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Editorial

Do we need a Euro tax regulation?

Professor Jacques Malherbe, *the Catholic University of Louvain*

Regulation 1103/97 C.E. of the EU of 17 June 1997 lays down various provisions relating to the introduction of the Euro.

The most important provision in this Regulation is certainly contained in Art. 3. According to this Article, the introduction of the Euro does not modify the terms of any legal instrument and does not give to any party the right to modify or terminate such an instrument. This provision applies notwithstanding any other agreement between parties. Although its enforceability beyond the ambit governed by the legal systems of Member States has been questioned, this matter is not our concern here. Instead, we will concern ourselves with the influence of the introduction of the Euro on business taxation.

The aim of the European legislator, author of the Regulation, was to give certainty to contracting parties in a situation which could give rise to some doubts relating to the civil consequences of contracts.

In various countries, those accounting bodies, empowered to lay down rules for the implementation of accounting legislation and more particularly for the implementation of the various statutes governing company accounts modelled after the Fourth Directive of 25 July 1978 concerning the annual accounts of certain types of companies, have issued rules or recommendations as to how the introduction of the Euro should be dealt with from the point of view of accountancy practices. However, the national tax administrations have generally remained silent. It seems to us that the taxpayer deserves as much certainty as a contracting party or the drafter of accounts with which he is identified.

The tax authorities have often issued rules as to the way in which they will deal with the assessment and reimbursement of taxes during the transitional period, leading up to the Euro's introduction, i.e. between 1999 to 2001. The procedure is rather simple. Under the system of no prohibition and no compulsion, the taxpayer will be generally free to deal with the tax authorities in his national currency or in Euro. The tax authorities are likely to respond to the choice of the taxpayer by communicating with him in the currency which he has elected. The same choice will apply to tax returns.

In other respects, vast differences exist between professional opinions. Significant discrepancies could arise in connection with the tax treatment of costs as yet uncleared on the date of introduction of the Euro and in relation to the tax treatment of exchange differences arising at the same time.

The costs relating to the replacement of accounting systems and computer software, the training of personnel and the provision of information to the public etc., which will be particularly heavy for banking institutions, will be either charged to the current year's expenses or capitalized and depreciated according to their nature.

From a taxation perspective, differences between Member States may emerge because of possible discrepancies between Member States' national laws put in place to implement the Fourth Directive. In some countries, the expenses incurred can be booked on the assets side of the balance sheet as e.g., restructuring costs. In other countries, this is prohibited.

Depreciation rules and rates are also different between Member States. Those are, nevertheless, differences which have been considered as tolerable by the drafters of the Fourth Directive. Consequently, their tax implications do not seem to be of such a magnitude as to distort competition between Member States.

The matter of reserves is much more important. According to Art. 20 of the Fourth Directive, reserves for risks and charges can be booked to cover losses or debts which are defined as to their nature but are still undetermined as to their amount and the date of their occurrence. On the basis of this definition, the Urgency Committee of the French National Council for Accountancy has determined that reserves could be created for expenses having as their sole purpose to adapt the business to the introduction of the new currency, without having a favourable effect for the future. The latter are booked under the assets and depreciated. Other expenses are booked as current expenses because of their recurrent nature (training expenses, updating of software etc.).

Tax-wise, there seems to be disagreement about the principle of the creation of reserves and the period during which they could be created.

Is the introduction of the Euro already now sufficiently likely so as to allow the booking of reserves in the countries which are likely participants or, on the contrary, do companies have to wait until 1998 or even 1999?

In some countries, the deductibility of reserves is restricted to reserves covering expenses which bear on the profits of the tax year concerned.

In view of the magnitude of the expenses concerned, it would be highly desirable that the tax

treatment of such reserves be made uniform throughout the EU and be determined by a European tax regulation specifically addressing the tax implications of the introduction of the Euro.

The same is true for the tax treatment of exchange gains or losses. The tax treatment of unrealized gains and losses is different throughout the Union. In some Member States a non-realized exchange gain e.g. on the claim in foreign currency which is to be paid in a number of years, must be reported tax-wise, if the foreign currency has appreciated in relation to the national currency, at the end of each year, even if, for accounting purposes, the gain may not be accounted before realization for reasons of prudence. In other countries, such a non-realized exchange gain is not taxable. In most Member States, exchange losses are deductible, even if not realized, for the same reasons of prudence. Here again, a uniform treatment would be desirable, at least in the countries where, as of now, unrealized exchange gains are not taxable.

In a discussion paper of 12 September 1996, which related to the Euro, Directorate-General XV of the European Commission admitted that even from an accounting point of view, a strict interpretation of the realization principle could imply that exchange differences are only realized upon the final cash receipt or disbursement which completes the transaction. This would have the result that the payment of taxes on the realized gain is matched with the cash receipt, which is obviously desirable. Another interpretation is of course that, when the Euro is introduced, the exchange rates will be fixed and the exchange risk disappears. Therefore, any exchange difference is considered to be realized from an accounting perspective.

This does not imply, however, that it is realized from a tax perspective where realization is very often defined in terms of a change in ownership or the completion of a transaction.

While it is clear from the present Regulation relating to the introduction of the Euro that contracts are unaltered by this introduction, it would be strange to consider that, tax-wise, exchange gains are made because the conversion rates have been finally determined and cannot be altered further when of course the underlying claim to money remains deferred to future years. The taxpayer would be compelled to pay tax on money which he has not yet received, because of an event which is beyond his control and which has been defined as an event leaving him in an unmodified contractual situation.

Here, the tax treatment leaving unrealized gains outside of the scope of taxation seems predicated on the coherence of the treatment which the EU has determined for the substitution of national currencies by the Euro generally. If nothing has changed in relation to the contract, it is normal that nothing be taken into consideration in relation to tax. Here again, a regulation establishing uniform rules could achieve this result.