly jurisdiction for not imposing tax and are protecting the secrecy of a transaction.\textsuperscript{19} This can be called a “tax haven”.\textsuperscript{20}

Tax havens play an important role in tax planning schemes. These countries levy a low percentage of tax or levy no tax at all. The OECD observes that tax havens that drive the effective tax rate levied on income from the mobile activities significantly below rates in other countries have the potential to cause harm.\textsuperscript{21} Ultimately, the competition for lowering the tax rates can lead to a “race to the bottom”. This means that one country starts by lowering its corporate tax rate for example. Other countries follow by lowering their tax rates as well. The first country reacts to this by lowering its rate again. This process could continue for years, reaching a critical low point of corporate tax. In the end this could mean that profits are only minimal taxed but more important it lowers the revenue for the treasury. To increase revenue again, governments might shift the tax burden to less mobile factors such as labour. Eventually, this will lead to a loss of welfare.

Furthermore, the flaws in the national tax systems can be exploited because of differences between the treatment of transactions by countries. For example, a company is transparent for the laws of country X while it is non-transparent for the laws of country Y. This can lead to double taxation or double non-taxation. Tax arbitrage is the result of profiting from these differences. The only way to prevent these problems is to develop tax systems that follow the economic and social developments. In other words, they need to become more globally oriented. As a result, it will become more difficult for companies to set up specific tax structures to exploit the flaws in national tax systems.

\textsuperscript{§ 2.3: The influence of EU law}

Member states of the European Union are even more stimulated to improve their tax system to a more global oriented system. This is caused by the special provisions in the EU law.\textsuperscript{22} A general anti-discrimination condition in the treaty of the functioning of the EU disallows countries to discriminate non-resident people (residents of other member states). This broad anti-discrimination

\textsuperscript{20} The OECD uses three criteria to determine if a state is a tax haven: lack of transparency, laws preventing the exchange of information and the absence of a substantial activity test. OECD, available at http://www.oecd.org/document/23/0,3343,en_2649_33745_30575447_1_1_1_1,00.html
\textsuperscript{22} The treaty on the European Union and the Treaty of the functioning of the European Union. Most recent version: 2010/C83/01
clause is worked out into more specific freedoms. These freedoms allow citizens of a member state to (freely) travel, work or move in another member state and allow companies to settle in other member states. The European court of justice has the task to safeguard these freedoms and interpret the EU law. Discriminating tax laws will not hold in front of the Court. The ultimate goal is to work towards an internal market. Next to that, the European Commission has the task to monitor the competition in the internal market. It will monitor all systems of aid in the European Union. When it finds a certain rule incompatible with the internal market it can order a member state to change this. Member states have to consult the commission before they can introduce new aid measures.

In addition to primary EU law, soft law also has an influence. The Ministers of Finance of the member states have concluded a code of conduct about harmful tax competition in the European Union. This code is not a legally binding directive but does have political force. The member states adopting this code have accepted to roll back existing tax measures that constitute harmful tax competition and they will refrain from introducing new measures. Fair tax competition is still allowed because of the positive effects the council stated. The code sets out criteria for identifying potentially harmful tax measures.

§ 2.4: A possible starting point for a calculation of the tax base

These developments described in the previous sections provide incentives for countries to change their tax system towards a more global tax system. Especially in the EU, the Member States are encouraged to change their tax systems. However until now, there has not been any harmonisation in the field of direct taxation. So an important question still remains: how should we develop towards a more global tax system in the EU or even the world? As the main theme of this thesis is the calculation of the tax base, the question can be narrowed to: how should the calculation of the tax base develop? In my opinion, there are two important directions: We could use the commercial accounting standards as a starting point for tax accounting or we could harmonise the tax base independently from commercial accounting. With respect to these starting points, two possible developments provide opportunities for the calculation of a tax base in a global tax system.

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23 For example, the treaty for the functioning of the EU contains article 49, the freedom of movement and article 63, the freedom of capital.
24 Important cases for direct taxes are for example: Saint-Gobain, ECJ 21-09-1999 nr. C-307/97; Marks & Spencer, ECJ 13-12-2005 nr. C-446/03.
25 A measure not justified by the rule of reason. More information about the rule of reason:
26 Article 108 of the treaty for the functioning of the EU.
27 ECOFIN, 1 December 1997, (98/C2/01)
28 Which positive effects the council is referring to is unclear but you could think of improved efficiency of the allocation of production factors etc.
§ 2.4.1: The introduction of IFRS

The first important development in the EU is the harmonisation in the field of commercial accounting. In the past decades there has been some coordination on the level of company law and reporting between the member states. This has resulted in a couple of guidelines which address important aspects of company law. The guidelines though were not enough and each member of the EU continued to use its own system for financial reporting. With the growing importance of the internal market (and with it the financial market), the need for unified standards has increased. Investors should be able to compare the profitability of companies across the EU. Therefore, in 2002 a directive was concluded by the European council about the mandatory use of IFRS in the financial reports of listed companies. Since the start of the year 2005, listed companies in the European Union have to use IFRS in their annual financial statements. The aim of this directive is to harmonize the financial information presented by the listed companies. This introduction is also an important event for taxation because commercial and tax accounting in countries are often related to each other. Tax accounting may be based on the commercial accounting or the other way around. IFRS could have caused countries to make their tax system more in line with these standards thus making it more internationally oriented. This influence will be investigated by using the result of the comparative law discussion in the EUCOTAX Wintercourse session in Poland.

As IFRS is widely used in Europe but also in the rest of the world, it could provide a valuable starting point for a calculation of the tax base in a global tax system.

§ 2.4.2: The CCCTB proposal

Harmonising the commercial accounting standards but not doing the same with tax accounting standards does not help companies doing business across the EU. Therefore, the commission also started working on a proposal for a harmonized tax base for corporation tax: the common consolidated corporate tax base. It took until the beginning of 2011 to present a proposal of a directive for this CCCTB. The directive will introduce a calculation of the tax base which can be used in the EU. Next to that, it also introduces a consolidation regime which can be used in cross border situations. Applying CCCTB is, however, optional for companies so true harmonisation is not the case here. The proposal has received a lot of criticism by governments. It will take years of discussion to implement a

29 See for example the fourth guideline (78/660/EEG) concerning company law of companies with stock capital (NV or BV in the Netherlands) and the seventh guideline (83/349/EEG) concerning the consolidated annual statement.
31 IAS/IFRS guidelines have to be approved by the commission before they can be used in Europe. For example, regulation nr. 1725/2003, 29th of September 2003.
32 Article 1 of the directive nr. 1606/2002.
directive. This proposal from the Commission is an attempt to create a more internationally oriented tax system in the EU member states. It would be realistic to state that it is very important for the internal market to come to some kind of harmonised tax base. Tax systems of member states will be influenced by CCCTB but even without a directive it could influence the tax systems. For example, some countries might decide to introduce it on their own.

The Proposal for a CCCTB is not based on any of the commercial accounting standards. This means that it harmonises the tax base independently from commercial accounting. Is this preferable for the calculation of the tax base in a global tax system?

This chapter showed that there are processes which demand countries to improve their tax system. Not changing their system could cause economic harm in the long term. Especially, Member States of the European Union are triggered to change their legislation because of the impact of the EU law. But where should we go in a global tax system? Should our tax base become more in line with commercial accounting standards such as IFRS? Or should we harmonise our tax systems independently from commercial accounting by enacting the CCCTB Proposal?
Chapter 3: The Dutch commercial accounting standards and the introduction of IFRS

This chapter provides a brief overview of the current system of the Dutch accounting standards. First, the legislation on financial reporting and other important players in the field of reporting is discussed. After explaining this legal framework, attention is given to the purpose of financial reporting and the consequences for the regulating framework. The influence of IFRS is included in these sections as well. The last section, however, is explicitly dedicated to the differences between IFRS and the Dutch Generally Accepted Accounting Principles.34

§ 3.1: The legislation on financial reporting for legal entities in the Netherlands

The legislator in the Netherlands was, compared to other countries, late in introducing legislation with respect to external financial reporting.35 It took until 1970 for the first bill to be introduced: the Company Financial Statements Act. In this same period, important legislation about the organization of companies was introduced as well. The current rules can be found in Book Two of the Dutch Civil Code. This book contains legislation for legal entities; more specific Title 9 contains the rules on the annual reports of legal entities. European directives are codified in this title as well. Title 9 is only applicable to companies stated in article 360 of Book 2 Civil Code. This is a limited listing of legal entities which have to comply with Title 9. The most important ones are the BV and the NV.36 In addition to, these entities also less common entities such as cooperatives, limited partnerships, and mutual insurance companies are included. There is a special rule for foundations and associations. If they conduct business activities then they have to comply with the rules of Title 9. Other legal forms and foundations and associations not conducting a company do not have to comply with the rules of Title 9. For this remaining category, only limited instructions apply with regard to the yearly balance sheet.37

The standards codified in Title 9 concern almost every aspect of financial reporting. Rules for the structure and disclosures of the balance sheet are listed in section 3 (art. 364 to 376). Section 4 (art. 377) concerns the profit and loss account. Special conditions for certain disclosures make up section 5 (art. 378 to 383e). Section 6 (art. 384 to 390) is important as it contains the valuation rules for the items on the balance sheet. Section 13 is about the consolidation of financial statements. The rules for the consolidated financial statement do not really differ from the normal reporting rules as set out in

34 The term Dutch GAAP is used as an abbreviation for the total system of accounting standards.
36 The besloten vennootschap and the naamloze vennootschap can be compared to a private limited company and a public limited company.
the other sections. The other sections of this title contain more specific regulations about the other aspects of financial reporting. For example, section 9 contains the auditing procedures for the financial statements and section 10 regulates when companies have to publish the annual report. As can be seen, Title 9 does not only deal with pure bookkeeping procedures but also involves a couple of other different aspects about financial reporting.

The directive concerning the introduction of IFRS in the EU has been implemented in Title 9 as well.\(^{38}\) Although the directive is directly applicable for the consolidated financial statements of listed companies, the legislator also wanted to give other legal entities the option to use IFRS. Therefore, section 8 of article 363 states that every legal entity is allowed to use the IFRS as endorsed by the EU. When a company decides to use IFRS, a large part of Title 9 will not be applicable.\(^{39}\) Furthermore, the applicability of the rules set out in this title also depends on the size and the activities of a company. Articles 396 to 398 take into account the size of the company. Article 396 sets out the rules for small companies; article 397 does this for medium sized companies and article 398 does this for large companies. Companies listed on a stock exchange always have to use the IFRS standards in combination with the Dutch accounting standards. The business activities of a company can also determine the rules they have to follow. If a legal entity runs a bank as defined in the Dutch law then this company has to use the special reporting rules of section 14 (art. 415 to 426).\(^{40}\) The same goes for insurance companies and certain stockbrokers. They have to follow the rules set out in section 15 (art. 427 to 446).\(^{41}\)

§ 3.2: The role of important Dutch institutions in the financial reporting process

With the enactment of the law on the Financial Statements, a private-law body was introduced: the Tripartite Consultative Body. This body was later renamed to the “Raad voor de Jaarverslaggeving”.\(^{42}\) A foundation coordinates the activities of the board. Since the start, this board has been in charge of issuing guidelines with respect to interpreting Title 9 and addressing the problems encountered by practice. These guidelines also took into account the case law of the commercial chamber and the standards of the International Accounting Standards Board\(^{43}\). These Dutch accounting standards do not have the power of law. In practice, companies follow the

\(^{39}\) Section 9 of article 363 depicts the articles not applicable.
\(^{40}\) Article 415 states that a financial company settled in the Netherlands with a license to perform financing activities in the Netherlands is a bank for Title 9.
\(^{41}\) Article 427 gives the definition of an insurance company and refers to the law on the financial supervision. It concerns risk insurers, stock brokers and credit facilitation companies who are monitored by the Dutch national bank.
\(^{42}\) According to their own English webpage, the RJ can be referred to as the Dutch Accounting Standards Board (DASB) in English: http://www.rjnet.nl/RJ/RJ+Meta/International+visitors/default.aspx
\(^{43}\) For example this includes the International Accounting Standards (IAS), predecessors of the International Financial Reporting Standards.
guidelines as published but they are allowed to deviate when they have a good reason. Since the introduction of IFRS, endorsed standards by the EU constitute an important part of the guidelines set by the DASB as well. This introduction also has made the role of the DASB smaller as the guidelines only apply to non-listed companies.\textsuperscript{44} On the international level, the DASB has also provided feedback to the IASB since its founding in 1973\textsuperscript{45} by commenting on exposure drafts and discussion papers.\textsuperscript{46} As stated previously, the DASB tried to publish guidelines in conformity of the IASB standards. The DASB believes that it still has a role in the financial reporting environment in the Netherlands.\textsuperscript{47}

With the introduction of legislation, an important role was also created for the courts. Disputes about the application of certain legal provision can only be settled by a judge. A party (shareholder, works council) involved in the financial reporting of a company can file a complaint at the special section of the Court of Amsterdam.\textsuperscript{48} This court decides on the disputes rising because of the rules in Title 9. It takes into account not only the legal rules of Title 9 of the Civil Code but also the guidelines set by the DASB. An appeal of this decision can be filed at the Dutch Supreme Court.

§ 3.3: The main objective of financial reporting in the Netherlands

What exactly is the main objective of financial reporting in the Netherlands? In other words, why did the legislator introduce such an extensive system as set out in Title 9? Before answering this question, it is necessary to make a distinction between the goals of financial reporting in two different systems. Financial reporting in Anglo-Saxon countries such as the United States and the United Kingdom has traditionally focused on providing information to the capital markets based on a “true and fair” view.\textsuperscript{49} Other countries, such as Germany and France, for example have followed the continental (or Roman) approach: financial reporting focuses on providing information to the creditors of the company. The Netherlands can be considered an Anglo-Saxon country as the information provided in the annual report has focused on the capital markets. By investigating the financial statements of a company, an informed person should be able to form a responsible judgement about the assets and profitability of a company.\textsuperscript{50} The legislator has confirmed this Anglo-Saxon view in article 362, section 1 (part of Title 9). This means for example that shareholders should be able to assess the risks of the company when making investment decisions.

\textsuperscript{44} J. Klaasen, M. Hoogendoorn en R. Vergoossen, 2008, page 47.
\textsuperscript{45} The IASB was an initiative of six professional organizations of accountants, including the Dutch organization NIVRA. See L.G. van der Tas, “International Financial Reporting Standards – Een overzicht”, TFO 2010/125.
\textsuperscript{46} http://www.rjnet.nl/RJ/Organisatie/Stichting+en+Raad/default.aspx
\textsuperscript{47} See the webpage of the previous note, “RJ and international relations”.
\textsuperscript{48} Also known as the “Enterprise Chamber”.
The Netherlands holds a special position in the list of Anglo-Saxon countries because the financial reporting is mostly driven by developments in the field of business economics. This is different compared to the other Anglo-Saxon countries. The objectives of reporting are the same but the way the reporting has developed differs. Because the science of business economics is continuously developing, a reporting system was needed that was able to respect this dynamic process. Therefore, the legislator has chosen for the system as set out in Title 9 because it leaves room for interpretation and choices. Considering this, the Dutch GAAP can be called principle-based. Principle-based standards provide a conceptual framework for companies to use for their financial reporting. Setting some mandatory rules is unavoidable in this situation, but the framework provides guidance on how to structure the annual report so that the main objective of reporting is met.

The main objective of financial reporting does not significantly differ from the objective of IFRS. In the IFRS Framework, section 12 states: “The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions”. This definition is closely related to the Dutch definition as set out in article 362, section 1. Therefore, it can be stated that the objective of financial reporting has not changed with the introduction of IFRS. Over the years, the IFRS standards have become less principle-based and provide more application guidance. The Dutch GAAP allows more options and provides less application guidance. The Dutch rules thus are more principle-based than IFRS.

Although the objective and purposes of IFRS and Dutch GAAP form a close match, the reporting rules are not always similar. In the next section we will look more closely at this difference.

§ 3.4: The influence of the introduction of IFRS on financial reporting in the Netherlands

The previous sections in this chapter include some aspects of the introduction of IFRS. This section focuses more closely on some of the differences between the two sets of rules. As stated previously, listed companies in the Netherlands have to report on the basis of IFRS. Other legal entities in the Netherlands can choose to use Dutch GAAP or IFRS. Although the objectives of IFRS and Dutch GAAP are related, the way in which these standards achieve their objective differ. Some DASB guidelines deviate substantially from the IAS or IFRS standards. Sometimes, these standards might even conflict. It is beyond the scope of this thesis to discuss every difference in detail. An in-depth and extensive comparison between IFRS and Dutch GAAP can be found in reports made by

52 Countries such as the UK and Ireland followed a more pragmatic way. See Helleman, van der Tas, page 226.
some accounting firms.\textsuperscript{54} Therefore, some examples will be given that show the most important
differences between the two reporting standards. The report of Ernst & Young shows that there were
72 conflicting items between IFRS and the Dutch GAAP in 2010.\textsuperscript{55} Since the introduction of IFRS,
this number has only increased. Deloitte also observed this trend and states that in 2010 substantial
differences at the area of pensions, merger and takeovers and transactions with minority shareholders
have arisen.\textsuperscript{56}

Companies using IFRS have to calculate a pension obligation as if they are responsible for
paying out the pensions to former employees. This implies a considerable number of actuarial
calculations. Under the Dutch rules, companies only have to assess if there is an obligation to make a
payment to the pension fund: if the contribution is paid in a given year then there is no obligation on
the balance sheet. The IFRS rules concerning mergers and takeovers have changed so that they are
more in line with the American standards. New specific rules were added and also more items have to
be included in the profit and loss account immediately: for example acquisition costs or changes of the
takeover price. The Dutch rules deviate from this as these costs are only part of the acquisition price.
The last major deviation Deloitte observed involved the transactions with minority shareholders. A
company is allowed to use the “full goodwill method” in acquisitions. This means that when a
company for example acquires 80% of the shares of another company, it is allowed to recognise 100% of
the goodwill of the acquired company. The Dutch GAAP only allows the 80% to be recognised as
goodwill.

In addition to these conflicting regulations, the level of strictness in application also differs
between the standards. This means that IFRS and Dutch GAAP might use the same valuation method
but IFRS requires more disclosures. Ernst & Young has also made a comparison between the levels of
strictness between the rules. In 2010, IFRS was in 221 cases stricter than Dutch GAAP. On the other
hand, in 108 cases Dutch GAAP was stricter.\textsuperscript{57} The above shows that there can be substantial
differences between the financial reports of companies solely because they are using other reporting
rules. Comparing the results of these companies with each other is quite a difficult task without a
proper reconciliation form. The introduction of IFRS has not created harmonisation at this level of
reporting as long as other, non-listed companies are allowed to choose the standards they want to use.

This chapter has briefly explained the legal financial reporting framework including important
bodies in the Netherlands. It ended with substantial differences between IFRS and Dutch GAAP. The
next chapter will focus on tax accounting in the Netherlands.

\textsuperscript{54} PWC, “From Dutch GAAP to IFRS for SMEs: A comparison between IFRS for SMEs, Dutch GAAP and
IFRS”, 2009; Deloitte, “IFRSs and NL GAAP: A pocket comparison”, 2010 and Ernst & Young, “Vergelijking
IFRS met Nederlandse wet- en regelgeving 2010”; available at their websites.
\textsuperscript{55} Ernst & Young, “Vergelijking IFRS met Nederlandse wet- en regelgeving 2010”, page 7.
\textsuperscript{56} The following examples are derived from a press release of Deloitte: “Verschillen tussen nationale en
internationale boekhoudregels nemen toe”, 2 September 2010 available at www.deloitte.com
\textsuperscript{57} Ernst & Young, page 7.
Chapter 4: The relationship between commercial and tax accounting in the Netherlands

This chapter focuses on the relationship between commercial and tax accounting in the Netherlands. To provide a complete picture about the relationship it is necessary to discuss the Dutch rules with respect to the profit determination in the Netherlands. In chapter 5 this is discussed in more detail. This chapter will also explain how and why this relationship has developed over the years as it did. The last part of the chapter is dedicated to the corporate tax acts.

§ 4.1: No formal link between commercial and tax accounting

In the Netherlands, there is no formal legal relationship between commercial and tax accounting. Therefore, it is possible that the commercial account shows a profit and the fiscal account can show a loss. Tax acts with the purpose of taxing business profits do not really refer to Title 9, Dutch GAAP or IFRS for the determination of the profit. A limited number of references to Title 9 are made. The fiscal profit for the fiscal year can be determined without the determination of commercial profit for the same year. In practice, the commercial financial statements are usually used as the starting point. The tax acts concerning the taxation of companies use an autonomous concept of profit namely “sound business practice”. This concept will be discussed later in this chapter.

Fiscal profit determination has not been directly influenced by commercial accounting in the Netherlands. Essers observes two main causes why there is not a direct relationship. The first cause concerns the character of the corporation tax at the beginning of the 20th century. Unlike today, the corporation tax then was a distribution tax. This means that only the distribution of profits such as dividends was taxed. The tax laws of that time did not even contain a concept of fiscal profit. The other cause lies within the objectives of fiscal and commercial accounting in the Netherlands. As set out in section 3.3, the main objective of commercial financial reporting in the Netherlands is the provision of a “true and fair” view of the profitability of a company. Kampschoër states that an annual account has “to provide a commercial determination of profit and capital”. The goal of tax accounting is simply to provide a taxable base. Tax accounting based on the prudence principle would be better

59 For example, article 10d, paragraph 5 of the corporate income tax act 1969 refers to title 9 for the calculation of shareholders equity and debt capital. This article concerns thin capitalisation rules
60 P.H.J. Essers, De toekomst van Goed Koopmansgebruik na de invoering van International Financial Reporting Standards in 2005 (Geschriften van de Vereniging voor Belastingwetenschap nr. 224), Deventer: Kluwer 2005, paragraph 2.2
61 G.W.J.M. Kampschöer RA, page 693.
able to look after the interests of taxpayers. Unlike commercial reporting, a responsible insight into the assets of the enterprise is not really necessary. A taxable profit has to be calculated which, after deduction of allowed expenses, forms the taxable figure.

In the end, it can be concluded that there is no direct formal legal link between commercial and tax accounting. This does not, however, mean there is no relationship at all. A form of indirect relationship can be observed as the science of business economics has been a starting point for both commercial and tax accounting in the Netherlands. Next to that, the interference of the legislator can make an indirect relationship possible.

§ 4.2: The indirect relationship between commercial and tax accounting

The science of business economics was and is very important for the determination of the tax base in the Netherlands. Fiscal profit has to be calculated using the concept of sound business practice. Every year, the taxable profit is determined according to sound business practice regarding a consistent behaviour that is independent of the probable outcome and which can only be changed if this is justified by sound business practice. This term is not defined in any law and it needs to be interpreted by the courts of justice. As the highest legal court in the Netherlands, the Supreme Court (Hoge Raad) has the final decision about the concepts used in sound business practice. The Supreme Court thus acts as a legislator but this is something the legislator explicitly wanted. The Dutch Supreme Court would be better able to provide a framework for taxpayers and respond to the changes in the dynamic social and economic society. In the fifties, the Supreme Court ruled in an important case that “a system of fiscal profit determination must be in accordance with sound business practice if this system is based on proper business economics views. An exception to this rule is made when this system conflicts with any regulation in a tax law or any principle underlying the tax law.” Every method in line with business economics can be in accordance with sound business practice but it always has to be tested against the fiscal concept. Therefore the Supreme Court denied the usage of the equity method for the valuation of a participation. In this case, this method would lead to a lower value than the business value of the participation. In its judgement the Court stated that “although the equity method is allowed according to article 389 of the Civil Code, to provide a true and fair view of

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62 P.H.J. Essers, paragraph 2.2
63 G.W.J.M. Kampschöer RA, page 693.
65 This is a simplified explanation; more details about the whole system will be given in chapter 4. To be able to discuss the relationship it is necessary to discuss some of the details of the system itself.
66 Translation derived from P.H.J. Essers and R. Russo, 2008, paragraph 2.4
68 HR 8 May 1957, BNB 1957/208.
the capital of the company, this objective is not relevant for corporate taxation.”

According to Bruijsten, the Supreme Court has never explicitly referred to Dutch GAAP or IFRS. However, it seems that the Court does sometimes take into account the commercial standards. For example, in a case concerning the hedge transactions, the Court introduced a highly effectiveness test. This test is also used in IAS 39 for hedge transactions.

The concept of sound business practice with the Supreme Court as a standard setter has resulted in problems between the legislating power and the judicial power. The Supreme Court is not democratically legitimated so its decisions could violate the principle of legality. This happens when the Supreme Court formulates a solution to a problem that should have been dealt with by the legislator. However, sound business practice is a concept in a tax law and the Supreme Court does not create tax laws. Therefore, there should not really be a problem with the principle of legality as the Court is just explaining the meaning of this concept. Of greater concern is that the legislator sometimes decides to interfere with sound business practice. It decides to introduce legislation whenever a decision of the Supreme Court is not “right” in its view. Usually, this is the case when the legislator thinks that a decision will be bad for the public treasury. It introduces new legislation, sometimes even with retroactive effect, to repair the undesired effect. When the government needs funds to finance some facilities or a tax cut, it increases the taxable base by introducing specific legislation. These developments limit the concept of sound business practice and also limit the power of the Supreme Court to set out a dynamic framework which takes into account a rapidly changing society.

The introduction of legislation on sound business practice brings us to another possible indirect influence of commercial accounting on tax accounting. The Secretary of Finance has explicitly stated a couple of years ago that the fiscal profit determination should be connected with commercial accounting: “There should be a larger connection between the fiscal balance sheet and profit and loss account and the commercial balance sheet and profit and loss account.” In his opinion this should mean that the “tax base will become more closely connected to the commercial financial statements”. These statements were made at the time of the parliamentary debate on the introduction of a special bill concerning the broadening of the tax base. This would be the ideal time for the Secretary to comply with his statements by introducing legislation for broadening the tax base by making tax accounting more in line with commercial accounting. It is quite remarkable then to observe that the new legislation concerning, for example, depreciation and work-in-progress is not line with

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70 HR 23 September 1992, BNB 1993/60.
72 More information about hedge transactions will be given in section 5.9.
73 C. Bruijsten, paragraph 3.1.5.
74 C. Bruijsten, paragraph 3.4.1.
75 Verslag van een notaoverleg, Kamerstukken II 2005/06, 30 107, nr. 9.
76 See sectio 3.4.2.
commercial accounting rules such as IFRS. A more detailed discussion of this legislation can be found in chapter 4. So the legislator has not used this opportunity to create a closer relationship.

It can be concluded that sound business practice has led to a system in practice that is almost completely independent from commercial profit determination. The introduction of IFRS has not changed anything on relationship: these rules are not used in tax accounting either. Since a few years quite the opposite has actually been the case: it is allowed for some companies to apply fiscal valuation in commercial accounts.

§ 4.3: Applying tax accounting in commercial financial statements

Since the book year 2007, small legal entities are allowed but not obliged to base their commercial financial statements on a fiscal basis. A new paragraph in article 396, book 2 of the Civil Code has been added. This section 6 states that small legal entities are allowed to use the criteria as set out in the Corporate Income Tax Act 1969 for the valuation of assets and liabilities and the determination of taxable profit in their commercial accounts as well. As this section, Title 9, only concerns legal entities, companies such as a sole proprietorship cannot use this rule. This does not really matter because non-legal entities do not have mandatory accounting rules and can therefore decide to use the fiscal valuations as well. The new section basically makes the rules of sound business practice applicable in commercial accounting as well. Rules in Title 9 with respect to other obligations such as disclosures and auditing remain applicable. Legal entities have to meet two of the three criteria to be considered small: Less than 4.4 million of assets, less than 8.8 million turnover or fewer than 50 employees. A decree provides more specific rules for the implementation of this option.

Legal entities using the option have to apply the fiscal valuations to every commercial balance sheet value. Companies are not allowed to cherry pick between commercial and tax rules. Companies have to make some additional disclosures when they decide to apply article 396, section 6. In the year of change, the shift from commercial to fiscal valuations has to be disclosed as an accounting change. This can be implemented either prospectively (via article 1 of the decree) or retrospectively. Article 3, section 1 of the decree states that additional disclosures about balance sheet components should be made whenever this is required to provide proper insight into the capital of the company. This does not have to be a quantitative reconciliation but it has to show the users of financial statements the effects (positive or negative) of the use of fiscal valuation. Shareholdings in other companies of over 20% require an extra disclosure because they have to be valued at cost. Article 392, section 2 then requires

77 C. Bruijsten, paragraph 3.4.1.
an extra disclosure about the result of this shareholding. According to the decree, article 3, section 2 and 3, specific fiscal effects have to be disclosed: when the company applies (fiscal) discretionary depreciation for example. This is a fiscal facility which can be used to deprecate an asset at a greater rate at the beginning of its lifecycle for example. It does not require, like other fiscal facilities, a commercial mandatory disclosure to receive this facility.

The remainder of this chapter is dedicated to the explanation of the two important tax acts concerning the taxation of companies. As we have seen, sound business practice forms the core of the calculation of the tax base in the Netherlands. The regulation concerning sound business practice is written down in the Personal Income Tax Act 2001 (PITA). The PITA has a special profit regime that applies to natural persons and transparent legal entities that conduct a business. The non-transparent entities are taxed under the Corporate Income Tax Act 1969 (CITA). In the next sections, the rules are discussed. As these acts are very comprehensive, only the most important features are discussed.


§ 4.4.1: Natural persons subject to tax in the PITA 2001

Natural persons, conducting an enterprise are directly taxed for their profit under the PITA 2001. A taxable person owning an enterprise are included in the PITA 2001 profit regime when it matches two criteria. First of all, there needs to be a physical enterprise (objective criterion). Based on case law of the Supreme Court, Essers has developed a modern definition for tax purposes:\[81\]: An enterprise is a set of independent and durable activities,\[82\] participating in the economic environment\[83\] and facing economic risks.\[84\] Second, the taxable person must own this enterprise (subjective criteria). This means that the person has to qualify as an entrepreneur according to the PITA 2001. Article 3.4 of this act sets out the requirements a person should needs to be considered an entrepreneur. The taxable person is entitled to the benefits of the objective enterprise\[85\] and this person should be directly liable for the liabilities of the enterprise.\[86\]

When both the objective and subjective criteria are met, the person qualifies as an entrepreneur and his business profits are taxed in the profit regime. The profit is directly attributed to the owner of the enterprise. For partnerships this means that the profit is split between the different persons owning

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\[81\] P.H.J. Essers, “Personenvennootschappen en aanverwante rechtsvormen”, Kluwer Deventer 2004, part 2.1.2.2
\[82\] Durable activities derived from the case HR 20 December 2000, BNB 2001/88.
\[84\] The size and the type of activities of an enterprise do not matter.
\[85\] This means that the person should have an unlimited claim for the profits of the business and the intention to make profit (follows from HR 9 December 1953, BNB 1954/9 and HR 21 March 1990, BNB 1990/134)
\[86\] The Supreme Court has stated that this responsibility should be determined following civil right (HR 14 July 2006, BNB 2006/321)
the enterprise. The entrepreneur has to use sound business practice to calculate the taxable profit and is granted the facilities in this regime.

§ 4.4.2: Important other legislation on tax accounting in the PITA 2001

There is no general legislation on tax accounting in the Netherlands as is the case with commercial accounting. No rules regarding the valuation and profit determination can be found in the tax acts either. The most important legal source is the case law of the Supreme Court. In this case law, the Supreme Court has set out the framework for tax accounting. Nonetheless, the Personal Income Tax Act 2001 does contain extensive legislation on certain aspects of profit calculation. The legislation has different origins. Some (important) categories of rules can be observed: the so-called “repair” legislation, tax base increasing legislation, and fiscal facilities legislation for entrepreneurs.87

The first category is the so-called “repair” legislation: whenever the legislator does not like the outcome of a decision of the Supreme Court it, introduces new legislation to repair this decision.88 For example, a decision by the Supreme Court on the calculation of pension obligations90 led to the introduction of article 9a PITA 1964, which was in turn succeeded by articles 3.26 to 3.28 PITA 2001.89 Also articles concerning the broadening of the tax base, for example the profit realisation on work-in-progress, can be seen as repair legislation: the legislator overruled the Supreme Court.

The next category legislation is about broadening the tax base. Sometimes the legislator decides to reduce certain tax rates and in order to fund this reduction, the tax base is broadened. Introducing specific legislation for particular subjects interferes with sound business practice. For example, at the end of 2006 the government filed a law which introduced important changes in the profit regime to increase the competitiveness of the Dutch fiscal profit regime.91 To fund the decrease of dividend and corporate tax rates, the tax base was broadened. For example, article 3.29b PITA 2001 dealing with the profit realisation on work in progress was introduced. Sound business practice allowed enterprises only to recognize a profit when the project ended and an allowance was received. By introducing article 3.29b the legislator decided to follow the commercial accounting rules which have a stricter profit realisation regime.92 The legislator overruled the Supreme Court. At the same moment it introduced articles 3.30 and 3.30a that give specific rules regarding the depreciation of assets. The depreciation of buildings was maximized and the depreciation period of goodwill was increased.

87 This is a simplified distinction to provide some more information about important parts of the tax act.
88 J. Doornebal, “De (dreigende) uitholling van goed koopmansgebruik”, in: D.A. Albregtse en P. Kavelaars (red.), Maatschappelijk heffen, 2006, par. 2
92 J.M. van der Heijden, “De verhouding tussen goed koopmansgebruik en art. 3.29b Wet IB 2001”, TFO 2007/30, paragraph 3.2.3.
The last category legislation is dedicated to fiscal facilities for entrepreneurs. Some of these facilities are dedicated to investment such as the small scale asset investment deduction\textsuperscript{93}, the energy and the environment deduction. The goal is to stimulate investment in environmental friendly assets. Other entrepreneur facilities are the self-employed deduction\textsuperscript{94}, a deduction for research and development, a cooperating deduction\textsuperscript{95}, the starter deduction\textsuperscript{96} and a profit exemption for small and medium sized entities. For most of the facilities, the entrepreneur has to spend enough hours in the enterprise: a minimum of 1.225 hours in 2012. These fiscal deductions have two goals: firstly to stimulate businesses and entrepreneurship and secondly it lowers the tax burden for independent entrepreneurs. The profit of these companies is usually used for consumption, investment etc. so it would be more in line with taxation to exempt some of this income.\textsuperscript{97} This completes the profit regime of the PITA 2001. The next section will look at the non-transparent entities subject to tax in the other corporate tax act.

§ 4.5: The Corporate Income Tax Act 1969

§ 4.5.1: Entities subject to tax in the CITA 1969

The other important tax act concerning the taxation of companies is the Corporate Income Tax Act of 1969. It is only applicable to certain legal forms and special enterprises listed in this act. This is a limited list. It is important to observe that the bodies itself are subject to tax, not the shareholders or owners of the company. Article 2, section 1 contains an exhaustive list of the bodies subject to corporate tax. The most important taxable bodies are the corporations with share capital such as a naamloze vennootschap (NV) or besloten vennootschap (BV). Taxable enterprises are for example also legal entities governed by public law or cooperative bodies. A special category of taxpayers are foundations and associations. They are subject to tax when they conduct business activities (article 2, section 1, part e). The criterion “conducting business activities” has been extended by the legislator in article 4: If the foundation or association conducts activities to compete with normal companies, it is subject to tax (article 4). They are only subject to tax for the business part. Other entities such as companies with share capital, cooperatives and mutual associations are all fully liable to tax. Article 2, section 5 states that these companies are expected to conduct business activities with all of their capital. Special attention should be given to companies incorporated to Dutch law. These companies

\textsuperscript{93} This is a deduction related to the size of the investment.
\textsuperscript{94} A deduction is received because you are an independent entrepreneur.
\textsuperscript{95} A deduction when the fiscal partner works in the enterprise.
\textsuperscript{96} A facility that provides an extra deduction for starting entrepreneurs.
are deemed to be established in the Netherlands and are therefore also fully taxable. The place of effective management is not relevant here.

The legislator has decided to use the rules for calculating the taxable profit laid down in the PITA also for the CITA. The (objective and subjective) criteria as set out in the PITA, however, do not matter for the taxable entities. The connection between the CITA and the PITA is established in article 8 of the CITA. Section 1 refers to the profit determination in the PITA. This means that sound business practice also applies to corporations. The legislator has decided that not every article of the profit regime of the PITA is suitable for use in the CITA. Therefore, the second section states that the articles of the first section will not be applied when the CITA states otherwise or the difference between a natural person and legal entity makes the application impossible. The rest of this article further specifies the details regarding the application of the different PITA articles.

§ 4.5.2: Important other legislation on tax accounting in the CITA 1969

The CITA uses the profit determination system from the PITA but this act also contains special legislation dedicated to entities. A large part of this act is dedicated to (repair) legislation to combat the abuse of tax law. For example, article 10d limits the excessive deduction of interest (thin capitalisation rules). Some of these articles will be discussed in more detailed in chapter 5 or in the papers of my colleagues. It is beyond the scope of this paper to fully discuss these anti-abuse articles. Therefore some of the interesting facilities for taxable entities are discussed: the fiscal consolidation regime (tax unity) and the participation exemption.

§ 4.5.2.1: The tax unity of article 15

Starting with the consolidation regime of article 15 and onwards. When a legal entity owns 95% or more of the shares in another company it can request the application of article 15, by which the companies are treated as one taxpayer. As a result of this loss compensation between group entities is allowed. Further, transfers of assets and liabilities between group members are disregarded for tax purposes. There is also a possibility to include a permanent establishment in the Netherlands of a foreign company to the group. From a fiscal perspective (at least a CITA perspective), the subsidiary company ceases to exist. This means that this company does not have to file a tax return. This can be a huge administrative advantage especially when there are not only one but more subsidiaries. To combat improper use, the legislator has introduced a number of anti-abuse rules.
§ 4.5.2.2: The participation exemption of article 13

The other facility is the participation exemption of article 13. Profits received from distributing companies in which the receiving company has an interest equal or bigger than 5%, are exempted from tax. This concerns the dividends and the capital gains on participations. This facility has been introduced by the legislator to combat the double taxation which occurs in holding situations. An example will show the possible double taxation. Company A has a holding of 10% of the shares of company B. Assume that company B has made a fiscal profit of 1000. After tax 800 (assuming the company paid 200 of tax) is distributed to its shareholders as a dividend. Company B has to withhold 15% dividend tax of this payout. Company B will receive 68 as a profit from the holding of company A. This profit has to be included in company B’s profit as well. This dividend will then be taxed again at the level of holding company. To prevent this double taxation the legislator introduced article 13 CITA 1969. Section 1 states that the benefits received from share holdings in other entities will not be included in the fiscal profit. However, this does not concern the costs incurred for acquiring these shareholdings, they are still deductible. Making the costs deductible while the benefits are not taxed gives options for abuse. Therefore the legislator has tried to tackle abuse structures by introducing thin capitalisation rules for examples. As no corporate tax is levied on shareholdings, no dividend tax has to be withheld by the company distributing the profits: article 4 of the Dividend Tax Act gives an exemption when article 13 CITA applies. In the end the profit of company A is only taxed once in the corporate tax act.

§ 4.6: The classical system in the Dutch tax acts

The double taxation between companies is mitigated because of participation exemption in the CITA. However, natural persons are still facing some double taxation as the CITA uses the classical system to tax companies. A non-transparent company is taxed in the CITA and its shareholders are individually taxed in the PITA. The PITA does not allow a deduction of corporate tax paid by the company itself. Shareholders can be taxed in three ways in the PITA.

First, if the shares are part of the business capital of a natural person, this person is taxed progressively in box 1 of the PITA. The maximum tax percentage in this box is 52%. Secondly, if a person holds 5% or more of the shares of a company, the holding qualifies as a substantial participation for the PITA 2001. Benefits received from the shareholding are taxed in box 2 at a proportional tax rate of 25%. To take into account the corporate tax, the percentage is fixed at 25%. Effectively this means that the dividend received by a natural person is taxed at a maximum rate of

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99 Labour revenues are for example taxed at a maximum percentage of 52%.
Lastly, persons with shareholdings below 5% are taxed in box 3. This box only taxes the deemed return on the capital of natural persons. The actual capital gains and dividends are not taxed like in a capital gain tax. The legislator takes a deemed income of 4% of the average market value of assets and liabilities in consideration for tax purposes. This income is taxed at a rate of 30%. The effective tax rate is therefore 1.2%. This different treatment can lead to big differences in the tax burden and results in unfair situations.

This classical system also leads to a distortion to the neutrality of legal forms. As described above, the profit of a transparent company is directly attributed to the owner of the company. The profits are taxed at a rate of 33% to 52%. Because of the differences in the tax rates there can be a fiscal incentive to choose for either a transparent or non-transparent company. When the owner of a sole proprietorship is taxed at a rate of 52% in the PITA 2001, it can be profitable to change the legal form of the enterprise into a private limited company. It will then face a maximum effective tax rate of only 43.75%. The legislator has tried to restore the neutrality by adding a facility in the PITA 2001 which exempts 12% of the benefits received by an entrepreneur.\footnote{Article 3:79a of the PITA 2001}

\footnote{The maximum corporate tax rate is 25%, see article 22. Dividend of 100 – corporate tax of 25%. 75 will be again be taxed at a rate of 25%, this leaves 56.25. A total percentage of tax levied of 43.75%}
Chapter 5: A comparison between the Dutch system of tax accounting and the Common Consolidated Corporate Tax Base

This chapter will make an extensive comparison between the Dutch system of calculating the tax base and the Common Consolidated Corporate Tax Base Proposal (After: CCCTB or Proposal) as released by the European Commission on the 16th of March 2011. First, the general concept of fiscal profit determination will be compared with the CCCTB. After that, more detailed transactions and balance sheets posts are discussed.

§ 5.1: The concept of taxable profit

§ 5.1.1: The total profit and annual profit in the Dutch tax law

Before discussing the general principles of taxation it is necessary to provide an introduction to the concept of profit determination in the CITA 1969. The CITA will be the primary point of reference because the CCCTB Proposal is meant for the entities subject to tax in this law (Article 2, section 1 of the Proposal).

The starting point of the calculation of the profit in the CITA is article 7. This article defines the tax object. Section 1 of this article states that the payable tax is calculated using the taxable amount. Section 2 then states that this taxable amount is the taxable profit minus the carry-forward losses. Lastly, section 3 states that the taxable profit is the profit minus deductible gifts. The profit is determined by the rules of the PITA (article 8). Only the applicable aspects for the CITA of this profit determination are therefore discussed. It should be understood that that the term “profit” means total profit and annual profit.

Total profit is the starting point for the calculation of fiscal profit in the Netherlands. Article 3.8 of the PITA 2001 contains this concept. Total profit is the aggregate amount of benefits (income), in any name or form that is obtained from trade or business (this also includes investment income). This article taxes the profit of the company at the end of its lifetime. This resembles the total profit the company has created during its existence as a company. This definition is interpreted very broad by the Dutch Supreme Court. In an important decision it stated that every benefit received because of the conduct of an enterprise is included in total profit even when the benefits are not part of the normal

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business conduct. Total profit does not only take benefits into account but there is also room for costs.

As the government needs money every year this total profit figure has to be split. The total profit is divided and attributed to different years and taxed in these subsequent years. This is called the annual profit. The rules for determining the yearly income are laid down in article 3.25 of the PITA. According to this article, the annual profit is determined according to sound business practice regarding a consistent behaviour that is independent of the probable outcome and which can only be changed if this is justified by sound business practice.

This article consists of two parts. The first part says that the annual profit has to be calculated according to sound business practice. This is the actual calculation of the tax base for a tax year. Sound business practice will be discussed in more detail in section 3 of this chapter. In general, this means that profit is benefits minus deductible costs just like in commercial accounting. The second part of this article states that an entrepreneur should act in a consistent behaviour, independent from the probable outcome.

To calculate the fiscal profit, a company can use the balance sheet or capital comparison method. The capital increase is the fiscal capital at the end of the year minus the fiscal capital at the beginning of the year. The total profit distribution of a year has to be added to this amount. Capital contributions can be deducted. Lastly object exemptions are deducted from this figure. This results in a taxable profit at the end of the year. Next to using the balance sheet method, it is also possible to calculate the taxable profit by using the fiscal profit and loss account. This method requires the fiscal calculation of the costs and profits.

§ 5.1.2: The concept of profit in CCCTB

The CCCTB directive contains a clear definition of taxable profit. Article 4, section 9 of the Proposal states that profit is “the excess of revenues over deductible expenses and other deductible items in a tax year.” An important difference is that this article does not include a total profit concept to tax the profit of a company over its lifetime as the total profit regime does in the Netherlands. As the total profit of a company is taxed anyway at the end of its lifecycle, there is more flexibility allowed in the determination of the annual profit in the Dutch system. CCCTB will probably provide fewer possibilities for taxpayers to change their valuation method.

§ 5.2: The general principles of taxation

104 HR 16 April 1930, B4726.
105 Definition derived from P.H.J. Essers and R. Russo, paragraph 2.4
106 P.H.J. Essers, “Winstbepaling in de Conceptrichtlijn CCCTB”, WFR 2011/1395, paragraph 3.2
§ 5.2.1: The general principles of sound business practice

As we have seen the profit regime of the PITA actually only has two core articles dedicated to the profit determination.\footnote{Disregarding the articles breaching the concept of sound business practice.} The legislator has left much room for interpretation to the judicial power. Therefore no real general principles of taxation are codified. The second part of article 3.25 does contain a principle: the annual profit has to be calculated “regarding a consistent behaviour that is independent of the probable outcome and which can only be changed if this is justified by sound business practice.”\footnote{Definition derived from P.H.J. Essers and R. Russo, page 35.} It asks for a consistent behaviour of the entrepreneur to calculate the profit. Although this is the only codified principle in the Dutch tax law, other general principles are codified indirectly because they are part of the concept of sound business practice.

Since the introduction of sound business practice as the norm for the fiscal profit determination the Dutch Supreme Court has given a large number of judgements on profit calculation methods and whether they are in line with sound business practice.\footnote{J. Doornebal, “Invulling van goed koopmansgebruik”, NTFR 2003/469, page 1} Doornebal observes that many authors have tried to distil general principles of sound business practice by looking at this case law. While quite a lot of principles can be derived from the case law, he recognizes that five are the most important in sound business practice: the principles of realisation, matching, prudence, reality and simplicity. He then proceeds to order them into primary and secondary principles.\footnote{Primary principles have a direct influence on the correct determination of the benefits and costs of a certain tax year. Secondary only have an indirect influence on this determination. This view has been criticised in the literature by for example T.M. Berkhout and J.M. van der Heijden, “Fiscale padafhankelijkheid en hiërarchie tussen beginselen van goedkoopmansgebruik”, FED 2003/242.} Other authors believe that the principles of prudence, simplicity and realisation are the most important.\footnote{D. Brüll, J.W. Zwemmer en R.P.C. Cornelisse, “Goed koopmansgebruik”, Fed Fiscale Brochures, zevende druk 2008 blz. 22-57 and L.W. Sillevis and M.L.M. van Kempen, “Studenteneditie inkomstenbelasting”, Cursus belastingrecht 2010-2011, Kluwer Deventer 2010, paragraph 3.2.16.B.d1.} In this paper the view of Brüll, Zwemmer and Cornelisse is followed as the other two principles observed by Doornebal can also be viewed as part of the three main principles.

The principle of realisation or matching holds that the benefits and expenses should be attributed to the year they have come up. Profit realised in a year should be included in the taxable profit of the year. This means that arbitrary profit shifting to other years is not allowed.\footnote{D. Brüll, J.W. Zwemmer en R.P.C. Cornelisse, 2008, page 22.} Only the expenses incurred in the particular year may be deducted. This means for example that already paid but not yet incurred costs should be included on the balance sheet as a deferred payment.

The prudence principle means that costs can be deducted when they are reasonably foreseeable while profit only has to be taken when it is actually realised.\footnote{J. Doornebal, 2003, page 3.} The costs need to be caused by conducting business activities in the period before the end of the fiscal period. When there is reasonable assurance the costs will be incurred, they can be deducted from the profit. The benefits of a
transaction should only be classified as profit at the time that it can be considered realised. This realisation happens ultimately at the time of the actual deliverance of goods or performance of services and when the entrepreneur has the right to receive the remuneration unless this remuneration is based on material uncertainties. Applying the principle of prudence can also mean that assets should be valued at cost price or lower market value. An unrealised gain on the increased value of an asset does not have to be taken while an unrealised loss on an asset can be taken. As a result of this principle, fair value accounting is not allowed in sound business practice.

The principle of simplicity in the context of sound business practice means that a valuation or profit determination method should be simple and practical to apply. This means, for example, that small accruals can be neglected or that certain profit determination methods are allowed because this is easier for the company when taking into account the size of the company.

The previous principles do not have a strict order but they interact closely. The principle of realisation can limit the principle of prudence for example. A taxpayer is allowed to cautiously allocate the profit to a year but once the profit has been realised, further deferment is not allowed and the profit should be allocated to the year of realisation. From case law of the Supreme Court some authors argue that the principle of realisation is the most important principle.

§ 5.2.2: The general principles of article 9, CCCTB proposal

In article 9 of the Proposal the general principles of taxation are laid down. It consists of the four starting points for the taxation of profit. The general principles of sound business practice are not directly present in the proposal but there could be some resemblance or differences.

Section one depicts that “in computing the tax base, profits and losses shall be recognised only when realised”. Article 17 builds on this provision by stating that: “Revenues, expenses and all other deductible items shall be recognised in the tax year in which they accrue or are incurred, unless otherwise provided for in this Directive.” The rule that profits are only recognised when realised matches with the principle of realisation and prudence in sound business practice. Allocating the profit to the right year is also part of the realisation principle of sound business practice. But according to some authors, sound business practice does allow profit recognition before realization in

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118 HR 24 February 1960, BNB 1960/84.
119 L.W. Sillevis and M.L.M. van Kempen, 2010, paragraph 3.2.16.B.b.1
122 Or in the view of Doornebal, in a separate principle: the matching principle.
for example a situation where carry forward losses are about to evaporate. The tax authorities believe this is not possible; the Supreme Court has to provide the final answer. It is not really clear whether this is also possible under the CCCTB because article 18 states that “revenues accrue when the right to receive them arises and they can be quantified with reasonable accuracy, regardless of whether the actual payment is deferred.” It is also not really clear how it will work out in CCCTB when revenues are received that are connected to future expenses. In sound business practice these revenues can be allocated to the years the costs actually were incurred.

When looking at expenses, in sound business practice these costs can be deducted when they are reasonably foreseeable. Essers believes that this is not possible under CCCTB because of principle of article 9, section 1. Unless specific facilities are applicable such as for example using a provision, loss deduction before they are realised seems not to be allowed. In my opinion, this can also be observed from article 19 of the proposal that contains the general rule concerning the incurrence of deductible costs. This article states that an expense is deductible when: (a) the obligation to make the payment has arisen and (b) the amount of the obligation can be quantified with reasonable accuracy. Therefore it seems that CCCTB is stricter concerning the deduction of losses. In this tax base more certainty about the occurrence of the costs is needed before the costs can actually be deducted from the profit.

Section 2 prescribes that “transactions and taxable events shall be measured individually”. Although in general this principle returns in sound business practice, it can be put aside by the principle of simplicity: Sometimes it is not needed to value every debtor individually and a write-off of the debtors based on experience can be allowed. Also in the case of hedge transaction, sound business practice requires an associated valuation of related balance sheets items. More about hedge transactions in section 4.9.

The third section states that “the calculation of the tax base shall be carried out in a consistent manner unless exceptional circumstances justify a change”. This section shows resemblance with article 3.25 in the PITA 2001. The question arises if CCCTB is stricter when a taxpayer wants to change its valuation method. This cannot be really determined from this principle.

The last section states that “the tax base shall be determined for each tax year unless otherwise provided. A tax year shall be any twelve-month period, unless otherwise provided.” This principle does come back in the matching and the prudence principle which also tries to make sure that benefit and costs of a certain year are matched when possible. We can now proceed to the actual profit determination system in the Dutch tax system by looking at the revenues and costs.

123 P.H.J. Essers, 2011, paragraph 3.3.1.
124 P.H.J. Essers, 2011, paragraph 3.3.1.
126 P.H.J. Essers, 2011, paragraph 3.3.1.
§ 5.3: Taxable revenue

§ 5.3.1: Taxable revenue in the Dutch tax law

To be able to derive a taxable profit, it is necessary to define a taxable benefit. Article 8, section 1 CITA enables the concepts of total and annual profit for the taxation of legal entities. As we have seen there is a distinction between total profit and annual profit in the Netherlands. While it looks like there are two different concepts, article 3.8 is the main profit article. Benefits and expenses that do not match the criteria of article 3.8 can never be part of the annual profit or sound business practice. The legislator has also decided that some revenues should not be taxed and therefore introduced some exemptions.

It is important to keep in mind the different nature of the PITA and CITA. The PITA is dedicated to natural persons conducting business activities in, for example, a sole proprietorship. A natural person can have a private domain and a business domain. For legal entities, such as a public limited company, this is different. These entities are independent bearers of rights and obligations. The legislator has decided that these entities cannot have a private domain. Therefore, article 2, section 5 CITA determines that “legal entities” are expected to conduct an enterprise with all of its capital. This means in essence that every increase of capital leads to a taxable revenue, unless the increase can be classified as a capital contribution as this increase in capital is not the result of a business activity. The influence of the shareholder relationship should be eliminated from the profit of the company. Next to capital contributions, some income is exempt from the tax base.

A capital contribution is an increase in the capital because of the relationship between the company and the shareholder. An example is the issue of new shares. The capital increase is the result of a transaction with a shareholder and therefore it is not taxed. Not only formal capital contributions but also informal capital contributions are not included in the taxable profit. Informal means that there are not any new shares issued but that the shareholder-company relationship is still present.

This figure was created by the Supreme Court in an important case. In this particular case it allowed the capitalization on the balance sheet of machinery received for free from the parent company without the recognition of a profit. The gifts were caused by the shareholder-company relation so therefore the Supreme Court increased the equity of the company and introduced the concept of an informal capital contribution. An informal capital contribution is also possible in

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128 This can also be called revenue.
129 L.W. Sillevis and M.L.M. van Kempen, 2010, paragraph 3.6.2.A.
131 Such as the private and public limited company.
132 HR 3 April 1957, BNB 1957/165.
133 In a normal situation this would lead to taxable revenue.
relation with costs. This is the case when a shareholder e.g. provides an indefinite loan with a lower than normal (at arm’s length) interest percentage to the enterprise. The difference between the market interest and the actual interest is an informal capital contribution. An important case concerning the costs environment is the “Swedish grandmother” case. The Supreme Court ruled that “benefits which are the result of a zero interest loan granted by the parent company are not part of the taxable profit.” The loan was classified as informal capital contribution by the Supreme Court.

The opposite of a capital contribution is a profit distribution. These will be discussed in the section concerning the deductible costs. Now that the general definition of profit is determined, we can look at the objective exemptions.

The PITA and CITA both contain some articles that include an (object) exemption of revenue. As the CCCTB proposal is meant for the taxable entities of the CITA, only the applicable and most important exemptions will be discussed.

A first exemption is the exemption for concern financing companies of article 8c (Doorstroomlichamen). Interest and royalties paid within a concern are under certain circumstances not included in the taxable profit of the financing company.

The second exemption is a partial exemption. Article 12b contains a special “innovation box”. The benefits from certain intangible assets produced by the company itself are partially exempt from corporate tax. The effective tax rate on the benefits is therefore 5% instead of the normal maximum percentage of 25%. This partial exemption tries to stimulate research and development by Dutch companies.

One of the most important object exemptions is the holding exemption of article 13. This facility has been discussed in chapter 4 already. It is important to remember that the dividends and capital gains which are the result of a shareholding of at least 5% in another enterprise are exempt from tax. This exemption also requires that the shareholding is not part of the inventory of the company. When the participation is located in a low tax regime, then only a tax credit is granted.

The last important exemption of the CITA is article 15e. This article includes an object exemption for permanent establishments in other countries. The revenues and costs of these permanent establishments (but also of real-estate) in another are deducted from the taxable profit of the taxpayer.

Although not really an exemption but merely a delay of taxation are the merger facilities. In the case of a merger, taxable profit can arise when assets are transferred to the other enterprise or a newly created enterprise. Usually no new funds are received to be able to pay the tax resulting from a merger (because assets have to be sold to the new company for example). To make sure that genuine mergers but also split-ups are not hindered, these profits are exempt. Articles 14 to 14c contain these provisions for business mergers, legal mergers and business splits. There is also a facility in article 14c

135 See annex 1, paragraph u of the proposal. This paragraph lists the taxable entities in the Netherlands.
for changing the legal form from a legal entity to a sole proprietorship. The profit will be included in the tax base when funds are received. Some exemptions are located in the PITA 2001 but are also applicable because of the link article 8 CITA 1969. Article 8, section 1 CITA 1969 juncto article 3.11 PITA 2001 provides an object exemption for the profits realised by the exploitation of a forest holding. Article 3.12 does the same with the capital gains of agriculture lands, that are not the result of the activities conducted by the enterprise (speculation with lands is for example not exempt). These value increases are exempt from taxation.

The last important exemption is located in article 3.13, section 1, part a CITA. This article exempts the profits that are the result of the waiving of rights by creditors. Often this happens when the entrepreneur is close to bankruptcy, by waiving the claims the creditors give some financial room to the entrepreneur. Taxing this profit could again lead to financial difficulties and therefore this is exempt. This is just a limited list of exemptions that are important in my opinion.

§ 5.3.2: A comparison with revenue according to CCCTB

The last section has shown the definition of a benefit or revenue in the Dutch tax law. This is not really a straight-forward codified condition: article 8 shows how to derive the profit but does not provide information how to calculate it. The CCCTB proposal does include a comprehensive definition of revenues:

“(8) ’revenues’ means proceeds of sales and of any other transactions, net of value added tax and other taxes and duties collected on behalf of government agencies, whether of a monetary or non-monetary nature, including proceeds from disposal of assets and rights, interest, dividends and other profits distributions, proceeds of liquidation, royalties, subsidies and grants, gifts received, compensation and ex-gratia payments. Revenues shall also include non-monetary gifts made by a taxpayer. Revenues shall not include equity raised by the taxpayer or debt repaid to it;”

An important difference between the Dutch concept and the CCCTB concept is that the Proposal contains an extensive definition of revenue while it is not defined in the Dutch law, apart from the total profit concept. Although this allows the Dutch tax law to be more dynamical at times, it can interfere with legal certainty sometimes. This CCCTB definition of revenues tries to include every possible transaction that can be classified as revenue and therefore does not provide a general notion such as the Dutch system. Monetary or non-monetary, interest and dividends but also proceeds of liquidation are all called profit and it does not matter where these originate from. While this provides more certainty for the taxpayers this gives rise to other problems. For example, what happens when something is not included in the definition but has the same economic consequences as something that

136 Article 4, paragraph (8), CCCTB Proposal.
is included? In the same manner, what happens when classification issues arise? These questions have to be answered by the national courts of the Member States and this could lead to 27 different interpretations. This would result in legal uncertainty in CCCTB.

All income items that are mentioned in the first sentence of this section would also be regarded as taxable income under Dutch law. There are some slight differences that can be observed. The first difference lies in the disposal of assets. The proceeds received from the disposals of assets do not always have to be included as revenues in the Dutch tax system. In the case of the exchange of assets the capital gain can be rolled over to the received assets under certain circumstances. When the new asset takes the place of the old asset and the economic function remains the same then in reality no profit has been realised. Although Essers thinks this is not possible in CCCTB based on the realisation principle of article 9, section 1. In my opinion this definition of revenue shows that it might not be possible either because the disposal of assets is explicitly included in the revenue. Exchanging assets would then only be possible if these transactions are explicitly exempt from taxation. It is possible that the rollover relief of article 38 can provide a solution to this problem. Using this relief, it is possible to use the capital gain of an asset sold to invest in a new asset. It seems that the Dutch concept of revenue allows more flexibility. The proceeds of the disposal of an asset have to be explicitly exempt to make a rollover possible. By using the concept of sound business practice, the Supreme Court has made this rollover possible.

Article 11 of the proposal contains the exempt revenues of CCCTB. The first section states that “subsidies directly linked to the acquisition, construction or improvement of fixed assets, subject to depreciation in accordance with Articles 32 to 42” are exempt from corporate tax. This could mean that for example subsidies received from the government for the investment in a certain area are not taxed. The Dutch tax law does not contain a similar exemption article but under sound business practice subsidies are not always directly taxed. A subsidy can lower the purchase costs of an asset. As a result, lower fiscal depreciation of this asset is possible. Another possibility is that the subsidy is included as an obligation on the balance sheet.

The second section exempts from tax the “proceeds from the disposal of pooled assets referred to in Article 39(2), including the market value of non-monetary gifts”. Although the Dutch law does not contain the same way of pooling assets, in some situations the proceeds from the disposal of assets do not have to be included in the profit. As we have seen this based on case law but there is also a reinvestment facility. This reinvestment facility will be discussed later in this chapter. Sections c and d contain exemptions which have the same effect as the participation exemption in the Dutch tax law: received profit distributions and proceeds from the disposal of shares are exempt from taxation. There is no minimum shareholding percentage required in CCCTB while a minimum of 5% is required in the

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137 This has been developed in the important “exchange” case law of the Supreme Court: HR 4 April 1954, B 8970.
Netherlands. Income of a permanent establishment in a third country is exempt following section e. The profit has to be calculated according to the rules set out in the Proposal (article 73). In the Netherlands there is also an object exemption of income of a permanent establishment but the Dutch law exempts specific components of foreign profits. The profit of the permanent establishment does not have to be recalculated using the Dutch system.

It seems that the Dutch tax law consists of more exemptions than CCCTB. These exemptions are mostly developed for specific situations and the reasons behind it might be outdated.

§ 5.4: The definition of an expense

§ 5.4.1: Deductible expenses in the Dutch tax law

Just as is the case with revenues, a general definition of deductible expenses is not present in the Dutch tax law. Again, expenses that do not match the criteria of article 3.8 can never be part of the annual profit or sound business practice. In the same way as revenues are classified as taxable, expenses are classified as deductible. The most important criterion is that the expenses must be connected to a business activity. As the Supreme Court stated in a case: “Costs are considered expenses when they are directly attributable to the enterprise and are in the interest of the business, even when these expenses are not essential for the exercise of the enterprise.”

Again in this respect, article 2, section 5 of the CITA is important: Because of this article a legal entity cannot have a private domain. If an expense is not in the interest of the company this automatically means that this expense is in the interest of the shareholders. In other words, it is a (disguised) profit distribution. The Supreme Court explains this term as: A decrease in the capital (monetary or non-monetary) of the business covered by its profit and has the goal to favour the shareholder. In essence it is a shift of capital from the business to the shareholder.

As long as the business motive has been proven, expenses net of value added tax are deductible and the tax authorities may not challenge the size of the expenses. In principal, the fiscal courts and the tax authorities do not have the freedom to test whether an expense is necessary in the light of the business as the Supreme Court stated in an important decision. However, from this case can be derived that the tax authorities do have the right to challenge the motive of the expenses. So by proving the lack of a business motive the tax authorities try to challenge the costs in practice. Case law shows that the authorities indeed have the ability to question the motive of the costs. In the so-called

139 HR 31 December, 1958, BNB 1959/67.
140 HR 18 February 1959, BNB 1959/124.
141 Derived from HR 5 October 1955, BNB 1955/348.
first “Cessna” decision\(^\text{142}\) the Supreme Court applied a new test to challenge the costs: if a reasonable thinking entrepreneur would not incur these costs in conducting a business. The business motive was proven and so according to prior case law, the tax authorities should not be allowed to challenge the height of the costs. The Supreme Court thought this would not lead to a desirable outcome and invented this new test. The part of the costs that can be labelled excess according to this test will not be deductible and are classified as a profit distribution. The relevant law involved was the old Income Tax Act. The same test has been allowed for the CITA 1969 as well. In a recent case, the Supreme Court applied the same test but did not label it as a profit distribution\(^\text{143}\). The company was only not allowed to deduct the excessive part of the costs. However, in a follow-up case the Supreme Court stated that the excessive part of the costs (no business motive) have to be classified as profit distribution as it is the result of the shareholder-company relationship\(^\text{144}\).

Some costs are not deductible because they involve some kind of profit distribution or costs that normally might not be deductible such as the founding costs of an entity. Therefore, article 9 contains a list of expenses that are explicitly made tax deductible. A profit distribution (a bonus) to directors and employees, founding costs of the legal entity, the part of the profit that can be attributed to the managing partners in an open limited partnership\(^\text{145}\) are all examples of deductible costs. It would go beyond the scope of this paper to go into many details about the specific provisions. The deductibility of some expenses that normally would be fully deductible has been limited in certain articles. The most important category is interest: articles 10a, 10b, 10d and 15ad all contain specific anti-abuse rules with respect to interest paid. Article 11 limits the deductibility of the wages paid to a member of the supervisory boards when this member has a substantial participation in the company. These are just a few examples of articles that limit the deductibility. Section 4.5 will look more closely to non-deductible expenses.

\section*{\S 5.4.2: A comparison with expenses in CCCTB}

Article 12 of the CCCTB proposal contains the definition for deductible expenses:

\begin{quote}
“Deductible expenses shall include all costs of sales and expenses net of deductible value added tax incurred by the taxpayer with a view to obtaining or securing income, including costs of research and development and costs incurred in raising equity or debt for the purposes of the business.”
\end{quote}

Costs are deductible in CCCTB when they are incurred by the taxpayer “with a view to obtaining or securing income”. In this perspective, consideration 13 is also important: “Deductible business expenses should normally include all costs relating to sales and expenses linked to the production,\(^\text{142}\) HR 9 March 1983, BNB 1983/202.
\(^\text{144}\) HR 14 June 2002, BNB 2002/290.
\(^\text{145}\) These managing partners are taxed in the PITA. Therefore this profit can be deducted from the total profit made by the open limited partnership. Essentially, only the suppliers of capital are taxed in the CITA.
maintenance and securing of income.” Taking both these articles into account the definition of expenses conforms to the definition in the Dutch system in my opinion. With a view to obtaining or securing income looks like a test whether the expenses are made in the interest of the business. The Supreme Court also uses this criterion in the Dutch system. It is not certain if the “Cessna” test of the height of the expenses also applies in CCCTB.\footnote{146 P.H.J. Essers, 2011, paragraph 3.2.}

As a result of this article, the interest paid on debt (with a view to obtain or secure income) is fully deductible. The Proposal does not contain any specific anti-abuse articles to prevent the excessive deduction of interest. It only contains a general anti-abuse provision in article 80: “Artificial transactions carried out for the sole purpose of avoiding taxation shall be ignored for the purposes of calculating the tax base.” It is not really known how this will influence the deductibility of interest but this provision seems easily avoidable.\footnote{147 P.H.J. Essers, 2011, paragraph 3.2.}

Article 12 includes two additions that are explicitly made deductible: research and development and fund (debt or equity raising costs). In the Netherlands, the R&D costs incurred for the production of an intangible asset can be deducted immediately at moment of recognition of the asset, following article 3.30, section 3 PITA (also applicable for the CITA). The costs of acquiring new equity are deductible according to article 9. In principle the costs of acquiring debt are deductible as well. This is only different when an anti-abuse article denies the deduction of the interest (including the costs of acquiring the debt) but more about this in the next section.

The second section of article 12 contains a special deduction possibility for gifts to charity: “Deductible expenses shall also include gifts to charitable bodies as defined in Article 16 which are established in a Member State (...). The maximum deductible expense for monetary gifts or donations to charitable bodies shall be 0.5% of revenues in the tax year.” The same provision can be found in article 16 of the CITA. The maximum deduction in the Netherlands is 50% of the taxable profit up to a maximum of €100.000 a year. CCCTB does not contain such a maximum. In both tax bases, the gifts should be made to charitable bodies so ensure the gifts are made out of generosity.

§ 5.5: General non-deductible expenses

§ 5.5.1: Limitations on the deductibility of expenses in the Dutch law

The Dutch tax law contains some articles that are dedicated to costs that are never deductible. Other articles limit the deductibility of expenses in certain (abusive) circumstances. Because of the link article 8 CITA, the general non-deductible expenses article of the PITA is applicable as well. Therefore the applicable PITA article will be discussed first, followed by the relevant CITA articles.
The relevant article of the PITA is Article 3.14. Only the sections 1(b) to (h) and 2 to 6 are applicable for the CITA. Section 1 of this article lists a number of expenses that are never deductible. Part (b) prohibits the deduction of expenses of a recreational craft unless the company actually constructs these vessels. The other letters of this first section concern costs related to illegal activities such as: fines, arms and bribery. The rest of the applicable sections mostly provide a clarification of the first section.

Returning to the CITA, this law contains an article that is dedicated to non-deductible costs: article 10. The first section of this article, that contains the provisions, can be separated into two parts. Parts (a) to (c) involve profit distributions that would not be deductible anyway in the total profit view of article 3.8 PITA. The rest of this section includes expenses that might be deductible in the view of total profit or might be borderline cases. In this article they are explicitly excluded from deduction.

Starting with the first part, letter (a) states that profit distributions in whatsoever form are not deductible, unless explicitly allowed under article 9. This not only means that “official” distributions such as dividends are not deductible but also disguised distributions. This different treatment of equity and debt leads to a lot of abuse situations, especially in cross-border relations.

Letters (b) and (c) bring statutorily payments unless these costs are made in the interest of the business and the interest paid on loans received from stakeholders of the company under the scope of part (a).

The second part contains some expenses that could be deductible according to sound business practice but the legislator wanted to prevent this. The first letter of this part, (d) concerns the “hybrid” debt figure: a loan that is classified as debt capital but has the features of equity. This is the case when the interest paid is for example dependent on the profit of the company. The case law of the Supreme Court also prohibits the deduction of interest in these situations but to be completely sure that these expenses are not deductible the legislator added this section in 2007. Although taxes can be seen as expenses in commercial accounting, they are logically not deductible expenses in the corporate tax.

Next, the letters (e) and (f) prohibit the deduction of paid corporate tax, dividend tax and gambling tax. On the basis of article 25, paid dividend and lottery tax can be deducted from the payable corporate tax.

Then, letter (g) disallows the deduction of fictive wage based on a special regulation that is located in the act concerning the taxation of wages. (h) is a very specific provision concerning entities that have been controlled by public law bodies. The taxes levied from these entities by these bodies are not deductible when they are specifically aimed at eroding the tax base.

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148 Following the separation made by S.A.W.J. Strik and N.H. de Vries, 2011, paragraph 2.2.2.A.a.
149 Stakeholders such as shareholders, founders, participants etc.
150 S.A.W.J. Strik and N.H. de Vries, 2011, paragraph 2.2.2.A.a.
151 Such as municipalities and provinces.
Subsequently, (i) contains specific rules with regard to the expenses of a working place of the company in the house of a major shareholder. This has been introduced to tackle tax arbitrage between the CITA and PITA tax regimes.

The provision in the letter (j) prohibits the deduction of costs related to the issue of the company’s stock to for example employees. The last provision (k) is related to the payments to a central fund by housing corporations or foundations. The other sections of this article are merely a clarification of certain provisions.

The tax deduction of interest plays an important role in the CITA. Because of the different treatment of equity and debt, it is interesting for taxpayers to finance their company almost completely with debt, for example. The legislator does not want this as it erodes the tax base. However, before the legislator acted, the Supreme Court has already limited the deductibility of interest by developing case law concerning the reclassification of debt as equity. The Supreme Court has observed three different types of debt. The first situation is the case when debt has the “appearance” of equity while formally (civil-right) it is named debt.  

The intention of the lender was to provide a capital contribution to the other company. The second situation concerns a profit participating loan. The interest is dependent on the profit of the company, no fixed repayment schedule and no security is provided by the debtor. The loan has the characteristics of a capital contribution. This type has also been codified in article 10, letter (d) CITA. The last category is the “bottomless pit” loan: In this situation the debtor knows on forehand that the loan will probably not be repaid. The consequences of a reclassification are that the interest and, therefore, the costs are not deductible from the profit.

We have seen the Supreme Court has developed case law concerning the deductibility of interest. Although as a result of this case law the deductibility is already limited in certain situations, the legislator has also introduced legislation in the CITA to combat excessive interest deduction. These articles are discussed in more detail in the Wintercourse paper concerning anti-abuse provisions in the Netherlands. The Dutch law limits sound business practice in this matter as it wants to prevent tax base erosion.

§ 5.5.2: A comparison with the non-deductible expenses of article 14 CCCTB

The Proposal for a CCCTB contains a list of non-deductible expenses in article 14, section 1. It does not contain as many limitations as the Dutch law but it is quite an extensive list as well. Normally, these expenses would be deductible as they are business costs but this list prevents the deduction.

According to letter (a), profit distributions and repayments of equity and debt are not deductible, this agrees to the classification made in the Dutch law. When expenses can be considered profit distributions of any kind, they are non-deductible. Interest on the other hand is generally deductible. The different treatment between debt and equity can also become a problem in this tax base.

The next letter states that 50% of the entertainment costs incurred by the company are non-deductible. Via article 8, section 5, the PITA article concerning these costs is also applicable to non-transparent companies. Entertainment costs are not deductible up to a certain fixed amount or 73.5% of these costs are deductible in the Netherlands. This regime is more favourable than CCCTB which only allows for a maximum deduction of 50% of these costs.

Subsequently, the transfer of retained earnings to a reserve which forms part of the equity of the company is the next prohibition in letter (c). This provision seems to be redundant as retained earnings and reserves should both be classified as equity. A shift from one side to the other does not really change the size of the equity. The Dutch law does not contain a similar section but this is also non-deductible in the Dutch tax system.

Part (d) of is a copy of article 10, section 1(e) CITA. The deduction of corporate taxes is not allowed in both tax bases. Followed by letter (e), this paragraph concerns bribery. Bribes are also explicitly excluded in article 3.14, section 1(h), PITA. The CCCTB does not define the term “bribes”, unlike the Dutch law.

Part (f) prohibits the deduction of fines and penalties payable to a public authority for breach of any legislation. This paragraph matches the provisions in article 3.14, section 1(c) and 1(d).

The next letter is (g), this section is about the costs incurred by a company for the purpose of deriving income which is exempt pursuant to article 11. These revenues are exempt so that the expenses are exempt as well. The costs are set 5% of the exempt income unless the taxpayer is able to demonstrate that it has incurred a lower cost. When revenues are exempted, costs are usually exempted as well in sound business practice.\(^{155}\) To attribute the non-deductible costs to the income exempt the specific circumstances of the case are taking into account:\(^{156}\) There is no fixed percentage like in CCCTB.

In the case of the participation exemption, the legislator has made an exemption to the rule of not taxed, not deductible. As we have seen, the benefits received from a participation are exempt. Normally, the costs related to the participation should not be deductible. However, the finance costs related to the participation are deductible.

Monetary gifts and donations other than those made to charitable bodies as defined in Article 16 are not deductible via part (h). The Dutch tax law contains the same mechanism, so that unless the deduction facility is used, the gifts and donations are non-deductible.

\(^{155}\) This follows from HR 16 June 1971, BNB 1971/169.

\(^{156}\) HR 11 April 1973, BNB 1973/126, a proportional ascertainment was accepted in this case.
Part (i) is about the costs relating to the acquisition, construction or improvement of fixed assets except those relating to research and development. This provision prevents the immediate deduction of these costs related to fixed assets. They have to be activated and depreciated. The same procedure is used in sound business practice for acquisition and construction costs.\(^{157}\)

The last provision of this section is again related to special taxes levied in other Member States which are non-deductible. An exception to this rule is made in section 2 which states that a Member State can decide to allow a deduction. Sound business practice does not allow a deduction of taxes paid.

§ 5.6: The treatment of losses

§ 5.6.1: Loss offsetting in the Dutch tax law

When deductible expenses are greater than taxable revenues, the taxable amount of article 7 becomes negative. Article 20, section 1 of the CITA classifies this as a loss. As a formal requirement, a decision of the fiscal inspector is needed before a loss is recognized in respect of this article. Only losses made in the Netherlands are taken into account. As we have seen before, the legislator has introduced an object exemption for permanent establishments\(^{158}\) (p.e). As a result the foreign losses of p.e’s are not taken into account for the loss offsetting.

The law provides a carry-back and a carry-forward possibility of losses in section 2. A loss incurred in a year can be offset against the positive taxable profit of the preceding year. This leads to a tax return in current year. Losses are carry-forwarded up to nine years. So a loss in year 1 can be offset at the latest with a profit in year 10. Setting off the losses cannot lead to a negative taxable amount in the previous or upcoming years. The losses have to be offset in the order they have been incurred and taxable profit has been recognized. Before the year 2007, losses could be carry-forwarded indefinitely in the future. This is not surprising as the total profit concept taxes the benefits derived from a company over its lifetime. The losses should then also be taken into account over the lifetime of the company. But the legislator has limited this to only nine years in 2007.\(^{159}\) The reason for this change was to finance the reduction of the corporation tax rate. The limitation can be seen as a breach of the total profit concept as profits are still taxed over the lifetime of the company while losses can only be carried forward nine years.

To show how loss deduction works out in practice, a simple example is discussed. A company shows the following taxable income figures (in euro):

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\(^{157}\) Activation of acquisition costs, HR 19 November 1958, BNB 1959/6 and activation of construction costs, HR 30 September 1964, BNB 1966/52

\(^{158}\) Stb. 2011, 639.

<table>
<thead>
<tr>
<th>Year</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>300</td>
<td>-500</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Tax</td>
<td>75</td>
<td>0</td>
<td>25</td>
<td>50</td>
</tr>
</tbody>
</table>

Figure 1: Example of the carry-back and carry-forward.

The amount of tax is based on a fixed rate of 25%. The loss in 2006 of 500 has to be offset in the following way: First, a carry-back to 2005. The maximum carry-back is 300, this leads to a return of tax of 75 in 2006. A loss of 200 therefore remains which can be carry-forwarded to the years 2007 and 2008.

As in many situations, the legislator wanted to combat abusive usage (in its view) of this loss facility. Therefore it introduced a couple of anti-abuse measures. Section 4 of article 20 concerns holding and financing entities. When such entities acquire participations, they usually finance them with debt. Although the income from a participation is exempt, the financing costs are still deductible. As a result, this can lead to huge losses in the holding company. By adding operational activities the companies would be able to offset these losses. The legislator did not want this and made sure that losses can only be compensated with the same kind of profits. Next to that, the legislator also introduced article 20a to combat the trade in the so-called “loss-entities”. These entities have large losses that still can be offset by profit. By selling the shares of this entity and adding profitable activities, these losses can be fully used: article 20a prevents this. According to section 1 of this article, no carry forward of losses is allowed when there is at least a 30% change of shareholders. However, section 1 does not apply when the taxpayers conforms to two requirements set out in section 4. The first requirement is an activities test: the combined volume of operations should not have decreased to less than 30% of the original volume. The second requirement is a non-investment test: the assets of the company should not consist of more than 50% of investments during nine months of the year. This requirement makes sure that investment losses are not offset against operational losses. The remaining articles of this chapter: 20b, 21 and 21a all concern formal aspects of loss off-setting.

The fiscal consolidation regime of article 15 requires specific loss deduction provisions. In the case of consolidation, the subsidiary ceases to exist for the CITA and as a result, loss compensation between group companies is possible. This can lead to situations that taxpayers try to exploit this ability by forming a fiscal group. Three situations will be discussed: loss offsetting in the case of a liquidation loss, companies in a fiscal group that already have carry-forward losses and loss offsetting when the fiscal group is terminated.

The first situation is related to a liquidation loss. Assume company A has a 100% subsidiary, company B. Company B holds 50% of the shares in a company that will be liquidated. Normally the loss will not be deductible because of the participation exemption but article 13d contains a special provision that allows a deduction of the liquidation loss. As company B does not have enough profits

160 Profit derived by shareholdings in other companies.
to be able to offset the loss from the liquidation, companies A and B decide to form a fiscal group. Without a provision, the liquidation loss would be deductible from the total profit of the fiscal group. The legislator has prevented this by introducing article 15ab. This article limits the loss offsetting to the holding company (in this case, company B).

In a second situation it is possible that a fiscal group consists of companies that still had carry-forward losses before they were added to the group. Article 15ae determines that the pre-consolidated losses of a company can only be offset against the part of the profit of the group that can be attributed to that particular company (article 15ah determines how this should be calculated). For the application of these articles, the subsidiary companies do not cease to exist for the CITB.

The last situation concerns the termination of the fiscal group. Losses incurred during the existence of the group are all attributed to the parent company because subsidiaries cease to exist. Without provisions, these losses can only be offset by the parent company. That is why articles 15af and 15ag were introduced to make sure that every company would receive its “own” losses: the carry-forward losses before the company entered the group and a part of the group loss that can be attributed to the company.

These three situations show that there is a lot of additional legislation necessary to make sure that in the case of fiscal consolidation, no inappropriate loss offsetting takes place. The legislation discussed is only a part of the anti-abuse legislation the legislator has added.

§ 5.6.2: A comparison with losses according to CCCTB

Article 43 of the proposal is dedicated to loss offsetting in CCCTB. Section 1 states that “a loss incurred by a taxpayer or a permanent establishment of a non-resident taxpayer in a fiscal year may be deducted in subsequent tax years, unless otherwise provided by this Directive.” There is only a carry-forward possible; in the Netherlands also a one year carry-back is possible. In contrary, there is no time limit for the deduction of losses under the CCCTB. This limit is nine years in the Netherlands since 2007. An explanation why this system is proposed has been given in consideration (15): “Taxpayers should be allowed to carry losses forward indefinitely, but no loss carry back should be allowed. Since carry-forward of losses is intended to ensure that a taxpayer pays tax on its real income, there is no reason to place a time limit on carry forward. Loss carry back is relatively rare in the practice of the Member States, and leads to excessive complexity.” There is no explicit total profit concept in the Proposal but this consideration shows that the tax base wants to tax the total profit of a company so that indefinite carry-forward is justified. They have chosen not to provide a carry back because of the complexity it can cause. Although this could be the case, the liquidity advantages of a carry back for taxpayers might be a justification of a bit more complexity.

161 J.A.G. van der Geld, “Hoofdzaken vennootschapsbelasting”, Kluwer Deventer 2011, paragraph 10.5.4.2
The previous sections have compared general elements of the calculation of the tax base in the Netherlands with the proposed calculation under the CCCTB. The remainder of this chapter will compare more specific subjects such as: stock, work in progress, fixed, hedging, provisions, asset depreciation et cetera.

§ 5.7: The valuation of stock and inventory

§ 5.7.1: The valuation of stock and inventory according to sound business practice

Before going into the valuation of stock (or inventory) in sound business practice, it is necessary to define stock. The Supreme Court explains the term stocks as “the total of goods available at a company to be used in operations, processing or for sale: in other words the goods are intended to be included in the turnover.” This “included in turnover” means that the goods are used in a single production process of the company. So therefore stock is a liquid asset or working capital. Essers uses the following definition of stock: The total of goods, belonging to the working capital of the company, that: a) are destined to be sold, or b) are processed in such a way that they can be sold, or c) are used in the fabrication of an economic product, available for sale although technically these goods cannot be distinguished anymore. Work in progress can be seen as part of the stock; however, other valuation rules apply for work in progress. Reference is made to work-in-progress in section 4.8.

It is possible to make a distinction between technical and economical stock. Technical stock comprises of physically, available goods, within the company. The economical stock is technical stock plus the goods ordered but not yet received and minus the goods sold but not yet delivered. The taxpayer faces a price risk over this economical stock. The Supreme Court has allowed the use of economical stock in the valuation of stock. Furthermore, for the valuation of stock it is important to make a distinction between marketable and not easy marketable goods. The prudence principle of sound business practice requires a very conservative valuation of not easy marketable goods. Following the case law of the Supreme Court, these goods have to be valued at the expected selling prices minus the usual overhead and profit charges. Marketable goods have to be valued according to sound business practice by using one of the systems, accepted by the Supreme Court. At this moment, the following valuation methods are accepted:

   a) Valuation at cost price.

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162 HR 17 April 1957, BNB 1957/238.
163 L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.18.C.a
165 HR 19 June 1957, BNB 1957/240.
166 HR 10 June 1959, BNB 1959/262.
b) Valuation at cost price or lower market value.

c) Valuation at market value.

d) Valuation using the LIFO or FIFO method.

e) Valuation use the base stock system (IJzeren voorraadstelsel)

It is important to observe that valuation at replacement value is not allowed in sound business practice. The first three systems are all based on the nominalism principle. This means that they all try to maintain the starting capital of the company. Inventory profit is not meant to be distributed because it can reduce the capital of the enterprise, resulting in financial difficulties. The other methods are all based on the principle of substantiality. These methods are aimed at sustaining the substance: the production equipment. Goods play a central role in this system. The first four systems are all straightforward and known in the accounting so they do not really require an extensive explanation. The only aspect that sometimes causes problems in these systems is: which costs have to be included in the cost price?

The cost price of bought goods is the purchase price plus the costs related to the purchase. Costs not directly related to the purchase but for example for the storage of the goods are not part of the cost price. The cost price of manufactured stock is determined differently. The Supreme Court has allowed the usage of a differential cost price for valuation purposes. The Court furthermore requires a distinction between direct costs (have to be accrued) and indirect costs (only allowed to be accrued when they vary with the size of the production).

The base stock system, is quite a unique way of valuing stock in sound business practice. It is not allowed under Dutch GAAP nor under IFRS. It might be interesting to look at this system of stock valuation as it one of the most used methods.

The start of this system is the fixed stock, called the base stock. This stock is valued at a fixed basis price. In this manner increasing market prices, during the lifetime of the company, do not lead to capital gains on the base stock. The base stock is the required stock to operate at normal capacity. As the Supreme Court stated, the goal of this system is to “exclude the benefits received from the sale of stock from the profit determination, as far as these benefits have to be used to refill the stock used in the normal production process.” It is possible that the market price of the goods in stock drops below the basis price. Companies are then allowed to write off the stock to the lower market price. If the market price increases again, the stock has to be valued at the basis price again. This leads to a taxable profit.

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169 HR 30 May 1956, BNB 1956/222.
170 L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.18.C.g.g1.
When the actual stock is lower than the base stock at balance sheet date, the company is allowed to recognize a shortage provision. This provision is based on the market price of the goods.¹⁷³ In the case of a surplus, this surplus can be valued at cost or lower market price. Permanent changes in the base stock (because of increasing production capacity) can also occur. Increasing the stock leads to a new bracket that has to be valued at the cost price at that time. It is therefore possible that the stock eventually consists of more brackets because the base stock has been increased several times. Complex valuation issues can be the result of this.

§ 5.7.2: A comparison with the valuation of stock according to CCCTB

The valuation methods for stock and work-in-progress under the CCCTB are set out in article 29 of the proposal. The next section of this chapter is dedicated to long-term contracts which are classified as work-in-progress in the Netherlands. Stock and work-in-progress are taken together in the proposal but they are similar to stock in sound business practice. This follows from the general definition in article 4, (19):

“‘stocks and work-in-progress’ means assets held for sale, in the process of production for sale or in the form of materials or supplies to be consumed in the production process or in the rendering of services.” This definition almost resembles the definition of stock in sound business practice as set out by the Supreme Court.

Returning to article 29, section 1 of the Proposal: “The cost of stock items and work-in-progress that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be measured individually. The costs of other stock items and work-in-progress shall be measured by using the first-in first-out (FIFO) or weighted-average cost method.”

The first sentence seems to be dedicated to stock specifically related to projects et cetera. They have to be valued individually. As can be derived from the second sentence, the other stock items have to be valued using the FIFO or weighted-average cost method.¹⁷⁴ Compared to the allowed methods in sound business practice, the choices of taxpayers are limited to only two options. Systems such as the base stock method are also not allowed. As in the Dutch system, a taxpayer shall consistently use the same method for the valuation of all stocks and work-in-progress having a similar nature and use (section 2). The direct costs, such as purchase and conversion costs, have to be included in the cost price. Indirect costs can only be included by taxpayers who did this before opting for CCCTB. Section 3 states that “the valuation of stocks and work-in-progress shall be done in a consistent way.” This is also required in the Dutch tax law according to article 3.25 PITA. The last section of article 29 requires stocks and work-in-progress to be valued on the last day of the tax year at the lower of cost

¹⁷³ HR 7 March 1956, BNB 1956/121.
¹⁷⁴ The cost of inventory is based on the average cost of the goods available for sale during the period. The total cost of goods available for sale is divided by the total units available for sale to calculate the weighted-average unit cost. This unit cost is used in the valuation of the inventory.
and net realisable value. The net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. The prudence principle of sound business practice also implies a write-off to the lower realisable value of stock when market prices drop.

§ 5.8: Work-in-progress

§ 5.8.1: The valuation and profit determination of work-in-progress according to sound business practice

Work-in-progress can be seen as a special form of stock. Goods produced for the execution of (long-term) contract can be called work-in-progress. Goods produced for the company’s own account are called stock. As long as the buyer is not yet known, for tax valuation the goods have to be classified as stock. An exception to this rule is a purchase agreement (art. 7:1 Dutch Civil Code): The purchasing party is already known but the goods still have to be classified as stock. The acceptance of work (art. 7:750 Dutch Civil Code) leads to a fiscal classification of work-in-progress. The contractor has the obligation to produce and deliver a physical good (for example, a building) to the client. The client is obliged to pay a consideration to the contractor. This does not only concern physical goods but also services.

The valuation of work-in-progress is, unlike stock, dictated by an article in the PIT'A. By including this provision, the legislator interfered with sound business practice and overruled the case law of the Supreme Court. Section 1 of this article states that work-in-progress has to be valued at “at the portion of the consideration of the contract work” This consideration has to be attributable to the work in progress. This means that every year a portion of the profit of the contract will be realized and included in the taxable profit. Not only the direct costs and the constant part of the general costs have to be accrued but also a profit margin. Although the article states a portion of the consideration, this consideration usually also includes the costs related to the project. These costs then also can be deducted in the same year. It is not really clear how the progression of the project has to be determined; the legislator has not provided any guidance on this. This article gives more weight to the realisation principle of sound business practice at the expense of the prudence principle.

Until 2007, a taxpayer was free to choose a desired valuation method for work-in-progress as long as it complied with sound business practice. Profit realisation could be postponed until the

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177 MvT, Kamerstukken II 2005/06, 30 572, nr. 3.
completion date of the project. The constant part of the general costs could be immediately deducted from the taxable profit.\textsuperscript{179} With the introduction of this article 3.29b, a mandatory valuation method is chosen by the legislator.

§ 5.8.2: A comparison with long-term contracts according to CCCTB

Although work-in-progress in CCCTB is put on the same level as stocks, the proposal does contain an article related to long-term contracts. These contracts have the same characteristics as work-in-progress under Dutch tax law. Article 24, section 1 defines a long-term contract as:

“A long-term contract is one which complies with the following conditions:
(a) it is concluded for the purpose of manufacturing, installation or construction or the performance of services; (b) its term exceeds, or is expected to exceed, 12 months.”

This section resembles the Dutch definition of work-in-progress as a contract: It has the similar features as the acceptance of work in the Civil Code. Next to that, this contract has to exceed or is expected to exceed a period of 12 months: else it would be classified as stock in CCCTB.

Revenues related to the contract have to be recognised at the amount corresponding to the part of the contract completed in the respective tax year.\textsuperscript{180} Just like article 3.29b, the CCCTB requires recognition of revenues of a long-term contract at the amount corresponding to the part of the contract completed in the respective tax year. Next to that, the costs related to the project can be deducted in the corresponding tax year (section 3). Unlike the Dutch equivalent, section 2 does include a way to determine the percentage of completion:

“The percentage of completion shall be determined either by reference to the ratio of costs of that year to the overall estimated costs or by reference to an expert evaluation of the stage of completion at the end of the tax year.”

These methods of determining the percentage of completion might be accepted by the Supreme Court in the Netherlands, but case law has to be developed first on this subject. Setting out a predetermined method by the Dutch legislator would help legal certainty for taxpayers.

§ 5.9: Hedge accounting

§ 5.9.1: Hedge accounting according to sound business practice

Normally, assets and liabilities have to be valued separately. As we have seen, sound business practice allows a deduction of not yet realised costs and a possible delay of profit taking until the revenues are actually realised. In the case of related positions such as hedge transactions, this can lead

\textsuperscript{180} Article 24, paragraph 2 of the Proposal.
to a deduction of costs of which it is not certain whether these costs will actually be incurred.\footnote{S.F.M. Niekel, “Een multidisciplinaire analyse naar aanleiding van het cacaobonenarrest”, WFR 2010/576, paragraph 2.} Only recently the Supreme Court has set guidelines on the treatment of these hedge transactions.\footnote{The “hedge” case: HR 23 January 2004, BNB 2004/214, the “option” case: HR 16 November 2007, BNB 2008/26 and the “cocoa beans” case: HR 10 April 2009, BNB 2009/271.} An unrealised loss can only be taken into consideration when the total of the associated items (for example, the hedge contract and the hedged asset) leads to an unrealised loss. Sound business practice requires an associated valuation of two capital components to cover a price risk when the following two requirements are fulfilled.

The first requirement is that there must be a (formal) connection between the components. This has to be determined according to the circumstances of the cases. Important circumstances are for example the nature of the contracts, whether it is the goal to cover the price risk.

The second requirement holds that the price risk should, to a large extent, be limited on the balance sheet date. This is the case when there is a high correlation between the value developments of the two components (in the range of 80 to 125\%). An example can make clear how this works out. A company has bought a futures contract to limit the risk on its own stock of wood. As it is the goal to limit the price risk, the first requirement has been fulfilled. After a month, the value of the contract has increased by 10\% and accordingly the value of the stock of wood has decreased by 9\%. These fluctuations fall within the range of 80\% to 125\%: the second requirement is also fulfilled. These two assets have to be valued together.

Although the Supreme Court has set out the framework for the treatment of hedge transactions, in practice a certain amount of uncertainties remain. Hedging is not only used to cover price risks but also to cover cash flow risks (for example, interest swaps). It is not really clear how the requirements will work out for these hedging transactions as there will not be a high correlation between the value developments of the two items.\footnote{S.F.M. Niekel, 2010, paragraph 6.1} The effectiveness of a hedge is also more difficult to determine when options are used.\footnote{S.F.M. Niekel, 2010, paragraph 6.2.} The Supreme Court applies a prospective test about the effectiveness of a hedge transaction. This means that the Court looks at the expected outcome of the hedge transaction. It is not really clear how an actual ineffective hedge should be treated.\footnote{S.F.M. Niekel, 2010, paragraph 6.4.} The Supreme Court still needs to provide details about the treatment of certain aspects of hedge transactions.

§ 5.9.2: A comparison with the hedge accounting according to CCCTB

In the case of a hedge transaction, gains and losses on a hedging instrument shall be treated in the same manner as the corresponding gains and losses on the hedged item according to article 36 of

\footnotetext[181]{S.F.M. Niekel, “Een multidisciplinaire analyse naar aanleiding van het cacaobonenarrest”, WFR 2010/576, paragraph 2.}
\footnotetext[183]{S.F.M. Niekel, 2010, paragraph 6.1}
\footnotetext[184]{S.F.M. Niekel, 2010, paragraph 6.2.}
\footnotetext[185]{S.F.M. Niekel, 2010, paragraph 6.4.}
the Proposal. This means that unrealized costs cannot be deducted unless the corresponding gain is included in the tax base. The corresponding balance sheet items therefore also require a related association. The Supreme Court in the Netherlands requires the same treatment of hedge transactions. Subsequently, CCCTB requires two conditions to be fulfilled; (a) the hedging relationship is formally designated and documented in advance; and (b) the hedge is expected to be highly effective and the effectiveness can reliably be measured. The article does not state what can be regarded as highly effective. These requirements are almost completely similar to the requirements set out by the Supreme Court. The Court, unlike CCCTB, did provide an effective range. It seems that both the Supreme Court in the Netherlands and the European Commission have looked at IAS 39 (or IFRS 9) for inspiration on hedge accounting.

§ 5.10 Fixed assets.

§ 5.10.1: The depreciation of fixed assets according to sound business practice

Unlike other aspects of the calculation of the tax base, the depreciation of fixed assets is regulated mostly by law and not by case law the Supreme Court. The reason for the legislator to regulate the depreciation of assets was to broaden the tax base.

The starting point for the depreciation of assets is article 3.30. The legislator has provided a very general definition of an asset in article 3.30, section 1 PITA: “Goods used in the operation process of a company”. This definition includes tangible assets such as buildings, machinery, cars but also intangible assets such as goodwill, patents and some financial assets. It remains a legal question whether a good is an asset. This question is answered by investigating the specific place and function the good has in the enterprise. As the Supreme Court stated in a decision: Assets are goods, part of the fixed capital of the company, which are destined to be used in the operational activities of the company.²¹² A number of requirements can be detracted from this decision:

First of all, there needs to be a good. A good includes tangible assets which can be physically touched or intangible assets which cannot be physically touched. The civil-law definition of a good is therefore not leading, as this only includes tangible assets.²¹³ The good does need to have a certain independent function in the company.²¹⁸

Secondly, the asset needs to be part of the fixed capital. The goal of this requirement is to exclude stock from the asset definition. The good needs to have a certain amount of sustainability. A good can be called sustainable when it is used in more than one production cycle. According to

²¹² HR 11 March 1953, BNB 1953/119.
²¹³ HR 11 February 1953, BNB 1953/72.
Sillevis and van Kempen, this should not mean that the good has to be used in more than one tax year. But case law shows that this usually is the case, mainly for practical use.

The last requirement holds that the good has to be part of the capital of the enterprise. It can be only part of the capital when the taxpayer is the economic owner of the asset. Usually legal and economic ownership coincide but in some situations this is not the case e.g. in a leasing transaction. An asset can only be recognized if the taxpayer has the economic ownership of the good. Economic ownership means that the taxpayer has received the right to use a good and substantially faces the benefits and risks of the asset. In the case of leasing, a distinction can be made between operational leases and financial leases. The economic ownership stays with the lessor in the case of an operational lease. The lessor is then allowed to depreciate the asset. In a financial lease, the economic ownership transfers to the lessee so that the lessee can depreciate the asset. According to case law of the Supreme Court, the economic ownership transfers to the lessee when it receives the full economic interest in the asset. In practice this has lead to uncertainties about the boundary of an operational lease. Therefore, the secretary of finance has issued a decree dedicated to leasing. In this decree the requirements are set for an operational lease. For example, if the lessor has the legal ownership, than he needs to have at least 5% of the economic advantages and risks to be considered the economic owner of the asset.

A special category of assets are the financial assets, such as stocks, bonds et cetera. These assets are only part of the fixed assets of the company when they can be classified as a holding. The Supreme Court stated that this is the case when “there is a relation between the company that makes the investment and the business activities of the company invested in”. In other words the activities of the company have to be subservient to the investing company. The situation where a supplier invests in his main customer can be seen as an example of this. Otherwise the financial asset is just a way to invest excess cash (liquid assets). Although financial assets can be part of the fixed assets, this does not mean that they can also be depreciated. Sound business practice contains special valuation rules concerning these assets. Value changes of financial assets are taken into account when they are realised.

When a good (excluding financial assets) matches the above criteria, it can be classified as an asset. This means that according to article 3.30 PITA, the taxpayer is allowed to depreciate the asset. The goal of depreciation is to “spread the expenses that have come up in the purchase of an asset. This asset is used in the business activities of the company.” As an asset is used in the production process, it usually decreases in value because of wear and tear. Depreciation shows this decrease in the utility value of an asset. This also means that when there is no decrease in utility value (because there

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192 HR 8 May 1985, BNB 1986/75.
194 HR 26 January 1966, BNB 1966/89.
is no wear or tear), an asset cannot be depreciated.\textsuperscript{196} As the value changes of financial assets are taken into account at the time of realisation, they cannot be depreciated.

Section 1 of article 3.30 is the starting point of the depreciation of an asset. From this section it can be derived that the depreciation base is the total acquisition or production costs of an asset. This has to be determined for every individual asset: tangible or intangible. In the case of self-produced assets, the base does not only include the direct production costs but also the integral cost price. Every year a portion of the costs of the assets that can be attributed to that year can be deducted as depreciation. Two exceptions are made on this general allocation rule. The production costs of intangible assets can be depreciated immediately in the year of production. Unlike acquired intangible assets: the acquisition costs related to these assets have to be accrued. The second exception can be found in section 4 of the article. The acquisition or production costs for objects of small value (less than €450) can be fully deducted in the year of acquisition or production.

A special category of costs are the improvement costs. These costs are related to the improvement of a used asset. The goal is to increase the economic lifetime of the asset. The costs related to the improvement have to be distinguished from maintenance costs. Maintenance costs are for example the costs incurred to fix the worn parts of the asset.\textsuperscript{197} These costs are part of the normal business costs and do not have to be accrued. Improvement costs have to be accrued when they concern the replacement of worn parts of the asset and these costs are substantial in relation to the acquisition costs of the asset. In the case of the improvement of an acquired used asset, the improvement costs should be predominately caused by previous owner’s usage of the asset.\textsuperscript{198} The seller has used the asset so that it needs to be improved because of that. The depreciation base thus not only includes the acquiring costs but also the improvement costs.

After determining the depreciation base, it is necessary to determine the expected life of an asset and the expected residual value at that time. This is usually the technical life, although in certain cases the economic life can be used: in certain situations, the technical state of an asset is still all right but it does not provide economic benefits to the company. Before it is possible to select a depreciation method, it is also necessary to determine the residual value of the asset. This is the estimated market/economic value of the asset at the end of its usage in the business. The residual value of a building has to be determined using article 3.30a. This article sets a maximum residual value for buildings. There will be more information about the depreciation of buildings later in this section. Now that the depreciation base, residual value and expected lifetime are defined, a taxpayer can select the depreciation method.

The Dutch tax law or sound business practice does not require a mandatory depreciation method. In principle, a taxpayer is allowed to choose its own system as long as this leads to consistent

\textsuperscript{196} L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.22.A.a.a1.\textsuperscript{197} HR 3 October 1979, BNB 1980/231.\textsuperscript{198} Derived from HR 5 February 1992, BNB 1992/136; See L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.18.E.h.h2.
behaviour that is independent of the probable outcome. Consistent means that in loss situations, depreciation is also mandatory. The depreciation method can only be changed when there are important changes with respect to the asset such as a decrease in the lifetime. Some of the more common depreciation systems are: linear, degressive, decreasing percentage and progressive depreciation.\footnote{L.W. Sillevis and M.L.M. van Kempen, 2011, 3.2.22.A.e.e1.}

Although the system can be chosen freely, the legislator did interfere with sound business practice by setting a maximum depreciation percentage for assets in a tax year. The legislator made a separation between goodwill and other fixed assets. According to article 3.30, section 2, every tax year 10% of the not yet depreciated goodwill can be deducted from the profit. This means that the minimum depreciation time of goodwill is at least 10 years. The maximum percentage for other (tangible and intangible) assets is 20% of the not yet deducted purchase or production costs of the asset. The minimum time to fully depreciate these assets is 5 years. These percentages are arbitrary and, therefore, do not take into account the real economic life of an asset. An exception to this rule is made for intangible assets generated in the company. These assets do not have to be depreciated: the development costs of these assets can be deducted from the taxable profit immediately (section 3). These arbitrary percentages can lead to large differences between commercial and fiscal depreciation.

It is possible that because of certain circumstances, the business value of the asset is lower than the actual book value of the asset. This business value is the going-concern value of the asset as part of the entire company.\footnote{L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.22.A.c2.I} Sound business practice allows a write-off to this lower business value of the asset.\footnote{HR 15 February 1956, BNB 1956/102.} But when the lower business value is the result of circumstances that are already known at the time of investing in an asset, article 3.29c prohibits the write-off to this lower value.

A special category of fixed assets for the Dutch tax law are buildings. The residual value of buildings have to be determined according to article 3.30a PITA 2001. Depreciation of a building is only possible when the fiscal book value of this building is above the above the “base” value (section 1). This base value is based on the so-called “WOZ-value”.\footnote{The WOZ is the law on the valuation of real-estate. This valuation is used for example to charge a real-estate tax by municipalities.} It basically resembles the market value of a freely transferable building, in other words the replacement value. The usage of the building determines the actual percentage of the WOZ-value that should be used. When a building is held as an investment (for example to make it available for renting) the base value of the building is 100% of the WOZ-value. Buildings for own use only have to use 50% of the WOZ-value. The legislator justified this different treatment by stating that in practice there is a large discrepancy between the fiscal depreciation and the real decrease in value.\footnote{L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.22.B.c.c1} A taxpayer is only allowed to depreciate fiscally when the book value exceeds the base value. At the moment the book value passes the base value,
depreciation is prohibited. A write-off to the lower business value of the building is still allowed (section 2).

The introduction of this provision is an infringement on sound business practice. As we have seen, according to the Supreme Court, the goal of depreciation is to show the decrease in utility value of the asset. In the case of the increase of the market value of a building, sound business practice still allows depreciation. The new provision makes this impossible.

§ 5.10.2: A comparison with the depreciation of fixed assets according to CCCTB

Naturally, it is also possible to depreciate fixed assets in the CCCTB. Before an asset can be depreciated, it has to be classified as a fixed asset. Article 4(14) contains this definition: “fixed assets’ means all tangible assets acquired for value or created by the taxpayer and all intangible assets acquired for value where they are capable of being valued independently and are used in the business in the production, maintenance or securing of income for more than 12 months, except where the cost of their acquisition, construction or improvement are less than EUR 1,000. Fixed assets shall also include financial assets.” At first sight there is not much difference between this definition and the definition in the Dutch law: Just as in the Netherlands, this definition includes both tangible and intangible assets. The Dutch law does not explicitly state a 12 month period (although the Supreme Court does usually require). Another small difference is the objects of small value. The acquisition or production costs of these objects can be fully deducted in the year they are acquired or produced. The maximum amount for these objects is €450 in the Netherlands while the CCCTB allows a maximum of €1,000. Fixed assets shall also include financial assets.\footnote{Defined in article 4(15) as: “shares in affiliated undertakings, loans to affiliated undertakings, participating interests, loans to undertakings with which the company is linked by virtue of participating interests, investments held as fixed assets, other loans, and own shares to the extent that national law permits their being shown in the balance sheet.}

In the Netherlands these financial assets are not always part of the fixed assets: only when they are part of a holding.

Only the economic owner of an asset is allowed to depreciate (article 34, section 1).\footnote{The economic owner is defined in the general definitions of article 4, number (20).} The economic owner is the taxpayer which substantially has the benefits and risks attached to a fixed asset. It does not matter that the taxpayer is not the legal owner. Although the term “substantially” is not defined in the Proposal, full economic interest is not necessary. In the Netherlands, the economic owner has to face the full economic interests of the asset. To be considered the economic owner, the lessor only needs to face 5% of the economic risks according to the decree while in CCCTB; the lessor has to face substantial economic risks. The Commission is allowed to issue more detailed regulations regarding the definition of the economic ownership (article 34, section 5 of the Proposal). This can
provide more certainty, like the Dutch decree does, to taxpayers about the treatment of leasing. Section 2 of article 34 contains a special provision for leasing contracts. When legal and economic ownership do not coincide in a leasing contract (financial lease), the economic owner is also allowed to deduct the interest element of the lease payments from his taxable profit. This interest element is taxed at the legal owner and the asset is depreciated by the economic owner. Lease payments are deductible according to sound business practice because these are costs related to business activities. In my opinion CCCTB does not really need a special provision for the deductibility of these costs as they would also match the criteria of article 12.

There is one last requirement to be fulfilled before depreciation is allowed. The asset should not match the criteria of a non-depreciable asset. Article 40, section 1(a) sets out a general rule: fixed tangible assets not subject to “wear and tear and obsolescence”. It provides the examples of land, fine art, antiques and jewellery. It is not really clear if these are just examples or just to make sure that these examples will always not be depreciable. The Supreme Court in the Netherlands uses the wear and tear criteria as well but does not automatically rule out an asset from depreciation, even if it concerns land. Sound business practice seems a little less strict in this aspect. Returning to article 40, section 1(b) also rules out financial assets from depreciation. That is not surprising as they require a separate treatment. The provision is not strictly necessary as these assets do not really wear and tear anyway but it provides legal certainty to taxpayers. Sound business practice also requires a separate treatment and valuation of financial assets so they cannot be depreciated. Now that there is an asset to depreciate and the taxpayer is allowed to depreciate, the depreciation base according to the Proposal can be determined.

Chapter VI of the proposal is dedicated to the depreciation of fixed assets. In article 33 the depreciation base is determined. The base consists, according to section 1, of “any cost directly connected with the acquisition, construction or improvement of a fixed asset.” This resembles the Dutch depreciation base. The section continues that, in the case of fixed assets produced by the taxpayer, the indirect production costs have to be included in this base as well. In section 2, the depreciation base of a gifted asset shall be its market value. Although not codified in the Dutch tax law, this valuation will also result from the total profit concept: the aggregate amount of benefits is taxed, in any name or form: this also includes gifts. Because subsidies on the acquisition etc. of an asset are exempt, they are also not part of the depreciation base (section 3). In the Netherlands subsidies are also not taken into account when determining the depreciation base unless it is included as an obligation on the balance sheet.

Improvement costs are treated separately from other asset related costs in CCCTB. “Any additional expenditure on a fixed asset that materially increases the capacity of the asset or materially improves its functioning or represents more than 10% of the initial depreciation base of the asset” are called improvement costs according to article 4(18). The first part of the definition tries to make a distinction between maintenance costs and improvement costs. Maintenance does not improve the
capacity of an asset and should not be part of the depreciation. It seems that the limit of 10% is introduced for practical reasons as it is often difficult to make a distinction between the costs. However, this limit does automatically rank the costs as improvement costs while these costs could qualify as maintenance costs. The Supreme Court does not use a practical limit and tries to make a distinction in every single case at hand. Although this might lead to more realistic results, it does lead to uncertainties for taxpayers. Returning to the improvement costs, these costs have to be accrued and therefore depreciated in accordance with the rules applicable to the asset it concerns (Article 30 of the Proposal).

The actual asset depreciation is divided into two parts: individually depreciable assets and the asset pool. Unlike the Dutch system, the CCCTB takes some assets together that have to be depreciated in an asset pool. The categories of individually depreciable assets are set out in article 36. The article also sets out the useful life of these categories. Buildings are the first group of assets; they have a useful life of 40 years according to section 1(a). Long-life tangible assets other than buildings have to be depreciated using a useful life of 15 years. Long-life assets are defined in article 9(16): fixed tangible assets with a useful life of 15 years or more. Buildings, aircraft and ships shall be deemed to be long-life fixed tangible assets according to the second sentence. This fiction makes sure that these three asset types are always categorized as long-life assets, even when they have a useful life of less than 15 years. The last category is intangible assets. The useful life is not automatically set at a fixed level. According to section 1(c) this life is the period for which the asset enjoys legal protection or for which the right is granted. If that period cannot be determined then this period is set at 15 years. The second-hand equivalents of buildings et cetera are all treated in the same manner. The only exception here is that a lower useful life is allowed for used assets when the taxpayer demonstrates a lower expected life. Every asset category has to be depreciated on a straight-line basis. In the Netherlands there is more flexibility in choosing the depreciation method.

Assets, other than the ones mentioned in the previous subsection, have to be depreciated together in one asset pool at an annual rate of 25% of the depreciation base (Article 39). According to section 2, the acquisition, production or improvement costs are all included in the pool. The proceeds of the disposal of assets and any compensation received have to be deducted from the pool. This means that, when no new assets are bought in the upcoming years, the assets are depreciated in 4 years. Even when the effective life of an asset is 10 years, it can be depreciated in 4 years. This is quite remarkable as the assets discussed in the previous subsection all have a fixed life (with an exception for intangibles).

The biggest difference with the Dutch system of depreciation is that there is an asset pool. In the Netherlands every asset has to be depreciated individually to a certain point. Taking goods together is allowed when this complex of the same goods is used durably in the enterprise.\textsuperscript{206} The asset pool

\textsuperscript{206} Follows from HR 30 September 1959, BNB 1959/354. In this case, the taxpayer was allowed to take treat a stock of tires as a single asset.
could make depreciation less complex. Another difference with respect to the depreciation of buildings is that there is no fixed residual value in CCCTB. As we have seen, in the Netherlands this residual value has to be based on the WOZ-value of the building. However, the Dutch law does not contain a fixed useful life for buildings as is the case in article 36, section 1(a) of the proposal. Other assets can be depreciated in 4 years while the useful life for similar assets is at least 5 years in the Dutch system. Goodwill even has to be depreciated in at least 10 years. CCCTB does not contain a separate treatment of goodwill.

§ 5.11: Bad debt deductions

§ 5.11.1: The valuation of bad debt claims according to sound business practice

In the normal process of a company, products are sold and paid by buyers immediately or after some time. Sometimes some of these debtors have so many financial problems that it is not sure whether a payment ever will be received. Therefore, receivables have to be valued taking into account (potential) bad debt claims. Sound business practice allows a deduction of these possible bad debt claims. For the valuation of debtors two methods are allowed:

- An individual valuation of debtors: the weak debtors are evaluated individually and for every uncertain claim a cautious value is estimated.
- A general valuation of debtors: Assuming that a fixed percentage of the claims, based on business experience, will not be paid. This leads for example to a percentage of 5 which can be deducted from the nominal value of the debtors.

There are no real criteria for determining whether a claim is irrecoverable. It depends on the situation and the knowledge of the taxpayer. For example, a formal suspension of payments by a court can be a clear indication. With respect to the individual valuation method, a neglected impairment on a claim cannot be corrected in a next year. In that case, a possible loss can only be deducted in the year of the settlement of the claim. When using the general valuation method it is required that the percentage is really based on experience and research. A decrease in value is actually an accounting write-off; they are a correction entry on a too high book value.

207 L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.18.B.c
208 HR 18 December 1957, BNB 1958/64.
§ 5.11.2: A comparison to bad debt deductions according to CCCTB

A deduction for bad debt is possible under the CCCTB via article 27. As in sound business practice, section 1(a) prescribes two systems. An individual write-off (deduction) of debt is allowed at the end of the tax year when “the taxpayer has taken all reasonable steps to pursue payment and reasonably believes that the debt will not be satisfied wholly or partially”. Debt becomes bad when it matches the criteria of section 1. Section 2 states what should be taken into account to determine if “all reasonable steps to pursue payment” have been made. For example, is there any prospect of successful recovery? When the company has a lot of homogenous receivables it also allowed to estimate the amount of debt receivable on a percentage basis. Both systems seem to match the valuation methods in sound business practice. CCTB also requires a reference to relevant factors, including past business experiences.

The provisions in 1(b) to 1(d) include some formal aspects of the deduction facility. The debtor cannot be part of the same group as the taxpayer. This is logical in a consolidated tax base as these transactions are eliminated. If the taxpayer has used the exceptional depreciation method of article 41 to write-off the bad debt then letter (c) prevents another deduction possibility. The last condition is that the receivable should have been included in taxable revenue before. This last requirement conforms to the treatment of accounts receivable in sound business practice: they also need to be included in the taxable profit and activated on the balance sheet.

§ 5.12: Provisions

§ 5.12.1: Provisions according to sound business practice

It is possible that the present business activities can give rise to a future obligation or future costs.210 In certain circumstances it is allowed in sound business practice to form a provision for this future expenditure. The composing of a provision is a consequence of the realisation principle of sound business practice: expenses have to be attributed to the year they have come up by using a provision. Until the decision of 26th of August 1998, the Supreme Court demanded an existing legal relationship on the balance sheet to which the probable future expenditures could be attributed.211 Only if this requirement was satisfied, a provision was allowed. In this landmark decision of August 1998, the Supreme Court changed its mind and eased this requirement of a legal relationship. The Court stated that sticking to this requirement would result in unsatisfactory results as the probable future costs do have its origin in earlier years but no legal relationship exists yet. Therefore, the Court formulated three new requirements:

210 L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.25.A.d2.1
- The future expenses have their origin in the facts and circumstances before the balance sheet date: the origin requirement.
- The future expenses can be attributed to this period: the sound business practice requirement.
- There is a reasonable assurance the costs will actually be incurred.\(^{212}\)

Next to these requirements, the Supreme Court also introduced the possibility to catch up previously not executed allocations to the provision.

§ 5.12.2: A comparison with provisions according to CCCTB

A provision can also be formed in CCCTB via article 25. The requirements are set out in section 1 of this article. A taxpayer needs to have a legal obligation or a probable future legal obligation at the end of the tax year. This obligation should be the result from activities or transactions carried out in the current or previous tax years. It should be possible to reliably estimate the amount of the obligation. As a last requirement, the actual expense should be deductible otherwise a provision is redundant. When comparing these requirements to the requirements of sound business practice, it follows that there is one important difference: instead of a legal obligation or probable future legal obligation, sound business practice only requires reasonable assurance the costs will actually be incurred. Forming a provision in CCCTB will therefore be more difficult than in the Dutch tax system.

The Proposal also requires the future expenses have their origin in the facts and circumstances before the balance sheet date. By the addition of “or previous tax years”, it might include a catch up possibility like in the Netherlands.

The other paragraphs of section 1 provide some more formal details concerning provisions. Where the obligation relates to activities or transactions which will continue in future years, the deduction should be spread proportionally over the estimated duration of the activity or transaction, also taking into account the revenues derived there from. Although not explicitly stated by the Supreme Court, this will also hold in the Netherlands because of the sound business practice requirement of a provision. The last paragraph states that amounts deducted have to reviewed and adjusted at the end of every tax year. In future years, previous deductions should be taken into account as well. Section 2 describes the definition and characteristics of a reliable estimate. It can be concluded that forming a provision is almost the same in both systems. CCCTB does seem to contain more rules.

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\(^{212}\) In the opinion of the secretary of finance, the chance the costs will occur has to be bigger than the chance the costs will not occur: Decree of 6\(^{th}\) of August 2010, nr. DGB2010/3706M.
§ 5.13: Pension obligations

§ 5.13.1: Pension obligations according to sound business practice

Often employees of a company are granted pension rights as a secondary employment condition. These rights are treated for tax manners as a deferred payment of wages. Sound business practice requires the costs to cover the pension obligation to be attributed to every year of employment.\footnote{L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.21.A.a} For example, an employee of the company has an age of 25. One of his secondary employment conditions is that he will receive a retirement pension at the age of 65. After 40 years the obligation should be enough to be able to provide the retired employee the agreed pension. These costs are business costs and deductible. However, only the reasonable business part of these costs is deductible. A pension scheme is reasonable when it can be classified as a fiscal approved scheme.\footnote{These schemes are defined in article 18 and onwards of the Wage Tax Act.} Pensions are facilitated in the Dutch tax system. The premiums paid by employers are deductible from their taxable wage but only for the part the pension scheme is a fiscal approved scheme. The excess part of the costs is not deductible for employees and immediately taxed. For the company this does not automatically imply that the costs are not deductible from the taxable profit. As long as the expenses can be qualified as business expenses, there is not a problem in the CIT Act. But it is also possible that it is a disguised profit distribution to a shareholder.

As we have seen, the shareholder relationship has to be eliminated in the total profit concept. For example, the majority shareholder and at the same time director of the company is able to determine the height of his pension. A reasonable pension would be €50,000 but he decides to grant himself a pension of €70,000. Since he is the shareholder and the director, it is logical to conclude that both the shareholder and company are aware of the received advantage. Therefore, the €20,000 is treated as a profit distribution and according to article 10 CIT this distribution is not deductible from the taxable profit. The pension schemes for normal employees have to be placed at an independent legal entity of the company\footnote{This is a so-called "Pension" entity: the only goal of the entity is to pay out pensions to retired employees.} or a pension insurance company.\footnote{This requirement follows from article 24 of the Pension Act.} A pension granted to a shareholder with at least 10% of the shares may also be serviced by the company itself.

According to article 3.29, actuarial techniques have to be used in order to estimate the value of the pension obligation. A minimum rate of 4% is required to discount the obligation. Special attention should be given to the “back service”. Now, the 25 year old of the previous example does not immediately receive the pension straight away but after 10 years. The pension, however, looks at the whole service time of the employee, including the 10 years before the right was granted. Therefore, at the moment the pension is granted a back service can be recognized by the company to cover service time before the granting. Another possibility to cover the costs is by reserving an increased premium:

\footnote{L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.21.A.a}
the normal premium plus an additional amount to cover the previous 10 service years. These catch-up provisions have to be discounted at a market interest (but at least a percentage of 4% according to 3.28 PITA). A back service also arises in the case of a wage increase.

§ 5.13.2: Pension obligations according to CCCTB

In the case of a pension obligation, according to article 26: “actuarial techniques shall be used in order to make a reliable estimate of the amount of benefits that employees have earned in return for their service in the current and prior period”. Just like in the Netherlands, it seems that the costs of the pension rights have to be attributed to the years of service of an employee. Although there are no specific provisions for it, a back service also seems to be possible because of the addition of “prior periods”. This provision has to be discounted using the Euribor interest rate for obligations with a maturity of 12 months. This interest percentage might be unrealistic as the Euribor interest rate is not a real market interest. However, this makes sure that the value of the pension liability is not underestimated on the balance sheet. In the Dutch law, a minimum percentage of 4% is required. In current economic times, it might be difficult to earn a return of 4% on investments. A minimum percentage then underestimates the liability. CCCTB and the Dutch system differ from each other with respect to the interest percentage.

§ 5.14: Rollover relief for replacement assets.

§ 5.14.1: The reinvestment reserve in the Netherlands

A taxpayer in the Netherlands is allowed to reserve the capital gain, the proceeds minus the book value, on an asset in a special reserve called the reinvestment reserve. According to the Supreme Court, the proceeds are the benefits received minus the costs of sale.217 The reserve can only be formed when the taxpayer has the intention to reinvest in new assets.218 This facility is regulated in article 3.54 PITA. For the application of the facility the law makes a distinction between two categories of assets. The first category is the assets with a maximum depreciation time of 10 years (can also be called non-durable assets219). The second category is the assets with a maximum depreciation time of more than 10 years and the assets that will not be depreciated. The taxpayer, therefore, needs to take notice of the composition of the reserve: as the two categories have to be separated. Next to this separation the law also sets out some additional rules to follow.

218 L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.25.C.a2.I.
219 L.W. Sillevis and M.L.M. van Kempen, 2011, paragraph 3.2.25.C.a2.I.
A reinvestment reserve based on the sale of a non-durable asset has to be used for the purchase of another non-durable asset. The new asset does not need to have the same economic function of the asset sold. In the case of durable assets, the same economic function is a strict requirement following from art. 3.54, section 3. Therefore, the reserve that is the result of a capital gain on non-durable assets cannot be used to invest in a durable asset. The legislator wanted to prevent the shift of a short-time hidden reserve to an asset with a long-time hidden reserve. The book value of a newly acquired asset is decreased with the amount of the reserve, but this book value cannot be lower than the book value of the asset sold. The reserve will be included in the profit after three years if it has not been used to reinvest (art. 3.54, section 5). This section provides two escape possibilities: if the nature of the asset to be acquired is such that it requires a longer period (for example, the construction of a building might need a longer period) or special circumstances justify a longer period. It is also possible that the taxpayer buys the new asset first before it sells the old asset. In the case of non-durable assets, it is allowed to form a reserve if this happens in the same tax year.

For durable assets a purchase in the previous tax year is allowed (art. 3.54, section 11).

Using an example, it will be easier to explain the functioning of the reserve. On 01-02-2012 a company sells a machine (non-durable asset) with a book value of €100.000 to an independent third party for a price of €150.000. In first instance, a taxable profit of €50.000 has to be recognized. However, the company has the intention to reinvest and is thus allowed to store the €50.000 in a reserve. On 01-03-2013 a new machine is bought with a purchase price of €120.000. €20.000 of the reinvestment reserve can be used to lower the book value of the newly acquired machine. The book value requirement does not allow a larger deduction. The other part of the reserve can be used until 01-02-2015 (the three year period). This reduced fiscal book value leads to a lower fiscal depreciation. The result is more profit in the upcoming years. Therefore the capital gain is not taxed immediately but spread out over the years.

§ 5.14.2: A comparison with the rollover relief for replacement assets in CCCTB

The Proposal contains a facility that is similar to the reinvestment reserve in the Netherlands. Article 38 contains the rollover relief for replacement assets. The facility does not make a distinction between categories of assets but it is only available for individually depreciable assets. The proceeds from the disposal of an asset have to be to be re-invested before the end of the second tax year after the tax year in which the disposal took place (ar. 38, section 1, paragraph 1). This period is shorter than the three years which are allowed in the Dutch tax law. If the replacement asset is not purchased before the end of the second year after the year of disposal, the deducted amount is increased by 10%
and added back to the profit. This appears to be a sanction for not investing in time. The newly acquired asset has to be “used for the same or a similar purpose”. It is not really clear what this means and it could lead to a lot of case law.\textsuperscript{223} As we have seen, in the Netherlands, this requirement only holds for durable assets. CCCTB does not contain a book value requirement so that the book value of the newly acquired asset can drop below the book value of the asset sold. This makes application of the facility easier compared to the reinvestment reserve. Deduction of the proceeds leads to a lower depreciation base of the asset. An asset which is disposed of voluntarily must have been owned for a minimum period of three years according to the last paragraph of section 1. It is not really clear why they have added this requirement: there might a fear of abuse. Section 2 states that the replacement asset may be purchased in the tax year prior to the disposal. This is also allowed using the reinvestment reserve in the Netherlands.

This chapter has compared the Dutch calculation of the tax base to the proposed system of CCCTB. Although many parts of the tax bases are similar, a number of significant differences can be observed. In practice, this could lead to quite deviating profit figures. The last chapter will summarize the paper.

\textsuperscript{223} P.H.J. Essers, 2011, paragraph 3.3.3.2.
Chapter 6: Legal comparison between the EUCOTAX countries

In this chapter, the results of the legal comparison of the EUCOTAX Wintercourse 2012 conference in Łódź, Poland will be discussed. The participating countries in the workshop concerning the calculation of the tax base were: Austria, Belgium, France, Germany, Hungary, Italy, the Netherlands, Poland, Sweden and the United States. First of all, we will look at the relationship between commercial and tax accounting in these countries. This includes the influence of IFRS on tax accounting. After that, we will look at the characteristics of the tax accounting rules in the different countries: are they rule-based or principle-based? This is followed by a comparison with CCCTB and the Member States opinion on this Proposal. We will conclude by comparing specific topics of the calculation of the tax base between the EUCOTAX countries, including CCCTB.

§ 6.1: The relationship between tax accounting and commercial accounting

<table>
<thead>
<tr>
<th>Countries</th>
<th>Relationship between commercial and tax accounting</th>
<th>The level of correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>Belgium</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>France</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>Germany</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>Hungary</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>Italy</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>Netherlands</td>
<td>No</td>
<td>No formal legal relationship between commercial and tax accounting</td>
</tr>
<tr>
<td>Poland</td>
<td>No</td>
<td>No formal legal relationship between commercial and tax accounting</td>
</tr>
<tr>
<td>Sweden</td>
<td>Yes</td>
<td>Taxation is based on commercial accounting result</td>
</tr>
<tr>
<td>USA</td>
<td>No</td>
<td>No formal legal relationship between commercial and tax accounting</td>
</tr>
</tbody>
</table>

Table 2: The relationship between tax and commercial accounting

The relationship between tax accounting and commercial accounting is very different among countries. In most EUCOTAX countries the tax return is based on the result of the commercial account. However, adjustments are made on the commercial result to make the financial statements suitable for tax purposes. The Netherlands, Poland and USA are the only EUCOTAX countries that do not have a formal legal relationship between the commercial and tax accounting. These three countries can be characterized as having an independent system, but it can be said that both commercial and tax accounting are based on business economics in these instances.
In chapter 3 we have seen that the most important reason for this independency in the Netherlands were the differences between the objectives of commercial and tax accounting.

Poland has the following model: the rules for determining the financial gain in accounting are not accepted by the tax law which independently defines rules for determining income. So the rules for determining the tax income, in Poland, are determined only by the Corporate Income Tax and an application of the Accounting Act is only possible when the reference to them can be found. According to this the taxpayers will determine their tax income following two Acts, the Corporate Income Tax and Tax Act.

The USA handles this with two different systems, Tax accounting and U.S. GAAP. Tax accounting is a distinct system from financial accounting. With Tax accounting, the taxpayer is allowed a choice between using the accrual method of accounting or the cash method of accounting, with some restrictions. In contrast, the financial accounting rules require reporting entities to report based on the accrual method of accounting, specifically the U.S. GAAP accrual method. Tax accounting allows for any method of accounting to be employed by the taxpayer as long as it clearly reflects income and is used consistently. However, the mere fact that a taxpayer uses a method that is in accordance with U.S. GAAP is not sufficient to deem automatic compliance with the tax accounting standard of clear reflection of income. The most important reason why the two systems operate independently in the U.S. is the difference in reporting objectives of commercial and tax accounting.

All the other countries can be classified as having a dependent system. A few examples: In Austria there are different laws relevant for the calculation of the tax base. The most important are, besides the two income tax laws CITA and PITA, the accounting rules, summarized in the Commercial Code (hereinafter CC). The legal link for the application of the CC is provided for in sec. 7(3) CITA, which stipulates that the eligible companies regularly calculate their profit in compliance with the regulations of sec. 5 PITA. So, because of the legal connection and the adjustments there is a strong connection between the tax and commercial accounting in Austria.

The general principle of taxation in Belgium is that unless the tax law explicitly deviates, the fiscal result and accounting result are the same. So, the basis of the taxable profit is the result of the annual account.

France also has a dependent system. According to the Article 38 quarter of the Annex III of the French General Tax Code “the undertakings shall respect the definitions of the French Accounting Code, provided they comply with the rules governing the tax base”. So, for France the relationship between tax and commercial account comes from the legislation and not from an act or a regulation. More generally it can be said that French national tax law tends to converge to national commercial accounting standards.

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The German tax law has no basis for the preparation of a tax balance sheet. So the German tax law uses the commercial balance sheet for the determination of the tax base. This is a simplification for the commercial trader, so the commercial trader does not have to determine his profit twice. So generally the determined profit by the commercial balance sheet is the same profit for the tax balance sheet. However, a lot of regulations in the tax law prevent use of commercial balance sheet items without an adjustment.

We can conclude that the majority of EUCOTAX countries have a formal legal relationship between commercial and tax accounting. A logical follow-up question is then: How did the introduction of IFRS influence this relationship? The introduction of IFRS in the EU has achieved a harmonisation of account standards for listed companies. Because of the dependency, IFRS might have become relevant for tax purposes as well. This will be investigated in the next section.

§ 6.2: The relevance of IFRS on individual commercial accounts and tax accounting

In this section, we will look at the relevance of IFRS on individual commercial accounts and the relevance for tax accounting. We can conclude from the previous section that the majority of EUCOTAX countries have a formal legal relationship between commercial and tax accounting. How did the introduction of IFRS influence this relationship? For example: is IFRS now also relevant for tax accounting?

<table>
<thead>
<tr>
<th>Countries</th>
<th>IFRS for individual commercial accounts</th>
<th>IFRS relevant for tax accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Belgium</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>France</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Germany</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Hungary</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Italy</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Poland</td>
<td>Yes/No</td>
<td>No</td>
</tr>
<tr>
<td>Sweden</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>USA</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

Table 3: Relevance of IFRS
As shown in the previous chapter, most of EUCOTAX countries deeply link commercial and tax accounting\textsuperscript{226} (From now on, this link will be called “rule of dependency”). In these countries, the individual commercial accounts are usually used as starting point for the calculation of the tax base. Therefore, it is not surprising to see that most countries do not allow the use of IFRS in the individual commercial accounts of companies to prevent the tax relevance of IFRS. The majority of countries observe that IFRS are not fit for individual accounts because the use of fair value could lead to the record of unrealised profits and as a result of the link between tax and commercial accounting, the unrealised gains could be taxed.

From a commercial point of view, in Sweden the use of IFRS is limited to listed companies, but unlisted companies (mostly small ones) can use a part of Sweden GAAP for individual accounts, which is similar to IFRS system. In Poland, the use of IFRS for annual accounts is either mandatory, elective, or forbidden: depending on the type of the company. Only in Italy and Netherlands the use of IFRS is very widespread, since all companies (except small companies in the Italian case) are allowed to use IFRS for individual financial statements.

Only Italy\textsuperscript{227} and Sweden take into account IFRS when calculating the tax base. However both countries make corrections for the fair value valuation that is part of IFRS. Unrealized gains in both countries are not taken into consideration for tax purposes, even if it is used in accounting for commercial aims.

All other countries have avoided IFRS having impact on the calculation of taxable income. Poland and the Netherlands allow the use of IFRS in the commercial statements, but they do not establish the link between the tax base and the commercial accounting. It means that IFRS have no tax relevance just because the link between tax and commercial accounting is very weak. In the case of U.S., the link between commercial and financial statements is weak, so the future introduction of IFRS could be tax irrelevant. But overall it can be concluded that US GAAP and IFRS are very compatible so that no major differences are expected.

To sum up, most EUCOTAX countries establish that calculation of taxable base must be based on commercial income. Conversely, the use of IFRS for individual accounts is not very widespread among EUCOTAX countries, and it means that harmonization in matter of accounting rules is at its starting point.

§ 6.3: The comparison between the domestic systems and CCCTB

\textsuperscript{226} For a wider analysis, see M. lang, J. Schuh, P. Pistone and C. Staringer, “Common Consolidated Corporate Tax Base”, Linde: 2008

Since the accounting harmonisation is not complete yet, it is currently impossible to think about a calculation of the common European tax base starting from the result of the commercial income statement, since they are not ruled by common principles and criteria. As a consequence, the impact of CCCTB on the tax and accounting system of the EUCOTAX countries could be relevant. The results are shown in table 4.

<table>
<thead>
<tr>
<th>Country</th>
<th>Rule/principle based</th>
<th>Comparison with CCCTB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Rule-based</td>
<td>It is more flexible. More favourable to taxpayers</td>
</tr>
<tr>
<td>Belgium</td>
<td>Rule-based</td>
<td>It is more flexible. More favourable to taxpayers</td>
</tr>
<tr>
<td>France</td>
<td>Rule-based</td>
<td>It is more flexible. Advantages and disadvantages to taxpayers</td>
</tr>
<tr>
<td>Germany</td>
<td>Rule-based</td>
<td>It is more flexible. More favourable to taxpayers</td>
</tr>
<tr>
<td>Hungary</td>
<td>Rule-based</td>
<td>It is as flexible and favourable as the domestic system</td>
</tr>
<tr>
<td>Italy</td>
<td>Rule-based</td>
<td>It is more flexible. More favourable to taxpayers</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Mainly principle-based</td>
<td>It is more detailed. Less in favour to economic operators</td>
</tr>
<tr>
<td>Poland</td>
<td>Rule-based</td>
<td>It is more flexible. More favourable to taxpayers</td>
</tr>
<tr>
<td>Sweden</td>
<td>Principle/rule-based</td>
<td>It is more flexible. More favourable to taxpayers</td>
</tr>
<tr>
<td>USA</td>
<td>Rule-based</td>
<td>It is very similar to the domestic system</td>
</tr>
</tbody>
</table>

Table 4: Characteristics of the tax systems

From the perspective of many EUCOTAX countries, the CCCTB Proposal contains a tax base that is principle-based. This means that the CCCTB proposal is not very detailed in determining the elements of the tax base, providing for general provisions rather than for precise norms. This could be caused because many of the EUCOTAX countries have a rule-based system at the moment, meaning that they establish precise tax rules, in order to avoid any margins of discretion to taxpayers for the calculation of the tax base. A possible explanation could be that these systems are based on commercial accounting rules which are quite extensive. However, the US system is still rule-based while there is no direct link between commercial and tax accounting. The only exception among EUCOTAX countries is the Netherlands, whose system is mainly principle-based. Since there are not so many rules that determine the tax base, the taxpayer still have wide margins of discretion to make choices at what time an income item will be taken into consideration. As an example, the Dutch taxpayer has many options to value its inventory so the introduction of the CCCTB would limit his wide possibility of choice.

The Netherlands is the only EUCOTAX case in which the CCCTB is considered more detailed than the domestic rules. In France and Hungary, the advantages for the taxpayer opting for the CCCTB
are balanced by any contras, even if the CCCTB system is more detailed. In Sweden, the domestic tax base is based on principles and rules at the same time, but the system is still more detailed than the CCCTB one. In the USA, it has no sense talking about the differences between the domestic system and the CCCTB one, since they are very similar. For all other countries, CCCTB is much less detailed than domestic systems. As a result, this would greatly reduce the compliance costs of taxpayers. But also in general, the CCCTB seems more favourable to taxpayers than domestic tax systems.

§ 6.4: The countries views about CCCTB

Even if the taxpayers would prefer the introduction of CCCTB the Member States have their own reasons to be pro or contra in regard to its introduction. In most cases, the reason is political, and relate to the formula for apportionment. With respect to the calculation of the tax base, the CCCTB would take away power of the local parliaments to determine the tax base, which is an expression of the State sovereignty.

<table>
<thead>
<tr>
<th>Country</th>
<th>Opinion on CCCTB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Indifferent</td>
</tr>
<tr>
<td>Belgium</td>
<td>Favour</td>
</tr>
<tr>
<td>France</td>
<td>Favour</td>
</tr>
<tr>
<td>Germany</td>
<td>Not in favour</td>
</tr>
<tr>
<td>Hungary</td>
<td>Not in favour</td>
</tr>
<tr>
<td>Italy</td>
<td>Favour</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Not in favour</td>
</tr>
<tr>
<td>Poland</td>
<td>Not in favour</td>
</tr>
<tr>
<td>Sweden</td>
<td>Indifferent</td>
</tr>
<tr>
<td>USA</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

Table 5: Opinion on CCCTB

When taken into account the position of the EUCOTAX countries regarding the CCCTB, four groups can be distinguished. Since the USA is not a part of Europe, the CCCTB is not applicable. Austria and Sweden are the only countries that are indifferent about the proposal of the European Commission about the CCCTB. Another group consists of the EUCOTAX countries that are in favour of the CCCTB, namely Belgium, France and Italy. Lastly, there is the group of EUCOTAX countries that do not agree with the current proposal. These countries are Germany, Hungary, the Netherlands and Poland.
The differences between domestic tax systems and the CCCTB system are several. Therefore, the next sections will investigate some of these differences by looking at the specific treatment of certain items.

§ 6.5: The differences between domestic tax systems and CCCTB

§ 6.5.1: Tangible assets; the treatment of a building

In this section, we will compare the treatment of tangible assets in the EUCOTAX countries. More specifically, we are looking at the treatment of buildings because in a lot of countries, different rules are in place for different assets. The proposal for a CCCTB will also be included in the comparison. The results are displayed in table 6 and 7.

In most countries, the economic owner is allowed to depreciate the building. However, in Italy and Poland, only the legal owner is allowed to depreciate the building. Just like in the majority of EUCOTAX countries, in CCCTB, the economic owner is also allowed to depreciate the building.

In all the EUCOTAX countries the depreciation base is defined as all construction or acquisition costs. Only in Hungary is there no definition of depreciation base. But the depreciation base is usually calculated in the same way as in the other countries. The cost (original or production cost) of tangible assets less the residual value estimated for the end of the useful life of the asset shall be distributed over the number of years in which such assets are expected to be used.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Who is entitled to depreciate the building?</th>
<th>Depreciation base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>Belgium</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>France</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>Germany</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>Hungary</td>
<td>Economic owner</td>
<td>No legal definition</td>
</tr>
<tr>
<td>Italy</td>
<td>Legal owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>Poland</td>
<td>Legal owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>Sweden</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>USA</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
<tr>
<td>CCCTB</td>
<td>Economic owner</td>
<td>All production or acquisition costs</td>
</tr>
</tbody>
</table>

Table 6: Depreciation of a building
Now we can look at the actual depreciation rates of buildings in the EUCOTAX countries. In the table 7, the results of this comparison are shown. We can observe that currently there are a lot of different rules concerning the depreciation rate of a building. A number of countries use the useful life of a building such as Belgium and the Netherlands. However, with regard to the depreciation system the Netherlands make a distinction between buildings in own use and buildings that are rented out for investment purposes (see § 5.10.1). Other countries require different rates for different types of buildings, for example Austria and France. Only the USA and CCCTB provide for a constant depreciation rate.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Depreciation rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Different depreciation rates depend on type of building</td>
</tr>
<tr>
<td>Belgium</td>
<td>Useful-life of building</td>
</tr>
<tr>
<td>France</td>
<td>Different depreciation rates depend on type of building</td>
</tr>
<tr>
<td>Germany</td>
<td>Different depreciation rates depend on construction and usage of building</td>
</tr>
<tr>
<td>Hungary</td>
<td>Different depreciation rates depend on usage of building</td>
</tr>
<tr>
<td>Italy</td>
<td>Different depreciation rates depend on type of building</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Useful life, maximum depreciation amount depends on the use of the building</td>
</tr>
<tr>
<td>Poland</td>
<td>Different depreciation rates depend on type of building</td>
</tr>
<tr>
<td>Sweden</td>
<td>Different depreciation rates depend on type of building</td>
</tr>
<tr>
<td>USA</td>
<td>Constant rate for all buildings</td>
</tr>
<tr>
<td>CCCTB</td>
<td>Constant rate for all buildings</td>
</tr>
</tbody>
</table>

Table 7: Depreciation rates

It can be concluded that the overall treatment of a building for tax purposes is not that different among the EUCOTAX countries. Only with respect to the actual depreciation rate, real differences can be observed. The CCCTB Proposal provides a constant rate for all buildings. Although this option does not take into account the true economic life of a building, it does provide simplicity and does not require an estimate for the useful life of a building.

§ 6.5.2: Intangible assets

This section deals with the treatment of intangible assets with a special focus on the treatment of costs incurred for the purpose of research and development. Intangible assets offer a major sustainable competitive advantage for enterprises. Intangible assets are defined as identifiable non-monetary assets that cannot be seen, touched or physically measured, which are created through time and/or effort and that are identifiable as a separate asset. All EUCOTAX countries recognize the
existence of intangible assets in a similar way. The following tables will look at the treatment of intangible assets in the different countries.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Self-made intangible assets</th>
<th>Acquired intangible assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Immediate deduction</td>
<td>Amortization</td>
</tr>
<tr>
<td>Belgium</td>
<td>Immediate deduction</td>
<td>Amortization</td>
</tr>
<tr>
<td>France</td>
<td>Amortization</td>
<td>Amortization</td>
</tr>
<tr>
<td>Germany</td>
<td>Immediate deduction</td>
<td>Amortization</td>
</tr>
<tr>
<td>Hungary</td>
<td>Amortization</td>
<td>Amortization</td>
</tr>
<tr>
<td>Italy</td>
<td>Amortization</td>
<td>Amortization</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Immediate deduction</td>
<td>Amortization</td>
</tr>
<tr>
<td>Poland</td>
<td>Amortization</td>
<td>Amortization</td>
</tr>
<tr>
<td>Sweden</td>
<td>Immediate deduction or amortization</td>
<td>Amortization</td>
</tr>
<tr>
<td>USA</td>
<td>Amortization</td>
<td>Amortization</td>
</tr>
<tr>
<td>CCCTB</td>
<td>Immediate deduction</td>
<td>Amortization</td>
</tr>
</tbody>
</table>

Table 9: Intangible assets

For the treatment of self-made intangible assets two groups of countries can be distinguished as it is shown in table 9. On the one hand, the national tax systems in Austria, Germany and The Netherlands do not require the mandatory capitalization of costs incurred for self-made intangible assets, whereas the costs of acquired intangible assets have to be capitalized and amortized over the subsequent years. On the other hand, Belgium, France, Italy, Poland, Sweden and USA provide the option to either capitalize the acquisition or production costs or to immediately deduct them in the year of acquisition or production.

Under the CCCTB regime intangible assets have to be capable of being valued independently and have to have a useful life of more than 12 months. As intangible assets have to be acquired for value, self-made intangible assets are excluded from capitalisation and the related expenses can be deducted immediately. For intangible assets the useful life is determined by the period for which the asset enjoys legal protection or for which the right is granted or, if that period cannot be determined, 15 years.

Some countries provide for an amortization period in their income tax laws. The following table shows the applied amortization rates for acquired intangible assets and for self-made intangible assets, if the production costs do not have to be immediately deducted in the corresponding tax year.
From table 10, it can be observed that there are a lot of differences between the EUCOTAX countries. Four countries use the useful life of an intangible asset to determine the depreciation rate while others set a specific minimum lifetime. CCCTB uses the period of legal protection or when this period cannot be determined, 15 years. Again it seems that CCCTB uses an easy to determine depreciation rate so that estimates are not necessary.

§ 6.5.3: Treatment of losses

§ 6.5.3.1: Carry-back and carry-forward schemes

In this section of the chapter we will first look at how the EUCOTAX countries regulate the treatment of losses, including the treatment of non-definite losses of foreign permanent establishments. Among the studied countries, the carry-forward of the losses is a common general admitted principle. However, the conditions of the deduction of these losses differ. In addition, only some countries provide the possibility to carry the losses back. The table below provides a brief overview of these schemes:

<table>
<thead>
<tr>
<th>Countries</th>
<th>Amortization period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Useful life</td>
</tr>
<tr>
<td>Belgium</td>
<td>Useful life</td>
</tr>
<tr>
<td>France</td>
<td>5 years or more</td>
</tr>
<tr>
<td>Germany</td>
<td>Useful life</td>
</tr>
<tr>
<td>Hungary</td>
<td>Useful life</td>
</tr>
<tr>
<td>Italy</td>
<td>2 years or more depending the kind of asset</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>5 years or more</td>
</tr>
<tr>
<td>Poland</td>
<td>2 years or more</td>
</tr>
<tr>
<td>Sweden</td>
<td>Useful life or 5 years</td>
</tr>
<tr>
<td>USA</td>
<td>5 years</td>
</tr>
<tr>
<td>CCCTB</td>
<td>Period of legal protection else 15 years</td>
</tr>
</tbody>
</table>

Table 10: Amortization period
Four of the countries studied allow loss carry back; the other six countries do not. The four countries that allow carry back are Germany, France, the Netherlands and the USA. This right does, however, come with different limitations in these countries. For starters, in Germany, France and the Netherlands the right to loss carry back is limited to one year and in the USA the time limit is two years. In addition, Germany and France also have limitation regarding the amounts. Germany allow loss carry back up to the amount of $511,500\,€$ and France $1,000,000\,€$ increased by 60% of the annual taxable income (of the part that exceeds $1,000,000\,€$).

As mentioned above the Directive Proposal does not allow any loss carry back. As a consequence the Directive Proposal is less favourable than the regulation in four of the studied countries’ legislation. Carry-back of losses leads to an immediate liquidity advantage because a taxpayer will get a tax return. In a loss situation this can help a company to survive difficult economic times. Regarding the other six countries the enactment of the Directive would not lead to any change in this part.
All of the studied countries allow some sort of loss carry forward. Austria, Belgium, Germany, Hungary, France and Sweden have a right to loss carry forward that is unlimited in time. The other companies limit the right to carry forward losses in time. The time limitation differs from country to country. In Poland the time limit is five years, in Italy it is three years, in the USA it is twenty years and in the Netherlands it is nine years. In addition, some countries limit the right in terms of the amount. The amount limitation applies in Austria, France, Germany, Hungary, Poland and Italy. In Austria the taxpayer is not allowed to deduct more than 75% of the tax base, for example; if there are losses amounting to 200 in year 1 and profit amounting 100 in year 2, only 75 can be deducted in year 2 and the rest, i.e. 125 is carried forward to year 3. The same thing applies in Italy and Hungary but the limits are 80% and 50%. Germany, France and Poland have limits that are a bit more complicated.

The Proposal for a CCCTB offers an unlimited carry forward of losses, both regarding time and amount. Therefore, the enactment of the Directive Proposal would mean a more favourable treatment of carry forward than many of the studied countries.

§ 6.5.3.2: Treatment of losses of Permanent Establishments

In general the EUCOATAX countries apply two systems. In the first system the losses of a foreign permanent establishment are consolidated with the results of the head office and the profit is exempt in order to avoid double taxation. In the second system the result of the permanent establishment is tax exempt and does not affect the overall tax result of the company to which the permanent establishment belongs to.
<table>
<thead>
<tr>
<th>Countries</th>
<th>Deduction of P.Es losses allowed</th>
<th>Deduction of P.E losses not allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Germany</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Hungary</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Italy</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>The Netherlands</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Poland</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>CCCTB</td>
<td>x</td>
<td></td>
</tr>
</tbody>
</table>

Table 12: Treatment of cross-border P.Es’ losses.

As illustrated in the table, there is no a generally accepted scheme for the treatment of P.E. losses among the studied countries. In fact, two groups of countries need to be distinguished.

First, some countries recognize the income of permanent establishments as a part of the parent company to which they belong to, wherever the P.E’s are located. This is the case for Austria, Belgium, Germany, Sweden, Poland and the USA. Consequently, the losses of a foreign permanent establishment are deductible from the income in the country of the company they belong to.

On the other hand, in the other countries the tax system is based on the general principle of territoriality. According to this principle, only the entities located in a country are recognized as resident from this country for tax purposes and so are subject to corporation tax. In this case, the losses (and the income) of the foreign permanent establishments shall not offset the profits of the parent company to which they are related to. These countries are: France, Hungary and the Netherlands.

According to the Article 43 of the Proposal, the cross-border deduction of P.Es’ losses is allowed. For companies located in countries that do not take into account the losses of P.Es at the moment it would be more favourable to choose for the application of the CCCTB.
§ 6.5.4: Gifts and donations

In this last section, the treatment of gifts and donations in the EUCOTAX countries are discussed. A country could allow the deduction of gifts from the taxable base to stimulate donations made to charitable bodies. This is necessary because these payments usually cannot be considered business costs so they would not be deductible without a provision.

Is it a common thing to allow the deduction of gifts made to a charity or are there big differences between the countries? In the next table the results of the comparison are included. It shows whether a gift is stimulated or not by providing a deduction and also shows the limit of this deduction.

<table>
<thead>
<tr>
<th>Country</th>
<th>Amount of deduction</th>
<th>Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Not exceed 10% of the previous year’s profit</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>10% of net income</td>
<td>-</td>
</tr>
<tr>
<td>France</td>
<td>60% of the gift</td>
<td>Limit of 0.5% of the entity’s turnover</td>
</tr>
<tr>
<td>Germany</td>
<td>20% of current net income or 0.4% of the sum of turnover plus employees benefits</td>
<td>-</td>
</tr>
<tr>
<td>Hungary</td>
<td>20% of the value of the gift, 50% for Hungarian Fund for Clean-up and Salvage</td>
<td>Maximum deduction limited to pre-tax profit</td>
</tr>
<tr>
<td>Italy</td>
<td>2% of current taxable income, or 5% of current revenues if CCCTB used</td>
<td>-</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>50% of the taxable profit</td>
<td>Maximum of EUR100,000 per year</td>
</tr>
<tr>
<td>Poland</td>
<td>10% of net income</td>
<td>No limit for donations made to Catholic charitable organizations</td>
</tr>
<tr>
<td>Sweden</td>
<td>No deduction</td>
<td>-</td>
</tr>
<tr>
<td>USA</td>
<td>Full deduction</td>
<td>The amount of the current year’s taxable income</td>
</tr>
<tr>
<td>CCCTB</td>
<td>0.5% of revenues</td>
<td>-</td>
</tr>
</tbody>
</table>

Table 13: Gift deductions

Table 13 shows that every country, except for Sweden, allows a deduction of gifts and donations to charitable bodies. Sweden did not want to allow a deduction for foreign charitable bodies so that they do not allow a deduction at all. The size of the facility differs greatly between the
countries: the USA allow full deduction of the gift up to the amount of the current year’s taxable income while Austria only allows a deduction of 10% of previous year’s profit. CCCTB also provides for a deduction of gifts but the amount is related to the revenues. This could be more favourable to taxpayers that have high revenues but only minor profits: they will be able to deduct more.

§ 6.6: The Dutch tax system compared to the EUCOTAX countries

The Netherlands does not have a real formal legal link between commercial and tax accounting. The majority of EUCOTAX countries do have a legal link in their tax system. The Netherlands are liberal about the use of IFRS for individual accounts. In the majority of countries, the use of IFRS is prohibited. The reason behind this is that otherwise IFRS would become tax relevant in those countries. Only in Italy and Sweden, IFRS is currently used for tax purposes.

Compared to the other EUCOTAX countries, the Netherlands have a tax system that lacks extensive rules for the calculation of the taxable profit. The other EUCOTAX countries all use a (mostly) rule-based system. While in the Netherlands CCCTB is referred to as a rule-based system, from the perspective of the other countries, it is considered to be a principle-based system. For these countries this would mean that the flexibility of the tax system increases. For the Netherlands it is the other way around: the flexibility would decrease because the concept of sound business practice allows a greater flexibility in the calculation of the taxable profit.

Nine EUCOTAX countries are also part of the EU. Of these countries, only two have expressed a positive opinion on the current proposal for a CCCTB. While the Netherlands encourages the development of a CCCTB, it cannot accept the current proposal because it will lose a great part of its revenue.

In the second part of this chapter we have investigated the differences between the domestic tax systems, including CCCTB. It can be concluded that there are a lot of differences between the tax systems at the moment. However, general concepts are usually quite similar. For example, in the majority of countries, only the economic owner is allowed to depreciate a building, an acquired intangible asset has to be amortized in every country and loss carry-forward is possible in all countries. Major differences occur with respect to the instrumental use of the tax systems. For example, the depreciation rate of a building differs a lot between the countries. It could be that governments might want to influence the behaviour of taxpayers. This could be achieved by prescribing certain depreciation rates base on the type of building or providing an additional deduction of R&D costs like the Netherlands does. CCCTB would limit the instrumental usage of the tax law by Member States as it does allow this room of discretion.
Chapter 7: The calculation of the tax base in a global tax system

§ 7.1: Introduction

In this chapter we will try to formulate an answer to the second part of my research question: how should the calculation of the tax base develop in the Netherlands? In the transformation to global tax systems, it is in my opinion possible to observe two important starting points for the calculation of the future. We could make tax accounting more in line with IFRS so that a link between commercial and tax accounting emerges or we could harmonise tax accounting independently from commercial accounting; CCCTB could be a starting point for that.

The introduction of IFRS has lead to a single set of accounting standards for listed firms across the EU. The goal of this harmonisation was to increase the comparability of the financial statements across Europe. But also beyond Europe, the influence of IFRS increases. This development could provide opportunities with respect to the calculation of the tax base. We have seen that, historically, commercial and tax accounting in the Netherlands have developed autonomously. IFRS can provide a starting point for a calculation of the tax base, thus making tax accounting more in line with commercial accounting. But this connection will raise questions and problems with respect to important principles of taxation. Fair value accounting violates the principle of liquidity which could be problematic for taxation. IFRS standards are developed by private bodies, resulting in possible legitimacy issues.

Another starting point could be the Proposal for a Common Consolidated Corporate Tax Base. This Proposal by European Commission provides a harmonised calculation of the tax base for the Member States of the European Union. This tax base is independent with respect to commercial accounting. This system contains a lot of rules so that we can say that this is a rule-based system. Therefore, the legal certainty might be very high in this system but does it provide enough flexibility? The current calculation of the tax base with sound business practice provides flexibility for taxpayers but might provide less legal certainty. Do we want a harmonised tax base that provides more legal certainty than our current system does?

The next sections will test the three different systems against the important principles we observed in the previous sub-paragraph. The results of the EUCOTAX comparison will be included in this discussion as well. The next section will provide a definition for the principle. Then, we will look at the different systems and how they relate to the certain principles. We will look at the advantages and disadvantages of these systems as starting point for the calculation of the tax base. The current system of sound business practice is also included in this discussion. This chapter will end with a

conclusion about how a calculation of the tax base could look like in a global tax system. In this section, harmonisation at the European level is used as a first step towards a global tax system.

§ 7.2: Benchmark

To be able to provide a judgement about a preferable starting point for the calculation of the tax base in a global tax system, we need to have a benchmark. With the help of this benchmark we can try to formulate an answer to the question how the tax base should develop.

In this thesis we will look at three important principles of taxation: the principle of liquidity, legal certainty and legality. These principles are chosen because they resemble important discussion points for the calculation of the tax base in my opinion. One discussion point is the “true and fair view” approach (fair value accounting, for example) in IFRS that can lead to problems when it is used in taxation because taxation often requires much more prudence. This is related to the principle of liquidity. Next to these three principles, usually other principles are taken into account as well such as equality, ability-to-pay, simplicity, neutrality.229

§ 7.2.1: The principle of liquidity

The first principle that will be investigated is the principle of liquidity. This principle implies that an entrepreneur or an entity is only deemed to pay taxes if the business activities have provided the necessary funds to actually pay the taxes.230 It should be avoided that external financing is necessary because the payable tax cannot be financed out of the taxable base.231 On the other hand, it should also be avoided that taxation is lagging behind on the available liquid assets because of a conservative tax base.232 This principle implies that taxation should as much as possible be connected to the actual realised profits and losses. According to Bruijsten, the principle of liquidity is not just a specific principle for the taxation of businesses but it is a general principle that is applicable in every area of taxation.233

A strict application of the principle of liquidity is unrealistic. Only a true cash-based system would be able to fully comply with this principle. Therefore, this principle has to be balanced against other principles such as realisation and matching. As a result, in practice usually an accrual-based system is used in the calculation of the tax base. This system is used in the Netherlands but also in the other EUCOTAX countries. This method makes sure that the profit and losses are attributed to the

229 A. Oestreicher and C. Spengel, “Tax Harmonization in Europe: The Determination of Corporate Taxable Income in the Member States”, European Taxation 2007 (47), nr. 10, paragraph 2.2
230 C. Bruijsten, “De toekomst van het fiscale jaarwinstbegrip”, WFR 2009/823, paragraph 3.4.3.
232 H.P.W. Snijders, 2004, paragraph 3
233 C. Bruijsten, 2009, paragraph 3.4.3

85
right year but that might violate the principle of liquidity. It is important that violation of this principle is minimized in a calculation of the tax base. A violation would mean that taxation is triggered while funds are not yet available to these taxes: this could lead to liquidity problems for taxpayers.

§ 7.2.2: The principle of legal certainty

Legal certainty is considered to be one of the most fundamental principles of a constitutional state.234 This principle holds that a government may not affect the legal position of its citizens in an unexpected and unpredictable way.235 This principle falls apart in different elements such as for example: there should be general legislation available to taxpayers, adequate announcements of new legislation etc.236 With respect to the calculation of the tax base; one particular element is of most importance in the context of this thesis. This element concerns the clarity of laws. A taxpayer should be able to determine his rights and obligations on a certain moment.237 Therefore, in a calculation of the tax base, a taxpayer should be able to know what the tax consequences are of a proposed transaction. In general you could say that there are two ways to design a profit concept.

A legislator could include a number of principles and open norms in the tax law. The legal courts or standard setters have the responsibility to interpret the open norms: a principle-based system. For example, the concept of sound business practice in the Netherlands is not defined in a law. By only setting out general principles, a tax system is not as complex as a rule-based system. Next to that, the system might also be able to provide more flexibility to taxpayers as only the general framework for the calculation of the tax base is codified. However, an open norm causes uncertainty on its own as it is not very easy for a taxpayer to determine his rights and obligations at a certain moment.

The other option is to codify as many rules as possible to make sure that every situation is covered by a rule: a rule-based system. This could improve the legal certainty but on the other hand it requires a lot of regulations that could decrease legal certainty again because of the complexity of the regulations. As a result it could become more difficult to determine the exact implications of a certain transaction. A country could decide to use a pure principle-based, a pure rule-based or a mixed (rules and principle) calculation of the tax base. We will discuss how the different systems provide legal certainty. In my opinion, a fundamental question that needs to be addressed is: should the tax base become more rule-based or should it remain mainly principle-based?

234 P.G.M. Jansen, Beginselen van behoorlijk bestuur in het belastingrecht. Fiscale geschriften, Amersfoort: Sdu 2006, paragraph 3.1.1
235 P.G.M. Jansen, 2006, paragraph 3.1.1
237 J.L.M. Gribnau, 2006, paragraph 5.4
238 R. Russo, “Een nieuw winstbegrip: nu de invulling nog”, Forfaitair 2011/217, paragraph 1.1
§ 7.2.3: The principle of legality

The last principle that will be included in the discussion is the principle of legality. This principle holds that taxation should have a basis in a law. In the Netherlands, this principle is very important with respect to taxation. Article 104 of the Dutch Constitution namely states that: “all taxes in the Kingdom of the Netherlands are levied by virtue of law”. Every tax needs to have a basis in a law. As we have seen, these laws are the PITA 2001 and the CITA 1969. Taxes are a breach of property of an individual, so therefore it is important that this breach is justified by a law that is created by a democratic body.

Next to looking specifically at the legality of a new tax base, we will also look more generally at the role of the legislator. Tax incentives like accelerated depreciation, full write-offs or tax-free reserves are heavily used to promote certain economic goals and influence the economic behaviour of taxpayers.\footnote{W. Schön, “International Accounting Standards – A “Starting Point” for a Common European Tax Base?”, European Taxation 2004 (44), nr. 10, paragraph 2.4} This is also referred to as the instrumental use of the tax law. Are there still possibilities when we use IFRS or CCCTB as a starting point for the tax base?

§ 7.3: The international financial reporting standards as starting point for the calculation of the tax base

§ 7.3.1: Fair value accounting in IFRS

As we have seen in chapter 3, there is a very weak relationship between commercial and tax accounting in the Netherlands. From the results of our comparison in sections 6.1 and 6.2 we can conclude that the Netherlands are part of the minority of EUCOTAX countries that do not have a formal legal relationship between commercial and tax accounting. Only 3 countries do not have this relationship: the Netherlands, Poland and the United States. The other countries use the commercial accounting profit figure as a starting point for the calculation of the tax base.

It is then not surprising to observe that most of the countries that have a dependency of both systems, do not allow the use of IFRS in the individual accounts: this would mean that the IFRS indirectly determines the tax base of the countries. However, three countries allow the use of IFRS in the individual commercial accounts: Italy, the Netherlands and Sweden. Of these countries, IFRS is relevant for tax accounting in Italy and Sweden. Although IFRS is used for tax purposes, the fair value criterion is not taken into account as unrealized gains will be taxed. In fact, the fair value does not have relevance in both these countries, even if it is used in accounting for commercial aims. The main
reason for this is that fair value takes into account the unrealised gains on value increases. And as a result of the dependency, this profit would be taxed and would violate the principle of liquidity.

A violation of this principle is perhaps the main problem of using IFRS as a starting point. Van Hoepen recognizes this as well: “Commercial accounting is aimed at showing the ‘performance’ of the company. In addition, it does not matter that in certain circumstances a capital increase does not provide the required liquidity yet. When this method is used in tax accounting, an unrealized value increase would lead to taxation and may cause severe liquidity problems”.

The use of fair value accounting is the result of the objective of IFRS. The main objective of IFRS is providing information to the capital markets based on a “true and fair” view. By investigating the financial statements of a company, an informed person should be able to form a responsible judgement about the assets and profitability of a company. The emphasis of IFRS is on performance-reporting: the financial statements of a company should show profit potential of a company. With respect to performance-reporting, the calculation of a profit figure that shows the distributable profit is not really important. Opposite to IFRS, the distributable profit is very important in the calculation of the tax base. Funds need to be available to company to pay the tax. Therefore, applying performance-reporting for tax purposes could become problematic with respect to the principle of liquidity. When tax accounting will become dependent on IFRS, tax accounting could also become performance-reporting. Concepts used in IFRS to achieve the reporting objectives will also become applicable in tax accounting. Fair value accounting is one of these tools of showing a “true and fair” view.

Fair value accounting is a method to calculate the value of assets and liabilities. This method requires that assets and liabilities are valued at their fair value. The IASB defines the fair value as “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction”. Usually the fair value of an item is its market value. The only exception to this rule is when there is no market price available because of the specialised nature of the item. Fair value accounting is used in a significant amount of IFRS standards. Property, plants and equipment may be valued at fair value. For a number of financial assets and liabilities it is required to value them at fair value.

To investigate how fair value accounting works out in a specific can we can take a look at the example of the valuation of an asset in IFRS. According to IAS 16, it is allowed to use the revaluation model: “After recognition as an asset, an item of property, plant and equipment whose fair value can

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240 See P.H.J. Essers, 2005, paragraph 5.4 and C. Bruijsten, 2009, paragraph 3.4.3
243 P.H.J. Essers, De toekomst van Goed Koopmansgebruik na de invoering van International Financial Reporting Standards in 2005 (Geschriften van de Vereniging voor Belastingwetenschap nr. 224), Deventer: Kluwer 2005, paragraph 5.4
244 IFRS Framework
245 This depends on the business characteristics of the entity; see IFRS 9, chapter 4.
be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.\footnote{IAS 16 Property, Plant and Equipment, note 31.} An increase of the market value of an asset at the end of the year leads to a revaluation of the particular asset. The carrying amount is increased by the value change. IAS 16 requires this value increase to be recognised in other comprehensive income and accumulated in the equity. Additionally, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss. Revaluation leads to an increase in equity (or even profit) while the asset is still in use in the company. In other words, the value increase has not yet been fully realised. When IFRS will be the starting point of the calculation of the tax base, the increase will give rise to taxation. Remember that the fiscal profit is the fiscal capital at the end of the year minus the fiscal capital at the beginning of the year. Without an adjustment this amount will be taxed but the company has not received any liquidity to pay for the taxes.

Fair value accounting is an example of the performance-reporting character of IFRS. IFRS as a starting point for tax accounting could be problematic if we want to satisfy the principle of liquidity. As we have seen, a disadvantage of fair value accounting is that is causes taxation of unrealised gains. So to be able to use IFRS for tax purposes it is necessary to find a solution to the possible taxation of unrealised gains. In the EUCOTAX countries that use IFRS for tax purposes, the fair value accounting is simply eliminated from the taxable base. For example in Italy, it works out in the following way: IFRS, including fair value accounting, can directly influence the calculation of the tax base. But to make sure that the consequences of fair value accounting are not taken into account for tax purposes, a special degree states that states that certain categories of items have to be valued according to prescribed value methods. So, it is possible that IFRS prescribes the fair value of an asset while for tax purposes the cost method is required. Although this solves the fair value problem, it leads to additional complexity that might be unnecessary. A less complex solution might be the solution of Kampschoër. He comes up with a special solution in the form of a “liquidity reserve” for unrealised gains.\footnote{G.W.J.M. Kampschöer in P.H.J. Essers, De toekomst van Goed Koopmansgebruik na de invoering van International Financial Reporting Standards in 2005, Geschriften van de Vereniging voor Belastingwetenschap, Deventer: Kluwer 2005, p. 45.} Unrealised gains are stored in this reserve and will only be taxed when they are actually realised.

According to Bruijsten, the solution of Kampschoër will result in a complex system that gives little or no additional advantages than the current system of tax accounting.\footnote{C. Bruijsten, “De toekomst van het fiscale jaarwinstbegrip”, WFR 2009/823} In my opinion, this solution seems like a valid solution to the problem of fair value accounting. It would allow the tax and commercial systems to become more in line with each other without the problems of fair value accounting. Because at the moment companies have to calculate their profits twice: a commercial profit figure and tax profit figure. By using IFRS as a starting point for tax accounting, a company
only has to calculate his commercial profit and adjusts this to get to the taxable profit.\textsuperscript{249} This does not really make the calculation any more complex than it is today in my opinion.

On the other hand, fair value accounting can also provide advantages. It could make exit-taxes redundant because the value-increases of assets can be taxed every year. As a result, it could reduce the incentives of taxpayers to evade the claim by moving a part of the company to another country.

\textbf{§ 7.3.2: Improved legal certainty for taxpayers}

The IFRS are a system of standards and the interpretation of these standards. These standards are dedicated to certain aspects of financial reporting.\textsuperscript{250} Every standard covers specific topics in financial reporting such as property, plants and equipment, financial assets, mergers and acquisitions etc. Usually a standard consists of mandatory rules, guidelines for the application of these mandatory rules, examples and a Basis for Conclusion that shows why a certain rule has been chosen instead of an alternative.\textsuperscript{251} In 2010, the standards accounted for almost 2800 pages.\textsuperscript{252}

The Framework of IFRS is the starting point of the standards. It sets out the qualitative features a financial statement should meet, such as intelligibility, relevance and fair view. An important assumption is that “the financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.”\textsuperscript{253} Standards that are developed are based on the principles set out in the framework. When a transaction or event is not addressed in a standard, IAS 8 determines that an issuer should look at related or similar standards and interpretations.\textsuperscript{254} If that still does not provide a solution then it is possible to use the general principles of the Framework. Although IFRS is often referred to as a principle-based set of standards, they are becoming more and more rule-based.\textsuperscript{255}

Compared to the current system of sound business practice, this would mean that the tax system in the Netherlands would become much more rule-based. As we have seen in chapter 5.2.1, the annual taxable profit in the Netherlands is calculated according to sound business practice. This concept is an open norm that is not defined in any of the Dutch tax laws. As the highest legal court in the Netherlands, the Supreme Court, therefore, decides about the concepts used in sound business practice. The Supreme Court acts as a legislator with respect to the calculation of the tax base. According to the legislator, the Supreme Court would be better able to provide a framework for taxpayers and respond to the changes in the dynamic social and economic society.\textsuperscript{256} An open norm

\textsuperscript{249} G.W.J.M. Kampschöer, 2005, page 45
\textsuperscript{251} L.G. van der Tas, 2010, paragraph 3
\textsuperscript{252} L.G. van der Tas, 2010, paragraph 3
\textsuperscript{253} IFRS Framework, chapter 4
\textsuperscript{254} L.G. van der Tas, 2010, paragraph 3
\textsuperscript{256} MvT, Kamerstukken II 1998/99, 26 727 nr. 3, page 106-10.
allows the calculation of the tax base “to follow the changes in sound business practice and the science of the business economics, without changing the law.”

It provides the Supreme Court the ability to change the interpretation of the norm when a changing economic and social society demands it.

An advantage of an extensive set of regulations is that it increases the legal certainty of taxpayers. At this moment, legal uncertainty is often a problem in the current calculation of the tax base. Rules with respect to the calculation of the tax base have to be distilled from case law which develops gradually over the years. Because of this, the Supreme Court should not only provide a decision in a specific case but should also act as a “co-legislator”. This means that the Court should be more willing to provide general rules to taxpayers: there are not many rules of law available to guide taxpayers so the Court has to help. In quite some cases the Supreme Court hides behind facts and circumstances of the case without stating the importance and the relevance of these facts. It is, therefore, often difficult to deduce general rules from these cases. This makes the interpretation of sound business practice difficult and leads to additional legal uncertainty for taxpayers. As Essers formulates: “With respect to the legal certainty it is not only important that a decision of the Supreme Court is predictable and that this decision is a continuation of previous decisions but also that the Court shows how it came to this decision and how this decision might influence future decisions.”

Another problem with respect to the legal certainty is when the Supreme Court revises its previous opinion because the previous outcome was not satisfying. The Court should, as co-legislator, also provide transitional provisions for taxpayers.

However, certain authors in the literature believe that legal certainty is not much of an issue. Bruijsten argues that “the practical application of sound business practice is largely concretized in general principles of sound business practice”. Janssen observes this as well. The legal development mainly concerns the adjustment at detail level within the principles of sound business practice. According to Doornebal, the interpretation of sound business practice has lead to an acceptable level of legal uncertainty. Still, a certain level of legal uncertainty is unavoidable in a system that lacks detailed rules.

257 Handelingen II 1949/50, 1251, page 1607; Derived via C. Bruijsten, 2009, paragraph 3.1.2
258 J. Doornebal, "Goed koopmansgebruik als open norm", NDFR Beschouwingen 2008/33, paragraph 1.
261 P.H.J. Essers, 2005, paragraph 6.6
262 P.H.J. Essers, 2005, paragraph 6.6
263 R.P.C. Cornelisse and A.O. Lubbers, 2004, paragraph 3.1
264 R.P.C. Cornelisse and A.O. Lubbers, 2004, paragraph 3.1
265 P.H.J. Essers, 2005, paragraph 6.6
266 P.H.J. Essers, 2005, paragraph 6.6
267 C. Bruijsten, 2009, paragraph 3.1.3
269 C. Bruijsten, 2009, paragraph 3.1.3
270 J. Doornebal, 2008, paragraph 5.
IFRS might be able to provide more legal certainty to taxpayers. The standards cover a lot of different subjects. These subjects are also considerably developed and detailed. With the help of guidelines, interpretations and examples, a taxpayer is able to determine the consequences of a certain transaction. Instead of looking at relevant case law, the taxpayer has to look at a specific standard. This is case law of which it is not certain that it is applicable in another situation because it was specifically decided for a certain case. A standard is designed to be applied in a lot of situations so this could make it easier for taxpayers to determine the consequences of a transaction. As a result, this could lead to fewer lawsuits with respect to the interpretation of open norms. IFRS as a starting point for the calculation of the tax base will, therefore, increase the legal certainty. This would also mean that tax accounting could profit from the experiences of commercial accounting.

A problem of extensive regulation is that it can make the calculation of the tax base more complex. Companies would have to take into account almost 2800 pages in calculating the tax base. However, the relevant information for the calculation of the profit might be a fraction of these pages. For large, multinational companies this does not really pose much of a problem because they either already have the experience with IFRS in commercial reporting or have the capacity to comply with the standards. It could become problematic for small companies to comply with an extensive set of standards such as IFRS. A solution for this problem could be to include the general framework for the calculation of the profit according to IFRS in the tax law. So, a smaller company does not have to go through the full set of standards but could rely on the tax law. When something is not clear or a taxpayer needs more information, he could consult the standards.

A disadvantage of the use of IFRS is that it could decrease the flexibility of the calculation of the tax base. The reason behind is that IFRS does not allow as many valuation methods etc. as the current concept of sound business practice does. For example, sound business practice allows a lot of different inventory valuation methods including LIFO and the base stock system. These methods are not allowed in IFRS. However, the flexibility of the current system is limited as well. The changing society has not led to many fundamental revisions of previous decisions of the Supreme Court.

Next to that, by introducing new legislation on subjects such as depreciation and work-in-progress, the legislator has also limited the dynamic character of sound business practice.

§ 7.3.3: The tax base is influenced by private-law bodies

A calculation of the tax base that is dependent on the IFRS could be problematic with respect to this principle of legality. The standards of IFRS are developed by the IASB, a private-law body.

271 C. Bruijsten, 2009, paragraph 3.4.2
272 P.H.J. Essers, 2005, paragraph 2.5
273 P.H.J. Essers, 2005, paragraph 5.4
This would mean that the IASB is indirectly able to determine the Dutch tax base.\textsuperscript{275} Next to that, it would also mean that the Court of Justice is directly able to influence the determination of the taxable profit.\textsuperscript{276} However, at this moment the IFRS standards have to be endorsed by the European Commission via a special procedure before they are allowed to be used in the EU by the companies.

The first step is that the IASB issues a new standard. The EFRAG (the European Financial Reporting Advisory Group) delivers its advice to the Commission whether the standard meets the criteria of endorsement. The criteria examined are set forth in article 3, paragraph 2 in the IAS Regulation\textsuperscript{277}. This article sets out that the standards should not be contrary to the true and fair view principle set out in the 4th and 7th Company Law Directives and should meet the relevant criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management. After this advice, the Commission prepares a draft Directive that will be judged by the ARC (Accounting Regulatory Committee). When this draft is accepted, the European Parliament and the European Council have three months to oppose this draft Directive. Finally, the Directive is adopted by the EC.\textsuperscript{278}

This procedure makes sure that the standards comply with the reporting objectives of commercial accounting. However, as these objectives differ from tax accounting objectives, these have to be taken into account as well. Therefore, it would be necessary to codify the general framework for the calculation of the tax base in the Dutch tax law. This would mean that a company is able to calculate its profits using IFRS but for tax purposes this profit figure has to be adjusted according to the tax law. By codifying the general principles, the democratic legitimacy would be satisfied as well. Another solution could be to follow a same kind of procedure as the EU uses for endorsing IFRS standards for commercial purposes: an endorsement process for tax regulations. This could result in directives related to taxation.

IFRS could also make it difficult to use the calculation of the tax base as an instrument to steer the behaviour of taxpayers.\textsuperscript{279} Kampschoër refutes this argument by stating that an instrumental use of the tax law is still possible: The IFRS profit still has to be transformed to a taxable profit so that elements can still be included.\textsuperscript{280} On a European level this could be achieved by making IFRS a general “framework” for the calculation of the tax base so that countries are still able to give “tax incentives” for certain behaviour. IFRS could serve as a benchmark so that any deviation of domestic financial reporting is clearly visible.

\textsuperscript{275} W. Schön, 2004, paragraph 2.1
\textsuperscript{276} P.H.J. Essers, 2004, paragraph 5.4
\textsuperscript{277} Directive (EG) nr. 1606/2002, 19th of June 2002
\textsuperscript{278} Procedure derived from http://ec.europa.eu/internal_market/accounting/docs/ias/endorsement_process.pdf
\textsuperscript{279} P.H.J. Essers, 2005, paragraph 5.4
\textsuperscript{280} G.W.J.M. Kampschoër, 2005, page 46
tax accounting rules from this “common” tax base could be identified as state aid if it works selectively in favour of certain products or enterprises.  

§ 7.4: The Common Consolidated Corporate Tax Base as starting point for the calculation of the tax base

So, although in the majority of EUCOTAX countries there is a formal legal relationship between commercial and tax accounting, the use of IFRS for tax purposes is limited to only two countries at the moment. Therefore, it might currently be unrealistic to completely harmonise the commercial accounting in the way that IFRS would also be used for tax accounting. Another option is to harmonise the tax base by introducing a tax base that is separated from the commercial accounting standards.

Thus, a good alternative for the harmonisation of the tax base in Europe could be the CCCTB Proposal. Initially, it was the goal of the European Commission to take the profit determination rules of IFRS as a starting point for the Common Consolidated Corporate Tax Base but gradually the Commission revised its view. The main reason for this switch seems to be the use of fair value in IFRS. So the Proposal contains a whole new way of calculating the tax base that is designed purely for tax reasons. This Proposal might provide a better starting point for the calculation of the tax base. But how does this proposal relate to the principles have discussed in the previous paragraphs?

§ 7.4.1: Fair value accounting also used in CCCTB

Because CCCTB is explicitly designed for tax purposes, performance-reporting will most likely not be a problem. The objectives of CCCTB are more closely related to the current system of sound business practice: both systems provide a taxable profit figure. From this perspective it seems easier to use the Proposal as a starting point. However, it is still important to investigate how it relates to the principle of liquidity.

In CCCTB, profits and losses shall be recognised only when realised. With respect to revenue this means that they accrue when the right to receive them arises and they can be quantified with reasonable accuracy, regardless of whether the actual payment is deferred. As a result, profits will be taxed only when they can be considered realised: this is in line with the principle of liquidity. Nonetheless, article 22 requires a taxpayer to value its “financial assets and liabilities held for

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281 W. Schön, 2004, paragraph 2.4
282 P.H.J. Essers, “De winstbepaling in de conceptrichlijn CCCTB”, WFR 2011/1395, paragraph 3.1
283 P. Kavelaars, “Naar een Europese winstgrondslag [deel 2]”, WFR 2008/1218, paragraph 5.4.1 and P.H.J. Essers, 2011, paragraph 3.1
284 Article 10, section 1 of the Proposal.
285 Article 18 of the Proposal.
trading” at fair value. This is a mandatory valuation method; a taxpayer is not allowed to choose another method. The difference between the value at the end and the start of the year is included in the tax base. This means that the unrealised gain in a year is included in the tax base so that taxes have to be paid but the increased value of the financial asset has not lead to an increase in liquidity. This violates the principle of liquidity.

However, fair value is only required for the “held for trading” category which are in general meant for selling in the near term. An explicit reason for the choice of this valuation method is not given by the European Commission. In my opinion, there could be two reasons to use fair value accounting for these financial assets: these assets can easily be converted into cash and the funds are not necessary in the company. But it might not always easy to convert these financial assets into liquidity when there is a financial crisis going on, for example. Next to that, it might also require companies to sell a part of the investments to cover the taxes on the increase in value. These problems do not justify a valuation at cost price in my opinion. Not realising the value increase of the asset is a choice made by the taxpayer: he might believe that a higher return is possible in the upcoming years. According to Bavinck, that should not mean that taxation of an unrealised gain should be deferred until the actual realisation. The principle of prudence should not be followed here. In my opinion, taxation of these unrealised gains here is not problematic, although there is a violation of the principle of liquidity.

§ 7.4.2: A rule-based calculation of the tax base

In our comparison between the Dutch system of tax accounting and the CCCTB in chapter 5, we have seen that CCCTB contains a lot of rules. Next to these rules, the Proposal also contains a number of general principles. CCCTB is, therefore, mostly a rule-based system with some principles. But in the previous chapter we have seen that the majority of EUCOTAX countries have a rule-based system for the calculation of the tax base. This means that their tax laws contain a lot of rules and do not give much discretion to taxpayers. It is not surprising to observe then that the majority of countries believe that the CCCTB Proposal is a principle-based calculation of the tax base: their reference point is a system that consists of many rules.

As the commercial profit is not the starting point for the determination of the taxable profit, the Proposal carefully has to set out the framework for the calculation. The tax base shall be

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286 Article 23, section 1 defines these financial assets and liabilities.
287 Article 23, section 2 of the Proposal.
288 C.B. Bavinck, “Grondslagverbreding in goed koopmansgebruik”, WFR 2005/1215, paragraph 5.1
289 C.B. Bavinck, 2005, paragraph 5.1
290 R. Russo, 2011, paragraph 1.1
291 M.M.A. van Graafeiland en F.W.G. Kam, “Het voorstel voor een CCCTB - een beschouwing”, MBB 2011/09, paragraph 4.1
calculated as revenues less exempt revenues, deductible expenses and other deductible items. The Proposal has to determine the non-deductible costs because it is not based on the going-concern principle. Almost every concept used is defined in the definition article 4.

An advantage of a system with a considerable amount of rules is that a taxpayer knows exactly what the result of an action will be. For example, if a taxpayer wants to form a provision than he has to look in article 25. The article sets out the exact requirements as we have seen in the previous chapter. Compared to the current calculation of the tax base, CCCTB will provide more legal certainty for taxpayers in my opinion. Although the Supreme Court has already provided a lot of certainty with respect to the calculation of the tax base according to sound business practice, there is always the possibility that the Court will change its mind. As CCCTB contains exact rules for the calculation, this should uncertainty should not occur. However, according to Russo, the Proposal does not contain a “back-up” system for the determination of the profit. Legal courts still have to decide cases that are not included in the Proposal or of which the interpretation is not clear. The Proposal only contains some general principles which do not give the courts enough guidance to solve these new cases. This could lead to new legal uncertainty for taxpayers. Also, from experiences in countries such as France and Italy it can be concluded that too many rules are not good either. Taxpayers in these countries experience difficulties complying to the tax regulations because there are too many rules. For them, CCCTB will introduce a tax base that is simpler and less complex for the companies in their countries.

A clear disadvantage of the CCCTB Proposal is that it reduces the flexibility of the profit determination. CCCTB does not contain a concept like total profit in the Netherlands and as a result of this lacking concept, the Proposal does not give taxpayers a lot of options. For example, CCCTB only allow a maximum of three different valuation methods for inventory. In the current tax base, the Supreme Court has accepted more valuation methods. But we have seen in section 6.3 that for many EUCOTAX countries the flexibility of the tax base would increase because of CCCTB. Therefore, it seems unlikely that the amount of flexibility sound business practice provides is not really possible in a harmonised tax base. It is possible to add more flexibility by increasing the number of delegation provisions. This allows the European Commission to fill in and change concepts when it is necessary. Further it allows the EC to adjust the tax base whenever it seems necessary in the light of a developing internal market.

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292 Article 10 of the Proposal
293 M.M.A. van Graafeiland en F.W.G. Kam, 2011, paragraph 4.2
294 R. Russo, 2011, paragraph 1.1
295 See also: P.H.J. Essers, “De winstbepaling in de Conceptrichtlijn CCCTB”, WFR 2011/1395, paragraph 3.1
296 P.H.J. Essers, 2011, paragraph 3.2
§ 7.4.3: Instrumental use of the tax law

The Proposal for a CCCTB is a proposal for a European Directive. This means that the European Council and the European Parliament have to agree with the draft before it will become a Directive. Because the provisions have to be transformed to national regulations, a directive does not immediately have a self-executing function. Although this process makes sure that the CCCTB will have a basis in the law, it still means that the tax base will be determined by a foreign body.

As a result of this harmonisation process, the legislator will not have much room to use the tax base as an instrumental tool. The Directive sets out the rules for the calculation of the tax base and these have to be implemented by the Member States. When a government would like to stimulate certain behaviour by providing an exception or deduction, this would violate the Directive. The ability to use the tax law as instrument seems is a very important expression of their sovereignty. As Schön states: “It is simply not realistic to expect Member States to relinquish the power to enact tax accounting rules that seek to influence individual economic behaviour.” Although it can be disputed whether fiscal instrumentalism is effective in persuading individual economic behaviour. Still, in our comparison in section 6.5, we have seen that there are not very large differences between general aspects of the tax base. For example, in the majority of EUCOTAX countries, only the economic owner is allowed to depreciate a building, an acquired intangible asset has to be amortized in every country and loss carry-forward is possible in all countries. However, the specific implementation differs between countries: countries have other incentives to determine specific depreciation rates for example. Therefore, this might be an important reason to reject the current proposal for a CCCTB. Of the 9 EU member states among the EUCOTAX countries, only 2 are positive about the current proposal. Although not explicitly stated by countries, the loss of sovereignty on fiscal policy might be an important reason. A harmonisation of the tax base, independent from commercial accounting that leaves no room for interpretation might be step too far.

§ 7.5: A proposed calculation of the tax base in a global tax system

In this paragraph, a calculation of the tax base in a global tax system is proposed. Based on the analysis of the previous paragraphs an answer will be provided to the second part of the main research question: how should the tax base develop towards a global tax system in the light of the important principles of taxation? As we have observed, there are two possibilities: it is possible to make a legal relationship between commercial and tax accounting and use IFRS as the basis. On the other hand, it is also possible to harmonise the tax base independently from commercial accounting in the form of a CCCTB in the EU.

297 W. Schön, 2004, paragraph 2.4
Based on the analysis of the previous paragraphs, the calculation of the tax base in a global tax system should be connected to commercial accounting. The IFRS are the most appropriate set of standards for this connection. In the EU, they are widely spread because of the harmonisation of commercial accounting standards for listed companies but also in the rest of the world the influence is growing.

A major problem with using IFRS as the starting point for the calculation of the tax base is that fair value accounting violates the principle of liquidity. This also seems to be the main reason that IFRS is not allowed to be used in the majority of EUCOTAX countries that have a formal legal relationship between commercial and tax accounting. The countries that do allow the use of IFRS in tax accounting have not developed a solution to the problem of fair value. However, in my opinion, fair value accounting does not have to make a relationship between tax accounting and IFRS impossible. The liquidity reserve as proposed by Kampschoër seems like a valid solution to the problem of fair value accounting. It could be an option to keep the fair value requirement for certain financial instruments held for trade, in the same way as it is proposed in CCCTB.

The liquidity reserve does not necessarily make the calculation of the tax base more complex than it is today. At the moment, it is possible that companies have to calculate their profit twice: a commercial profit based on commercial valuations and a tax profit based on mandatory tax valuations. Using IFRS as a starting point would mean that it is only necessary to calculate a commercial profit figure. This profit figure has to be adjusted to come to a tax profit: It depends on the adjustments how complex the tax base will become. In CCCTB, companies will still have to calculate two independent profit figures which increase the complexity of the tax base.

Another advantage of using IFRS is that it will increase the legal certainty for taxpayers. The current system of sound business practice lacks detailed rules for the calculation of the taxable profit. As a result, legal certainty is often a problem. This principle-based system is quite unique compared to the EUCOTAX countries; they mainly have rule-based systems. IFRS are an extensive set of standards that cover a lot of subjects. With the help of guidelines, interpretations and examples, a taxpayer is able to determine the consequences of a certain transaction more easily. However, because IFRS are such an extensive set of standards, it could become problematic to use for smaller companies. Although it might not be necessary to use the full set of standards, it could still make the calculation more complex. A solution for this problem could be to include the general framework for the calculation of the profit according to IFRS in the tax law. So, a smaller company does not have to go through the full set of standards but could rely on the tax law. When something is not clear or a taxpayer needs more information, he could consult the standards.

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A downside of increased legal certainty is that the flexibility of the tax base could decrease. At this moment, the principle-based system of sound business practice allows quite some flexibility with respect to the tax base. As stated in section 7.3.2, IFRS is becoming more and more rule-based. It is unavoidable that the tax base will lose some of its flexibility to ensure greater legal certainty.

Legality is very important in the Netherlands: Every tax needs to have a basis in a law. A tax base that is linked to IFRS would mean that tax regulation is indirectly created by private-law bodies such as the IASB. However, at the moment in the EU, the standards have to be endorsed in a special procedure that safeguards the objectives of commercial financial reporting.

To make sure that the objectives of tax accounting are taken into account, the IFRS have to be endorsed in the same way as they are endorsed for commercial purposes in the EU. IFRS would become a general framework for the calculation of the taxable profit throughout the Member States. As a full harmonisation of the tax base might be problematic at this moment, in my opinion, this general framework could be a good starting point. The framework will still leave room for discretion by the Member States. Therefore, the States will still have some of their fiscal sovereignty and can still stimulate certain behaviour by providing tax advantages. However, to make sure this does not lead to harmful tax competition, the state aid rules could be used. For the Netherlands, this would mean that on an EU level, the general framework for the calculation of the tax base is decided. To satisfy the principle of legality, this framework should be codified in the tax law. The Dutch government would still have the possibility to influence certain economic behaviour although to a much smaller extent.

In my opinion, the solution presented in this paragraph would provide a good starting point for the harmonisation of the tax base in the EU. Although this does not lead to a full harmonisation as would be the case in CCCTB, it could be an acceptable first step. The next step towards a true internal market and harmonisation of corporate taxation would be a European corporate tax that is the same in every Member State.
Chapter 8: Conclusion

This thesis was written in the context of the EUCOTAX Wintercourse 2012. The main theme of this project is: international global taxation, from national tax systems towards global tax systems. Developments such as, for example, globalization and the liberalization of the world market and the introduction of the internet have made the world into a “global marketplace”. In Europe, the European Union is working towards an internal market. These trends and developments not only have their impact on global trade but also on the countries itself. They need to look critically at their legislation and make changes, for example, to remain competitive or to attract new companies. On top of that, Member States of the European Union also need to take into account the EU law when designing their legislation.

The tax system is a vital part of the legislation of a country. It is used to collect funds for the finance of public services. The tax system is also influenced by the international changes: it might require a change towards a global tax system as well. This thesis has addressed one important part of the tax system: the calculation of the tax base in the context of national tax systems developing towards global tax systems. This has resulted in the formulation of the main research question:

*How is the Dutch tax system, with respect to the calculation of the tax base, in the Netherlands developing towards a global tax system and how should it develop taking into account important principles underlying the current calculation of the tax base?*

In the first part of this thesis we have investigated how the current calculation of the tax base is developing towards a global tax system. This included the major subjects: the relationship between commercial and tax accounting in the Netherlands and the influence of IFRS on this relationship and a comparison between the current calculation of the tax base and the Proposal for a CCCTB.

With respect to the relationship between commercial and tax accounting, it can be concluded that there is no formal legal relationship between the two systems in the Netherlands. This is mainly caused by the different objectives of the two accounting areas. The goal of tax accounting is simply to provide a taxable base. A “true and fair” view is not needed for the taxation of income. Tax accounting based on the prudence principle would therefore be better able to look after the interests of taxpayers. Since 2005, the use of IFRS is mandatory for listed companies in the EU. The introduction of IFRS has not changed the relationship between the two systems: Although IFRS can be used for commercial reporting by any entity listed in Title 9, for calculating the tax base the standards are not taken into account.

However, an indirect relationship might be possible as the science of business economics has been a starting point for both commercial and tax accounting in the Netherlands. Next to that, the
introduction of legislation on sound business practice might lead to another possible indirect relationship between the two systems. However, the legislator has not used the opportunity to put tax accounting more in line with commercial accounting. Since a few years, there is a relationship the other way around: for particular (small) companies it is allowed to use fiscal profit determination in the commercial financial statements. It can be concluded that sound business practice has led to a system of tax accounting that is almost completely independent from commercial profit determination in practice.

In chapter 5 an extensive comparison between the Dutch system of tax accounting and the Proposal for a Common Consolidated Corporate Tax Base was made. The differences between the two systems can be quite significant in practice. Often, observed differences will be the result of the rule-versus principle-based character. The Dutch system allows more flexibility because of the lack of codified rules while CCCTB contains quite some detailed articles. CCCTB seems to provide general requirements that do not seem to give that flexibility. These rules could on the other hand, provide more legal certainty to taxpayers. Significant other differences, however, are the result of different choices made by the European Commission. For example, in the Netherlands a lot of different inventory valuation methods are allowed. In CCCTB, only a maximum of three different methods are allowed. But also for forming a provision, a probable (future) legal obligation is necessary while in the Netherlands only “reasonable assurance” is needed. These examples show that there could be major differences in the taxable profits of the two tax bases.

The goal of the second part of this thesis was to provide an answer to the question: how should the Dutch calculation of the tax base develop? In other words, how should the calculation of the tax base look like in a global tax system?

The legal comparison between the EUCOTAX countries has showed that the Netherlands are one of the few countries that do not have a formal legal relationship between commercial and tax accounting. However, with respect to the use of IFRS in individual accounts the Netherlands are liberal. In the majority of countries, the use of IFRS in the individual accounts is prohibited. The reason behind this is that otherwise IFRS would become tax relevant in those countries. Only in Italy and Sweden, IFRS currently is used for tax purposes.

The Netherlands is the only country that has a mainly principle-based calculation of the tax base. All the other EUCOTAX countries have a system that can be considered to be rule-based. In my opinion, two important starting points can be observed. First of all, tax accounting could become linked to commercial accounting. It is not surprising to see then that CCCTB is referred to as a rule-based system in the Netherlands, while from the perspective of the other countries, it is considered to be a principle-based system. For these countries this would mean that the flexibility of the tax system increases. For the Netherlands it is the other way around: the flexibility would decrease because the concept of sound business practice allows a greater flexibility in the calculation of the taxable profit. Although the flexibility would increase, of the EU countries participating in the
EUCOTAX Wintercourse, only two have expressed a positive opinion about the current proposal for a CCCTB.

An important part of the legal comparison is the treatment of specific items in the domestic tax systems of the participating countries and CCCTB. It can be concluded that there are a lot of differences between the tax systems at the moment. Although, general concepts are often quite similar, major differences occur with respect to the conditions for the application of these concepts. For example, loss carry-forward is possible in every country; the specific terms and maximum amounts differ in every country. It seems that a lot of differences occur because of the instrumental use of the tax law: governments want to influence behaviour of taxpayers. An introduction of CCCTB would limit this instrumental usage of the tax law.

As many countries already have a relationship between commercial and tax accounting, a calculation of the tax base in a global tax system that is based on commercial accounting standards could be viable option. The introduction of IFRS has lead to a single set of accounting standards for listed firms across the EU. The goal of this harmonisation was to increase the comparability of the financial statements across Europe. But also beyond Europe, the influence of IFRS increases. Therefore, IFRS could provide a starting point for the calculation of the tax base. However, IFRS is not widely used in the EUCOTAX countries that have a link between commercial and tax accounting. So, it might currently be unrealistic to completely harmonise the commercial accounting in the way that IFRS would also be used for tax accounting.

Another option is then to harmonise the calculation of the tax base independently of commercial accounting. Again, if we look at the EU, there is a development that could provide an important starting point for this harmonisation: the Proposal for a Common Consolidated Corporate Tax Base. This Proposal by European Commission provides a harmonised calculation of the tax base for the Member States of the European Union. This tax base is independent of commercial accounting. This system contains a lot of rules so that we can say that this is a rule-based system. To be able to determine whether IFRS or CCCTB should be the starting point for a calculation of the tax base, these systems were tested against important principles of taxation in chapter 7. The principles that were used in the discussion are the principles of liquidity, legal certainty and legality.

Based on the analysis in this chapter, the calculation of the tax base in a global tax system should be connected to commercial accounting. The IFRS are the most appropriate set of standards for this connection.

The principle of liquidity is violated by fair value accounting in IFRS. However, the problems with respect to fair value accounting in IFRS can be solved by using the liquidity reserve. As a result, unrealised gains will not lead to taxation. This reserve could make the tax base more complex but compared to the current system, taxpayers will only calculate their commercial profit and adjust this

figure. In CCCTB, taxpayers will still have to calculate two independent profit figures. Another advantage is that IFRS will increase the legal certainty for taxpayers. The standards provide an extensive framework for the calculation of the tax base. A downside of this could be that it will become problematic for smaller companies to calculate their profit. This can be solved by codifying the general framework in the Dutch tax law.

A tax base that is linked to IFRS would mean that tax regulation is indirectly created by private-law bodies such as the IASB. However, at the moment in the EU, the standards have to be endorsed in a special procedure that safeguards the objectives of commercial financial reporting. Therefore, in the EU, a same procedure could be used to endorse the IFRS for tax purposes to make sure that the objectives of tax accounting are taken into account. IFRS then could serve as a general framework for the calculation of the taxable profit at the EU level. Member States will still have the possibility to influence certain economic behaviour by using the tax law, however to a much smaller extent.

In my opinion, tax accounting that is connected to IFRS will provide important advantages to taxpayers while, at the same time, it can also provide a first step in the harmonisation process in EU. Eventually, it could serve as the basis for a calculation of the tax base in a global tax system. However, a full harmonisation in the EU of the tax bases such as would be the case in CCCTB might be unrealistic at this moment.
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