Global transparency

Large Corporate Management of taxes

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Andrew Cousins provides guidance on what needs to be considered when advising businesses on the impact of country-by-country reporting

Key Points

What is the issue?

The snowball of ever greater corporate tax transparency is seeing country-by-country reporting sweep the globe as the most immediately impactful outcome of the OECD/G20's BEPS project.

What does it mean to me?

Disclosure of multinationals' global distribution of profits and corporate taxes paid will inevitably be made to a very much wider audience, certainly across tax administrations and potentially to the wider public, exposing companies to a dual risk of increased tax exposure and tarnished reputation.

What can I take away?

Multinationals need to consider the impact of their disclosures on tax administrations and potentially on the company's reputation if the information is made public. Preparing a dry run of the country-by-country report now will assist businesses to identify and mitigate tax exposures, while strategies to engage with the new world of tax transparency may usefully be deployed to address reputational risk.

Of all the measures to emerge from the OECD/G20's Base Erosion and Profit Shifting (BEPS) Project, the one that has had the most immediate and widespread impact in effecting change has been the introduction of country-by-country (CbC) reporting. Always one of the goals of the BEPS Action Plan, the Action 13 proposal to enhance transparency for all relevant tax administrations, through the provision by multinationals of information on the global allocation of their income, economic activity and taxes paid among countries via a common template, has received rapid and widespread adoption.

Introduction of CbC requirements

A very limited number of countries, among whom the UK led the charge, announced their intention to implement the CbC reporting rules almost as soon as the interim measures introducing the concept were published by the OECD in September 2014, but in recent months the number of adopters and proposed adopters has snowballed. On 23 May 2016 the OECD Council approved the incorporation of the BEPS recommendations into the Transfer Pricing Guidelines, setting CbC reporting as a new global standard in the revised Chapter V on Documentation, targeting an introduction in respect of periods commencing 1 January 2016.

At the date of writing, 85 jurisdictions have joined the G20/OECD's 'Inclusive Framework on BEPS', 39 new BEPS members combining with the existing 46 OECD members, accession countries and G20 members in the project in a commitment to implement the OECD's four minimum BEPS standards, of which CbC reporting is one.

In a more concrete step towards adoption, at the first meeting of the Inclusive Framework held in Kyoto on 30 June/1 July 2016 a further five jurisdictions signed the Multilateral Competent Authority Agreement for the automatic exchange of CbC reports (CbC MCAA), bringing the total number of signatories to 44. Signature of the CbC MCAA represents a firm commitment by a jurisdiction to the introduction of CbC reporting, allowing all signatories to exchange, bilaterally and automatically, CbC reports with each other.

While some individual Member States, such as the United Kingdom, had already acted unilaterally to legislate for CbC reporting, on 25 May 2016 the Council of the EU approved the modification of Directive 2011/16/EU to introduce a specific requirement for CbC reporting across all the 28 Member States in respect of periods commencing on or after 1 January 2016.

In all, more than 50 countries have already taken tangible steps to implement CbC reporting and many more are expected soon to follow suit. In at least 17 countries, including the United Kingdom, legislation introducing CbC reporting is already in effect. The majority of these countries have introduced reporting with effect for periods commencing on or after 1 January 2016, to be filed within a year of the period end. In the remaining countries draft legislation has either been published or is in preparation. Given the widespread and increasing level of adoption, for the vast majority of multinationals over the €750 million turnover threshold recommended by the OECD, CbC reporting is a necessary compliance consideration for periods commencing on or after 1 January 2016.

Although the OECD has provided model legislation in the Transfer Pricing Guidelines, it has been left to each country as to how exactly it introduces CbC reporting. The UK, while holding firm to the basic tenets of the €750 million turnover threshold and 1 January 2016 start date, has introduced its own variation on secondary reporting (where the CbC report is not available for exchange from the jurisdiction of the foreign multinational's ultimate parent entity), requiring UK entities to submit to HMRC a 'UK CbC report', containing details only of the UK entities and their subsidiary entities in the group.

Guidance on preparation of CbC reports

It has been clear from the beginning that the disclosures associated with CbC reporting are potentially going to increase the risk of challenge from tax administrations. Tax directors should already be performing dry runs of the CbC report, firstly from the practical perspective of assessing the availability of the data to be disclosed and its ease of collection, secondly to ascertain the risks arising from disclosure to tax administrations of the information contained in the CbC report. Consideration will need to be given as to how best to explain the information presented in order to avoid misunderstanding and challenge. Remedial strategies may be needed to address egregious mismatches of value creation and profit or any material deviations between policy and practice that are revealed as a result of the reporting process.

The guidance on CbC reporting, as now enshrined in Chapter V of the OECD Transfer Pricing Guidelines, is not prescriptive and those multinationals that have begun to prepare a dry run of CbC reports have encountered a number of areas of uncertainty around definitions and disclosures where decisions are necessary.

What, for example, should the definition of ‘Stated Capital’ applied to legal entities per tax jurisdiction in Table 1 of the CbC report comprise? In the same table, should cumulative turnover figures be disclosed per tax jurisdiction in respect of Related Party Revenues (where for example a series of holding companies in one jurisdiction passes interest down one to another) or should the numbers be an aggregate of all entities in that jurisdiction? The Transfer Pricing Guidelines are silent on these points, which are left largely to the interpretation of the preparer. Some authorities, such as the US, have now issued clarifying guidance of their own, or promised future guidance, like Australia, which supplements the guidance provided by the OECD. The US guidance makes clear, whereas the Transfer Pricing Guidelines do not, that related party turnover figures are to be disclosed as an aggregate of the information for the constituent entities resident in each tax jurisdiction.

In June 2016, the OECD issued further guidance of its own which will support the current transitional period as countries bring the new requirements into force, setting out:

- Transitional filing options for multinationals that voluntarily file in the jurisdiction of the ultimate parent entity (so-called ‘parent surrogate filing’);
- Guidance on the application of CbC reporting to investment funds and partnerships; and
- The impact of exchange rate fluctuations on the €750 million CbC filing threshold for multinationals.

One outcome of this is that the UK is no longer likely to be a jurisdiction of choice for surrogate filing for the group in the majority of cases where the jurisdiction of the multinational's parent entity is a late adopter of CbC reporting. Perhaps the most significant example of a late adopter is the USA, which does not introduce CbC reporting for periods commencing before 30 June 2016. Other important examples are Switzerland, which will not introduce CbC reporting until periods commencing 1 January 2018, and Japan, where the introductory date is 1 April 2016. These countries have indicated that they will accept parent surrogate filing for periods commencing 1 January 2016, allowing the ultimate parent entity to file in its jurisdiction.

Public country-by-country reporting

While the OECD's standard for CbC reporting emphasises the confidentiality of the information disclosed and exchanged, if the European Commission and various civil society groups such as Oxfam and Christian Aid have their way, public country-by-country reporting will become the new standard.

In an initiative separate from the introduction of CbC reporting to the OECD standard, on 12 April 2016 the European Commission proposed amending the Accounting Directive 2013/34/EU to ensure that large groups publish annually a report disclosing the profit and the tax accrued and paid in each Member State on a country-by-country basis. This is currently submitted to the European Parliament and the Council of the EU for adoption but is not without controversy.

Sweden, Ireland, Austria and Cyprus are challenging the proposal, arguing on a technical point that as the legislative changes relate to European tax harmonization the legislation should be considered under EU tax law rules, whereby unanimous agreement of all 28 EU finance ministers is required, rather than under single-market rules that give the EU Parliament joint decision powers. Germany has also requested that any such legislation should not undermine the OECD standard of CbC reporting.

Nonetheless forms of public country-by-country reporting already exist for credit institutions and investment firms established in the EU (the EU Capital Requirements Directive IV) and, more widely, for the extractive industries, and it is an opinion voiced by many that the introduction of universal public country-by-country reporting is purely a matter of time.

Confidentiality and reputation

What also therefore needs to be given equal consideration in this new world of tax transparency, given the present risk of leaks and what is seen by some as the future inevitability of public CbC reporting, is the reputational risk of the company, should CbC information be disclosed. Tax directors need to give thought to the impact of the publication of the CbC report, the consequences of exposure in the press and the types of questions that this will engender from non-governmental organisations.

Whether or not public country-by-country reporting becomes a reality, it is a fact that there already have been cases where information exchanged between competent authorities has found its way into the public arena in the jurisdiction of the recipient tax administration, attracting a high degree of notoriety. Notwithstanding the scrupulous confidentiality clauses placed into the instruments for the exchange of CbC reports, nervousness exists about the standards of data security in certain jurisdictions that are likely to handle CbC reports and some tax directors admit that they consider the leaking of shared data into the public arena inevitable.

Increasingly, tax directors are going to have to consider how their companies are going to manage public relations, potentially through actively embracing transparency, publishing reports on taxes paid, as some companies have already done, and volunteering information in the public sphere before it is forced out through regulation. In the United Kingdom, the risk of public disclosure of the CbC report should be assessed in the same way as the newly introduced mandatory requirement to publish a tax strategy and thought should be given as to whether each of these bear the light of scrutiny.

The implications of Brexit on CbC reporting

While the origin of much angst in many a field, the decision to leave the EU is not anticipated to have any significant effect on the UK’s implementation of CbC reporting, which, although endorsed by the EU, remains an OECD/G20 initiative. Though perhaps no longer covered by EU Directives in future, the UK has been, and is expected to remain, an enthusiastic supporter of the BEPS Project. As a G20 and

OECD member, its adoption of CbC reporting, which has been introduced into British law through the Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016, is therefore unaffected by the decision to leave the EU.

If anything, the escape from the influence of EU Directives will allow the UK to remain set on its current course. To what extent the UK's interpretation of secondary reporting through the idiosyncratic concept of the 'UK CbC report' may have needed tweaking to be consistent with the Directive's more orthodox vision of secondary reporting is not entirely clear, but in the absence of the Directive's future sway in the UK, the inconsistency, such as it is, can be allowed to remain.

The effect of Brexit has the potential to be more pronounced in the non-OECD sphere of public country-by-country reporting, although recent indications are that the UK holds steady on its established trajectory. Prior to the referendum on EU membership, the UK was a proponent of the European Commission's push for public country-by-country reporting, and on 5 September 2016 the UK government accepted an amendment to the current Finance Bill that would enable future inclusion of the CbC report in the published tax strategy. However, the UK is highly unlikely to implement such a measure unilaterally and it has made clear that its commitment to increased transparency is through a multilateral approach.

Should the post-Brexit EU proceed with the adoption of public country-by-country reporting, however, full disclosure of UK entities would no longer be a requirement within the EU and it is to be expected that their results would be reported in the aggregated non-EU disclosure for groups with an EU presence.

Parting shot

With the first reports due to be submitted by the end of 2017, CbC reporting presents tax directors of multinationals meeting the €750 million turnover threshold with an immediate need to consider the consequences of the disclosure before tax administrations and potentially before a wider public audience. Preparing a dry run now of the CbC report will reveal any difficulties in the data-collection process and allow identification and possible mitigation of any tax risks. Strategies to engage with the new world of tax transparency may be a worthwhile investment now to head off the risk of reputational damage.