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INTERNATIONAL TAX SERVICES



Rough Seas Ahead for Multinationals?
Short Report: The New Country by
Country Reporting (CbCR) & Transfer
Pricing Documentation Rules

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This report stems from Alliot Group's International Tax Services Group meeting in Sydney, Australia where international tax advisors from across the world engaged in a round table discussion on Action 13 of the Base Erosion and Profit Shifting (BEPS) Action Plan. The report provides basic guidance on the CbCR and transfer pricing documentation recommendations, an update on the status quo in different countries and opinions from local tax practitioners.



Sophia Tian of Lee & Lee Associates provides perspectives on CbCR developments in China.

What is Action 13 and CbCR all about?

Action 13 contains a batch of OECD recommendations which relate to transfer pricing documentation and reporting requirements as they apply to multinational enterprises (*MNEs*). It formally recognises the need to ensure that national tax authorities have an enhanced ability to exchange information so that they can assess high-level transfer pricing (*and other*) risks that relate to companies shifting profits to lower tax jurisdictions. The OECD has come up with a model that provides MNEs with a template and guidance on how to implement CbCR using a specific format (*the local and master files*).

Companies can use this model to report annually for each tax jurisdiction in which they do business. A country by country report will be exchanged, even by countries that do not adopt the OECD standard.

What are the main goals of the BEPS Project?

Maarten Borrie, partner at Alliot Group's Netherlands accounting firm member **Borrie**, explained that implementation of BEPS proposals into national laws has been ongoing since 2016 and that the main goals of the BEPS project are to:

- ✔ Avoid double non-taxation (*or less than single taxation*) through cracks in the interaction of domestic tax systems
- ✔ Address situations where profits are geographically separated from activities i.e. ensure value creation is aligned with the allocation of taxable profits.



Which companies does BEPS apply to?

Borrie commented that

"BEPS is focused not only on exotic structures, but on all transactions within group companies."

It was explained that under pressure from governments, the media and the public, countries are taking coordinated action to address their fiscal deficits, and that steps are being taken at the international and national levels to prevent multinational enterprises (MNEs) from lowering their effective tax rate (ETR) through the use of tax planning.

In **Borrie's** view, tax authorities have become more aggressive:

"The tax authorities appear to be more reluctant to give certainty in advance (e.g. via Advance Pricing Agreements (APA) and Advance Tax Rulings). They seem to be more opportunistic in transfer pricing audits."

Asia Pacific Chair **Jamie Towers**, a partner at **Hanrick Curran** in Brisbane, agreed that while CbCR is an administrative burden for international companies, he emphasised that reports must be filed on time and that:

"MNEs cannot start soon enough to get prepared."

What does the OECD standard model for Country by Country reporting look like?

Under the standard model, the prescribed three-tier format for CbCR includes three tables:

Table 1 relates to financial data from each tax jurisdiction. This includes revenues from related and unrelated parties, profit/loss before income tax, income tax paid (*on a cash basis*), income tax accrued in the current year, stated capital, accumulated earnings, number of employees and tangible assets other than cash and cash equivalents

David Gibbs, Chair of the International Tax Services Group and a partner at **Alliotts** in London, commented that the problem with this schedule is that it is not per entity, but per tax jurisdiction, and that it is an aggregated reporting format, not a consolidated format, and as a result, all the companies have to be added together: *"This paints a picture which is difficult to interpret and there is little room to give context to the figures."*

Table 2 is also per tax jurisdiction and must be completed with high level information on the main business activities of the constituent entities in each jurisdiction, for example, whether the activity relates to R&D, manufacturing/production, sales, marketing and distribution, and so on...

Table 3 is for providing more detail on the information provided in the second table. While often overlooked, table 3 presents an opportunity for a corporate to include extra information that helps to provide a better understanding of global revenue and profit allocation.

There was general agreement among participants that the CbCR format is intended as more of a risk assessment tool rather than as a stand-alone document on which transfer pricing audits are based.



Who files the CbCR document and when?

It is the responsibility of the group's parent company to file the report within 12 months of the last day of the reporting period. It needs to include legal entities as well as any permanent establishments. MNE groups with annual consolidated group revenue in the immediately preceding fiscal year of less than Euros 750 million (*or a near equivalent amount in domestic currency*) are exempt from CbCR filing.

Borrie commented that he has found it to be a simple process for his subsidiary clients who have used the Netherlands tax authorities' online portal which requires a notification of the name of the ultimate parent entity and the subsidiary company's tax registration number to be submitted.



Guillermo Villegas of Villegas y Villegas shares his views on likely implementation of CbCR in Mexico.

What is contained in the master and local files?

While the master and local files contain the same types of information for the most part, they need to be submitted in addition to standard transfer pricing documentation. The threshold that makes submission of these files necessary is a domestic affair. The master file should generally be the same in all countries, whereas the local file is often tailored to meet local requirements.

Master file

The master file contains standardised information that is relevant for all MNE group entities. The OECD has specified that the following should be included in the master file:

Key items

- ✓ Organizational structure
- ✓ Chart illustrating the legal structure and location of operating entities
- ✓ Description of business
- ✓ Important drivers of the business
- ✓ Description of the supply chain
(5 largest products by turnover and > 5% group turnover)
- ✓ Brief description of service agreements *(and TP policies)*
- ✓ Description of main geographic markets
- ✓ Brief written description of functional analysis
- ✓ Description of important business restructurings, acquisitions and divestures during the reporting period.

There was agreement around the table that the last item is new and not something that typically appears in TP documentation. It would mean that, if for example a profitable part of the business is relocated to a different country where it gains from a lower tax rate, then that needs to be included in the master file.



Intangibles

- ✔ General description of the MNE's overall IP strategy
- ✔ List of important intercompany agreements related to IP
- ✔ General description of the group's transfer pricing policies related to R&D and IP
- ✔ General description of important interests in IP, including entities, countries and compensation involved
- ✔ Intercompany financing activities
- ✔ General description of group financing, including important third party arrangements [This is also new]
- ✔ Identification of central financing activities, including country of incorporation and place of effective management
- ✔ General description of the MNE's TP policy related to financing activities
- ✔ Annual consolidated financial statements
- ✔ List and brief description of unilateral APAs and other tax rulings (*income allocation*) [This is also new].

Local file

The OECD has specified that the following should be included in the local file:

Key items

The local file is more of an in-depth document for a specific country. It provides information on the local taxpayer's operations and material transactions, as well as intercompany transactions and the group's overall transfer pricing policy.

Local entity

- ✔ Description of the management structure, local organizational chart, description of individuals to whom local management reports (*and countries*)

- ✔ Detailed description of the business and business strategies
- ✔ Indication of whether the local entity has been involved in business restructurings or IP transfers in the present or past year and how these affected the local entity
- ✔ Key competitors.

Controlled transactions

- ✔ Description of the controlled transactions, including the context
- ✔ Amount of intragroup payments and receipts for each category (*products, services royalties, interests, etc.*)
- ✔ Identification of group companies involved in each transaction
- ✔ Copies of all intercompany agreements
- ✔ Detailed functional analysis
- ✔ TP analysis, indicating the TP method selection, tested party identification, important assumptions made, reasons for performing a multi-year analysis, list and description of any comparable uncontrolled prices (*CUPs*), description of comparable search methodology
- ✔ Copy of existing uni-, bi- and multi-lateral APAs and other tax rulings to which the local jurisdiction is not a party and which are related to the controlled transactions.

Financial information

- ✔ Annual local entity financial accounts
- ✔ Information and allocation schedules showing how the financial data used in applying the TP method can be tied to the annual financial statements
- ✔ Summary schedule of relevant financial data for comparables used in the analysis and the sources from which the data was obtained.



REGIONAL COMMENTARY

The participant international tax partners from various Alliot Group member firms across the world regions gave their views on the new transfer pricing documentation and CbCR rules:

ASIA PACIFIC



Australia



Jamie Towers, Tax Partner at **Hanrick Curran** in Brisbane explained that CbCR applies in Australia to significant global entities i.e. groups which have over AUD \$1 billion turnover for financial years starting on or after 1 January 2016.

Towers also commented that the requirements depend on whether the parent company is in Australia or if it is only an Australian subsidiary – if the former, the parent company is required to lodge the CbCR report, master file and local file using XML schema software by 31 December one year after the end of the financial year. Towers confirmed that

“If the reporting Australian entity is only a subsidiary company, it is required to prepare and lodge the local file, but also lodge the master file – the parent company’s master file can be used if it is in English, but if not available in English, it needs to be converted before being lodged.”



China



Sophie Tian, Tax Manager at **Lee & Lee Associates**, reiterated that China, as a G20 member, is a big supporter of information exchange. She also confirmed that China signed up to CbCR in January 2016 and that tax laws have now been updated.

Tian explained that technology, specifically China’s eTax portal, means that the Chinese tax authorities can see all of the business activity of companies operating in China and that as a result, *“It will be increasingly difficult for MNEs to shift profits around.”*

Tian also warned that under new CbCR rules, China can compel MNEs to provide information about their value chain, including profits generated in different countries and how profits should be calculated: *"In future, communications between MNEs and the Chinese local tax authorities will be more transparent and efficient. Profits will be monitored more strictly and MNEs wanting to transfer price will be required to prepare the supporting documents."*

Tian also affirmed that resident and non-resident enterprises which have established entities or premises in China have to submit an annual report of related party business transactions to China's tax authorities along with the annual income tax returns. Tian also advised that the tax authorities can launch special investigations into specific transactions.



Hong Kong



Tony Cheung, partner at **Lawrence Cheung CPA Company**, confirmed that the country's tax authorities have proposed certain amendments to tax legislation with a view to implementing CbCR from 1 January 2018 and that the threshold will apply to groups with over Euros 750 million annual consolidated revenues. However, owing to the lack of information available currently, Cheung was unable to confirm whether a Hong Kong MNE group subsidiary is required to file: *"Currently, it would seem that only the parent company, if tax resident in Hong Kong, is required to undertake the filing."*



New Zealand



Vanessa Williams, Partner at **Alliott NZ** in Auckland, pointed out that CbCR is currently not written into New Zealand's laws, but that the country's revenue minister will be putting a bill to parliament in July 2018. However, Williams suggested that it is just a matter of time until CbCR comes into use in New Zealand.



EUROPE



Giorgio Marcolongo, partner at **Sorefisa** in Milan, confirmed that Italian subsidiaries of MNEs see CbCR as an additional burden and will tend to give it to their tax consultant or lawyer to deal with.

Marcolongo also suggested that explaining to subsidiary clients why they need to do this and then securing their cooperation is difficult given that the client is required to collate a large set of information about the MNE group before filing with the Italian tax authorities. Such information includes the size of the group, annual turnover and the structure of the group – however, it is difficult to gather such information as it is not always the duty of the holding company to report.

“An Italian subsidiary may be requested to file the CbCR with local tax authorities if the ultimate parent company is not obliged to file the CbCR in its own jurisdiction or no specific agreement is in place for the automatic exchange of the CbCR data between Italy and the other jurisdiction. Issues can also arise if the Italian tax authorities have suspended the exchange of information with the other jurisdiction.”

Marcolongo emphasized the size of fines for non-compliance, hinting that MNE groups *“are becoming more familiar with the local/master files, with some clients even requesting them, worried about penalties, even if compliance in their situation is still optional as they are below the Euros 50 million threshold that applies in Italy.”*

 **Netherlands**

Maarten Borrie, Partner at **Borrie** in Rotterdam, explained that the Netherlands has been busy implementing the BEPS Action 13 recommendations into the country's income tax act, with the legislation entering into force on 1st January 2016:

"The CbCR regulations apply to Dutch entities belonging to a MNE group with an annual consolidated turnover of more than Euros 750 million."

 **United Kingdom**

David Gibbs, International Corporate Tax Partner at **Alliotts** in London, stated that the UK has a fairly well established transfer pricing regime. He also gave his view that the UK is relatively unique in that small companies with less than Euros 10 million revenues are, broadly speaking, exempt from the transfer pricing requirements, although this requirement does have to be fulfilled if the company is part of a large group where the other side of the transaction requires it.

"The UK has been an early adopter of all of the BEPS proposals, including CbCR. In fact, there was an early staging date of 1st September 2017 by which subsidiary companies were required to file a report, albeit of a basic nature."

Gibbs lamented that the country's tax authority, HMRC, only published guidance on what they were expecting in mid-August 2017, and that tax advisors only had two weeks in which to ask their clients to send their reports in: *"We had to educate our subsidiary clients on what this is all about and explain to them that even though they are not the parent companies, they are still obligated to file a report."*

Gibbs highlighted the important role his firm is having to play in identifying which of their clients (*largely subsidiaries of large complex groups*) are under obligation to file the necessary report.



AMERICAS



Guillermo Villegas, partner at **Villegas y Villegas** in Monterrey, commented that while the official formats have not yet been released online by Mexico's tax authorities, the information that will need to be gathered and submitted *"is likely to be very similar to the OECD recommendations."*

Villegas confirmed that the Procuraduria de la Defensa del Contribuyente (*PRODECON*) which acts as the taxpayer's ombudsman, has already released a statement which shows that the threshold will be set at Mex\$ 700 million (*equivalent to approximately US\$50 million*) and that the organization has been seen to use the same OECD format at various conferences.

"This threshold will apply to some of our clients, so we are communicating to them that we will need to file by 31st December 2017 for the 2016 tax year. We are using the OECD standardised format as a guideline when we approach our clients to ask for the required information," commented Villegas.

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