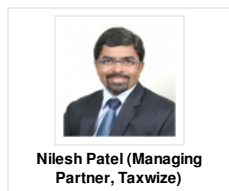


Why OECD's CbC Reporting has limited impact on risk assessment capability?

Date : 23 June 2015



1. Introduction

Two weeks back the OECD, as part of its Action Plan to address Base Erosion and Profit Shifting (BEPS), released on 8 June 2015, *Action 13: Country-by-Country (CbC) Reporting Implementation Package*. This Implementation Package is a follow-up on two reports previously released by the OECD:

- (i) September 2014 Report proposing a Three Tier Global Standard for Transfer Pricing Documentation (Master File, Local File and CbC Report) along with the Standard Template for CbC Report; and
- (ii) February 2015 *Implementation Guidance* on how to implement the CbC Reporting Regime.

The present 8 June 2015 Implementation Package brings –

- a. A Model Legislation for Countries, to introduce CbC reporting into their respective domestic legislations – the Model Legislation prescribes the mechanism of filing the CbC report; and
- b. *Three* Model Competent Authority Agreements (Exchange Agreements) for exchange of CbC report among the Tax Authorities of those Countries where a MNC Group has either a Parent Entity or a Subsidiary or a Permanent Establishment. Of the three Model Exchange Agreements:
 - the *first* is based on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,
 - the *second* is based on a Bilateral Double Tax Convention, and
 - the *third* is based on a Tax Information Exchange Agreement (TIEA).

2. What is a CbC Report?

The CbC report is part of a three-tiered documentation structure, along with a Global Master File and a Local File, which together represent a standardised approach to Transfer Pricing documentation^[1]. The CbC report is intended to enhance transparency for Tax Administrations, by putting into their hands relevant and reliable information. The information contained in the CbC report is expected to enable the Tax Authorities to perform an efficient and robust Transfer Pricing risk assessment analysis, for purposes of selecting appropriate cases for audit or scrutiny.

You can find in **Annexure – I** the Standard Template for CbC report which contains the information MNCs need to report, as prescribed by the OECD^[2].

3. Mechanism of filing CbC Report under the OECD Implementation Package

The Model Legislation, contained in the OECD Implementation Package, requires the *Ultimate Parent Entity* of an MNC Group to file the CbC report in its Jurisdiction of tax residence. To make that possible, Countries will have to enact the Model Legislation under their domestic laws.

What will happen when the Country of Ultimate Parent of the MNC Group does not enact CbC Legislation? To take care of such a situation, the Model Legislation contains secondary filing or backup filing mechanisms that require either direct filing by Local Subsidiaries or the appointment of a "Surrogate Parent".

- The term "Surrogate Parent" means an Entity of the MNC Group that has been appointed by such MNC Group, as a sole substitute for the Ultimate Parent Entity, to file the CbC report. The "Surrogate Parent" will file CbC report in its Tax Jurisdiction on behalf of the MNC Group, *when the Country of Ultimate Parent of the MNC Group has not enacted the CbC legislation.*
- If no Entity of the MNC Group is appointed as a "Surrogate Parent", then the Local Subsidiaries will have to directly file the CbC reports in their respective Tax Jurisdictions, *if the Country of Ultimate Parent of the MNC Group has not enacted the CbC legislation.*

Where the Local Subsidiaries directly file CbC reports in their Tax Jurisdictions, there the CbC reports will be directly available to the Tax Administration of those Jurisdictions. But when the CbC report is filed by either the Ultimate Parent Entity or the "Surrogate Parent" Entity, then that report will have to be exchanged by the Jurisdictions of those entities, with the Jurisdictions of Local Subsidiaries, to enable the later Jurisdictions in conducting risk assessment.

4. To what extent will the OECD Implementation Package increase transparency in Transfer Pricing Reporting – whether it will enhance the risk assessment capability of Tax Assessing Officers?

4.1 The Assessing Officers may not get the required information to make a meaningful Transfer Pricing risk assessment

Under the Model Legislation the Ultimate Parent Entity (UPE) has to file the CbC report in Jurisdiction of its tax residence, *for the Reporting Fiscal Year of the MNC Group*. Imagine what will happen when the Fiscal Year (FY) of the MNC Group or the UPE is different from the FY of the Indian Subsidiaries of the Group.

Say, the FY of a UK based MNC Group's UPE is January 2016 to December 2016 (Calendar Year); and the FY of Indian Subsidiaries of the Group is April 2016 to March 2017 (Indian Financial Year). You see, there is a mismatch here in the reporting-period. Assume, the UPE files CbC report in UK, for the FY January 2016 to December 2016 (Calendar Year); that report is forwarded by the UK Competent Authority to the Indian Competent Authority. But that CbC report does not have the relevant information of economic activity for the FY of April 2016 to March 2017 (Indian Financial Year); that CbC report has information for the Calendar Year of January 2016 to December 2016. Due to such mismatch in the reporting period, the CbC report

exchanged by UK is of little help, to the Assessing Officer holding jurisdiction over an Indian Subsidiary of the UK MNC, in selecting the case of that Subsidiary for scrutiny assessment.

Also, there is possibility that the Indian Assessing Officer may not receive the CbyC reports, filed by the UPE (or Surrogate Parent) of the Foreign MNC Groups, in time, to pick up the cases for scrutiny and issue notice under Sec. 143 (2) (within 12 months from the end of the month in which the Indian Subsidiaries file their tax returns in India). Under the procedure laid down in the Model Exchange Agreements, the Foreign Competent Authority will send the reports to the Indian Competent Authority. After receiving the reports, the Indian Competent Authority will further forward the report to the concerned Assessing Officers. This bureaucratic process of exchange might delay the receipt of the CbyC reports by the Assessing Officers of the Indian Subsidiaries of Foreign MNCs.

4.2 Only 10% to 15 % of the MNCs will get roped in

The Model Legislation proposes to cover - under the CbyC regime - only those MNCs which have consolidated group revenues of 750 million Euros (roughly INR 5250 Crores) or more^[3]. This monetary threshold, OECD itself has confessed, will rope in only 10%-15% of MNCs under the CbyC reporting regime^[4]. Besides, most of such large MNCs already fall under scrutiny assessments, even under the present Indian norms.

The CbyC reporting regime will, therefore, be of a very limited use to the Indian Tax Authorities in picking up cases for scrutiny, based on Transfer Pricing risk assessment.

4.3 Local Tax Authorities cannot ask for any additional information to assess risks

Para 10 of the February 2015 OECD Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting (Action 13) states that Jurisdictions should utilise only the Standard Template prescribed in the September 2014 Discussion Draft. Stated otherwise, under this condition no Jurisdiction will require that the CbyC Report include any additional information not contained in the Standard Template. So, the Tax Authorities cannot ask for any additional information even though it might be relevant for risk assessment.

Intercompany payments

In the original OECD Discussion Draft Dated 30 January 2014, the total amount of Royalties, Interest, and Service Fees paid by an Entity of a MNC Group to (or received by an Entity of a MNC Group from) other Entities of the Group was to be reported separately in the final six columns of the template. These intra-group payments are no longer included in the latest CbyC template (the September 2014 template). You will agree that these payments are very relevant to assessment of Transfer Pricing risks and BEPS risks. Yet, they are neither to be reported nor to be called for by Tax Authorities, for making risk assessment, while picking up the Transfer Pricing cases for scrutiny.

4.4 CbyC Report can be used only for selecting cases for scrutiny assessment

Tax Authorities can use the CbyC Report primarily for selecting cases for scrutiny assessment, based on high-level assessment, of transfer pricing risks and other base erosion and profit shifting related risks. Tax Authorities cannot use the information contained in the CbyC report for making Transfer Pricing adjustments; the OECD has clarified that Transfer pricing adjustments cannot be based on the CbyC Report^[5].

The concerned Jurisdictions have to agree that they will not use the information in the CbyC report as a substitute for detailed Transfer Pricing analysis, based on full functional analysis and comparability analysis. This means that the CbyC information cannot be used by Tax Authorities to allocate profits based on either Formulary Apportionment or Tangible Assets or Headcount. In that sense, the CbyC report will not help in assessing profits on basis of the location where value is created (which is the avowed objective of the OECD BEPS initiative).

5. Can India enact Domestic Legislation contrary to the Model Legislation, and ask the Indian Subsidiaries to directly file CbyC Reports?

To get over the hurdles highlighted above, one may be tempted to say that India should consider enacting CbyC Legislation that –

- Demands the CbyC information directly from the Indian Subsidiaries of Foreign MNCs,
- Lowers the monetary threshold for filing the CbyC report from 750 million Euros to realistic levels, and
- Empowers the Assessing Officers to call for additional information that might help them in fully understanding the CbyC information reported.

But can India do so? Being part of G20, which has initiated BEPS Project, it would be hard for India to break away, and unilaterally enact domestic legislation that is not consistent with OECD Model Legislation.

6. Conclusion

The CbyC Model Legislation and Model Exchange Agreements prescribed by the OECD in the 8 June 2015 Implementation Package are not likely to meet the objective of enhancing transparency for Tax Authorities. That objective can be met if the Local Subsidiaries of Foreign MNCs are mandated to directly file CbyC report in their Tax Jurisdictions. But India, and other Developing Countries, may not find it possible to unilaterally enact domestic legislation, demanding CbyC report directly from the Local Subsidiaries. The outcome: CbyC Implementation Package of OECD will have a very limited impact on risk assessment capability of the Tax Officers.

Annexure - I

Standard Template for the Country-by-Country Report

Table1. Overview of allocation of income, taxes and business activities by tax jurisdiction



Name of the MNE group: Fiscal year concerned:										
Tax Jurisdiction	Revenues			Profit (Loss) Before Tax Income (on cash basis)	Income Tax Paid (on cash basis)	Income Tax Accrued-Current Year	Stated capital earnings	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Table2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group: Fiscal year concerned:															
Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction if different from Tax Jurisdiction of Residence	Tax Jurisdiction of organization or incorporation	Research and Development	Holding or Managing intellectual property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to unrelated parties	Internal Group Finance Services	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Dormant	Other2
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	2.														
	3.														
	1.														
	2.														
	3.														

2Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

- [1] September 2014 OECD Report on Transfer Pricing Documentation and Country-by- Country Reporting
- [2] The Standard Template for Country-by- Country Reporting is prescribed by the OECD in its September 2014 Report on Transfer Pricing Documentation and Country-by- Country Reporting
- [3] Article 1.3 of the Model Legislation Related to Country-by-Country Reporting, included in the OECD Country-by-Country Implementation Package
- [4] Para 10 of the February 2015 OECD Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting (Action 13)
- [5] Article 6.1 of the Model Legislation Related to Country-by-Country Reporting, included in the June 2015 OECD Country-by-Country Implementation Package