EU-Japan Business Dialogue Round Table
Tokyo Meeting 17-18 July, 2000
Working Party "Accounting and Tax Issues"
Joint Position Paper

1. ACCOUNTING ISSUES

1.1 *Challenges*

Although many of the accounting standards in force across the world are converging, significant international differences remain. Multinational businesses require reliable ways of comparing financial performance and facilitating cross-border listings. The investment strategies of businesses headquartered in both trading partners would benefit from wider acceptance of international accounting standards (IAS).

1.2 *Current Status*

Systems of accounting standards have developed to reflect differences in the experience (especially historical and social) of the countries to which they apply. There are major differences between the standards of Japan, the US and the IASC especially in connection with:

- mergers
- financial instruments in respect of market value changes in securities held as long term investments
- investment in real property
- retrospective adjustment as a consequence of changes in accounting principles.

If international organisations setting common accounting standards for world-wide capital markets do not take sufficiently into consideration differences in the economic and social experiences of the countries to which those standards apply, there is a risk that companies will not receive a fair market valuation. In the EU it is the characteristics of the merger concerned that determines whether the purchasing method or the pooling of interest method is used. We believe that it is not possible to allow only the purchasing method to be used for mergers.

1.3 *Specific proposals*

Accounting standards agreed world-wide are indispensable but it is essential that they also reflect the actual management situation based on the variety of social and economic experience of the countries to which they apply. One way of achieving this would be to adopt worldwide core standards with local applications drawn from an agreed range. The issues mentioned in paragraph 1.2 above are already subject to IAS, which IOSCO has already approved. Accordingly IAS should be accepted soon for cross-border listings in capital markets.

We warmly welcome the work of the IASC in this context and we believe that it would be strengthened by the inclusion of representatives from Japan and EU at senior level in the Committee alongside those from the US, allowing them together to support IASC's activities.

1.4 *Other*

The Japan side will provide a brief explanation of current trends in the reform of Japanese accounting standards. In doing so, the EU side requests that consideration be given to the following questions in particular:

- Will all options or only the benchmark treatment of IAS be allowed in Japan?
- What guarantees will there be of the independence and professional standing of the auditing profession in Japan?
- Does Japan need a standard setting body covering accounting issues interpreting IAS in light of Japanese conditions and experience?

2. TAX ISSUES

2.1 CONSOLIDATED TAX

2.1.1 *Challenges*

Multinational companies are developing their businesses internationally and are engaged in world-wide investments. The investment strategies of businesses headquartered in both trading partners would operate more freely with the establishment of a consolidated tax system, which would also have beneficial consequences for the world economy.

2.1.2 *Current status*

In EU various types of consolidation tax system have been introduced. France, the Netherlands and Spain have the taxable income consolidation type (as does the USA, which has introduced the most complicated and accurate system among taxable income consolidation type). By contrast the UK, Germany and Sweden use the group relief type. Belgium and Italy have yet to introduce consolidated tax systems.

The Government of Japan has announced that it is planning to introduce a consolidated tax system once it has brought in a tax system for company separation, which will probably come in 2001. It therefore seems unlikely that the Government will act to establish a consolidated tax system in 2001 and it is not clear when it may do so. The type under consideration by the Government is the taxable income consolidation type.

We believe that any undue delay in introducing a consolidated tax system in Japan could serve as a barrier to FDI as well as an obstacle to the restructuring of companies in Japan, both of both domestic and foreign ownership.

To date, harmonisation of EU Member States' tax policies has not been effected, and it is not clear when a Directive to enable profits and losses outside the EU to be taken into account in an agreed way will be adopted.

2.1.3 *Specific proposals*

We call on the Government of Japan to introduce a consolidated tax system as soon as possible, and certainly before the year 2002. We call on the European Commission to make further efforts in the direction of fiscal harmonisation.

2.1.4 *Other*

The EU side will make a brief comment on the consolidated tax systems actually in use in the EU and the prospects for change. The Japan side has expressed particular interest in decreases in tax revenue, characteristics of types, and increases in operational costs.

2.2. TRANSFER PRICING

2.2.1. *Challenges*

We believe that the OECD's Advanced Pricing Agreement (APA) is a practical rule since it enables companies to discuss appropriate pricing beforehand with the tax authority. This could help to prevent taxation problems in cross-border transactions, facilitate healthy corporate development, and stimulate the international economy.

2.2.2 *Current status*

In principle transfer pricing taxation should be imposed transaction by transaction but obtaining detailed information about individual transactions is often difficult. This means that one of the following two methods tend to be used instead:

1. Taxation based on non-public information about individual transactions that the tax authority obtains from a company in the same business (the so-called Secret Comparable Method used by Japan and in the EU and elsewhere)
2. Taxation based on the operating profit ratio of a business unit of a similar company (the so-called CPM Method used by the USA and others).

The OECD's guideline is helpful but does not itself necessarily unify taxation methods.

Different methods of transfer pricing taxation in use world-wide increases the risk of double taxation to which companies may be exposed. They also burden companies with extended negotiation between countries. We believe that transfer pricing taxation should be imposed by rules that are internationally uniform.

We see attractions in the wider application APA especially from the viewpoint of its foreseeability and legal stability. On the other hand the current APA is not always a practical method for companies as it involves them in significant expenditure of time and money.

2.2.3 *Specific proposals*

It seems to us that the current transfer pricing taxation rule has been devised mainly with the tax authority in mind. It does not help a company wishing to use one method for setting transaction prices in all the tax regimes in which it operates. Furthermore the current rule often forms the background to international disputes on unilateral taxation.

As any transfer pricing taxation system is of considerable significance to a company, it is particularly important that the tax authority adopts a procedure that maximises foreseeability and legal safety from the company's perspective. We support the introduction of standard rules based on the fundamentals of transfer pricing practice common to international transactions.

We conclude that the wider introduction of an effective APA system should be encouraged. This system has been introduced in Japan, the US, and Canada, and then last year in the UK and France. However the substance of the systems and the way of approving price setting mechanism vary from country to country and this requires the expenditure of more time and money for advanced approvals.

We therefore propose that the EU and Japan agree uniform rules between themselves first with a view to promoting a world-wide model in the future. In standardizing the APA system, it will be important to determine a method of calculating transfer pricing based on information available to a taxpayer and to make clear that APA has priority over tax audit.

2.3. ELECTRONIC COMMERCE TAXATION

2.3.1 ***Challenges***

The challenge for Japan and the EU is to contribute to developing an international consensus on basic tax principles. A key feature of an equitable tax regime for e-commerce is that there should be no impediment either to the growth of existing businesses or the development of new businesses. Other essential features of taxes in this area include their neutrality, simplicity, fairness, effectiveness, international harmonization, and consistency.

2.3.2 ***Current status***

There is no international consensus about e-commerce taxation at present. European countries and the US are considering different measures to deal with it. Japan is watching the current situation of both areas. Meanwhile the OECD is also actively considering the question and is due to report later this year.

The European Commission has recently adopted an approach that, if endorsed, would mean that e-sales into the EU would be subject to VAT. By contrast the USA has a state sales tax and no federal indirect tax. The USA defines mail-order sales beyond state borders as being non-taxable and is expected to extend this principle to e-commerce as a whole for the time being.

We believe that the existence of differing tax regimes across the globe will constrict the healthy growth of e-commerce and distort fair competition between companies.

2.2.3. ***Specific proposals***

We regret moves to develop taxation rules for e-commerce before an international consensus has developed as to the best means of ensuring maintenance of the principles of neutrality, simplicity, fairness, effectiveness, international harmonization, and consistency.