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Consultation Document on the Review of Country-by-Country Reporting (BEPS Action 13)

Introduction

PwC International Ltd on behalf of its network of member firms (PwC) welcomes the opportunity to share its views in reaction to the OECD Secretariat's Consultation Document on the *Review of Country-by-Country Reporting (BEPS Action 13)*. While matters have developed considerably since our submission in 2014[1] in respect of the BEPS Action 13 proposals, as they stood at that time, there are still a number of points on scope and content which continue to apply.

Overall, CbC reporting is just one straw in a haystack of initiatives to make transparency "better" for both taxpayers and tax authorities. In that context, we hope to offer some constructive suggestions here but are happy to be engaged in broader areas of discussion.

Implementation of the BEPS Action 13 minimum standard

A number of elements have been implemented successfully and contribute toward a smoother process, in that they are harmonised, consistent and the result of developed/settled systems. There should be a high bar for making changes to these constituents, and it should be demonstrated that such changes are (i) wanted by a majority of tax administrations, who (ii) are able to demonstrate why they are wholly necessary in order to complete a high level risk assessment. Changes to them risk incurring a burden that is out of proportion to the benefit; gathering the necessary information can be difficult and understanding whether there is an obligation to file a return, as well as keeping track of notifications, and updating that analysis every year, can be challenging.

[1] https://www.pwc.com/gx/en/tax/tax-policy-administration/beps/assets/transfer-pricing-documentation-february-2014.pdf

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However, there are still quite a few inconsistencies in interpretations by different countries of particular requirements. These would benefit from incremental or, in some cases, more fundamental amendment to the extent that such changes can result in greater consistency.

Countries could be encouraged to continue to adopt and put in place exchange agreements to avoid the burden of local filing with its variations of content and timelines. This is particularly important for notifications and the potential secondary mechanism filing obligation that can arise when exchange agreements are not in place, i.e., the secondary mechanism could be deferred in territories unless information sharing provisions are in place. At the moment, a country in Europe might require local filing in its own format for all territories where it doesn't have exchange arrangements and if that included, say, US and China, there would be a lot of work required to 'translate' those US/Chinese CbC reports into that EU country's schema. Consideration could be given also to filing a CbC report centrally in these instances rather than filing with local tax authorities, avoiding the need for exchange agreements and the secondary mechanism, inconsistencies between schemas, etc.

The appropriate and effective use of CbC reports

The ultimate objective of CbC reporting is to share information about the geographical location of economic activity and resources of multinationals. It is arguable whether the reports could be used or interpreted in a way that will easily determine just transfer pricing risk without touching on the constituent parts of the value chain such as:

- Are local functions of a routine nature?
- Do you create marketing intangibles?
- What is the importance of your specific function in the value chain?
- Does the economic and legal intellectual property (IP) owner have the ability to bear and control risk?

After all, a CbCR serves as high level risk analysis tool and not as a blueprint for a transfer pricing analysis of the system profit.

We have seen very limited evidence of countries specifically referring to matters included in the CbC report (many countries do not disclose the sources they use). A broad evaluation of the use of CbC report information by countries might be a useful analysis. Some examples of actual use include:

- acknowledgements that CbC report data has been one of the key data sources used for risk assessment purposes in being a motivation for a request letter from the tax authority suggesting the taxpayer explain specific information and its tax treatment
- a tax authority highlighting data inconsistencies and omissions to large percentages of taxpayers demanding explanations/ refiling for corrections/ updated information.

The consultation document refers to the OECD Forum on Tax Administration (FTA) *CbC Reporting: Handbook on the Effective Use Of CbC Reporting Information in Tax Risk Assessment* (FTA CbCR risk assessment handbook), released in September 2017. It also suggests the OECD is still developing the CbC reporting Tax Risk Evaluation and Assessment Tool (TREAT), which will support tax administrations, including those from developing countries, in reading and interpreting CbC reports. This could be

supported with some quantitative/ ratio analysis for automation purposes and to simplify the process to select for audits in those developing countries or more widely. The analysis could be something similar to what we have used effectively to compare and contrast items, e.g., a high level comparison of entities within selected tax jurisdictions and items like revenue per employee, profit before tax per employee, profit before tax divided by total revenues per tax jurisdiction, income tax paid (accrued) divided by profit before tax.

Other elements of the BEPS Action 13 report

The master file (MF) is a strategic document and a significant part of the three-tiered documentation package. It contains information regarding the multinational group entities on a consolidated level. It aims to explain elements of the system profit allocation on a high level basis, i.e., factors creating value of the business.

The local file (LF) then contains information more specific to the business and entities in the particular country, necessary or considered helpful by the multinational to the understanding of the tax administration of the country of the tax return or its constituent elements in the context of the MF.

Emphasis should lie on the MF as the most important base document, although LFs are crucial to the granular transfer pricing analysis. This is probably the balance of the current guidance, and the main focus of the consultation document. The MF and LF do not constitute a minimum standard, so exist only in domestic law requirements but following best practices would deliver a more streamlined approach (e.g., formats, deadlines and filing dates). Countries have introduced different requirements in relation to both the MF and LF from what the best practices suggest would be optimal, including even third party documentation requirements. Multinationals struggle equally (or even more) with LF and Chapter V of the Transfer Pricing Guidelines (TPG) could be pushed more strongly.

Many countries have set thresholds for MF and/or LF below the CbC reporting threshold. Some countries also refer to balance sheet threshold figures (e.g., assets). Best practice would probably include a common threshold applicable to sales (whether the CbC reporting threshold or lower).

One issue we have found is that taxpayers sometimes think the MF/LF is a check list rather than a requirement to follow a standardised approach to structure pertinent evidence that supports the transfer pricing.

It seems supportable that, where local needs dictate, the information requested in the LF should extend beyond the scope of the guidance, e.g., particular types of investment for which a country experience of tax issues. However, sometimes this may go too far as a requirement for all CbC reporting businesses, perhaps in terms of a breakdown of employees into particular areas of the business or transfers of risks, functions and assets without reference to any 'hallmarks' for these kinds of disclosures. Where materiality thresholds have been included, these have appeared to be fairly arbitrary.

Topics concerning the scope of CbC reporting

Clarity of the guidance may help countries to interpret it in a more similar way and reduce the number of differences that currently apply.

An MNE group, for this purpose, arguably already includes an enterprise that is resident in one jurisdiction but has a taxable permanent establishment (PE) in another jurisdiction. But some groups have interpreted the guidance to deal with the data for PEs that results in skewed results. Clarity on the application of some definitions (stated capital, accumulated earnings) for PEs as well as the definition of a Group as including a single entity that conducts business through one or more PEs in other jurisdictions may be helpful.

Requiring a CbC report to be filed by groups under the common control of an individual or individuals acting together would seem to add considerable complexity to a situation that might more easily be dealt with by tax administrations as the need arises. Practically, a change could be very difficult as the different groups could have nothing in common and no ongoing business relationship. Also, it is unclear how this would interact with the requirement for consolidation which means a lot of private equity houses report only on individual portfolio groups and not across the whole fund's holding. If it were considered imperative, there may be some benefit in hypothesising the situation to be a commercial entity that is listed on a stock exchange (in a similar way to non-listed entities that don't consolidate), such that the current guidance could be applied without the need to change the recommendations.

The EUR750m threshold was said to cover 90% of corporate revenues and the high costs of applying it to other groups for some tax administrations and taxpayers would not be commensurate with the benefits.

Applying a threshold that takes into account consolidated group revenue of more than one fiscal year could be helpful, provided the practice is consistent. Being above the threshold for two of the preceding four years is perhaps the most straightforward for the benefit gained.

Extraordinary income is, by definition, outside the ordinary course of the business and including it risks distorting any high-level risk assessment. There is also a concern that time and resource may be wasted if investigation is encouraged on the basis that something is ‘extraordinary’, forgetting this is an accounting term in this context. Fundamentally, what is extraordinary will change from accounts to accounts due to GAAP differences and different auditor interpretation, making it inconsistent as any sort of indicator. Also, if something is extraordinary then it is unlikely to be repeated, risking groups falling in and out of the regime from period to period - a lot of the value of the data is being able to look at year-on-year trends and this may be frustrated or overcomplicated. If the extraordinary income itself is of interest to tax authorities they could enquire about it anyway.

If investment is an important part of the core activity of the group – a threshold to be determined - then it may be useful to include rather than exclude gains. Below the threshold, there would be a strong possibility that the high level analysis could be distorted. GAAP differences and problems with different definitions being applied could also cause distortions/ inconsistencies across territories.

Where the preceding fiscal year is less or more than 12 months, the different approaches currently adopted cause complexity. An adjustment of the threshold pro-rata to the time period seems the most straightforward resolution.

Topics concerning the content of a CbC report

Presenting Table 1 information by entity rather than by tax jurisdiction would add significant complexity and review/ governance requirements for companies while the local tax administration it provides no more useful information that it can get from accounts, the tax return(s), LF and other typical transfer pricing documentation. It would also be near impossible for countries without entity level statutory accounts and tax returns (e.g., the US).

This is another instance in which disturbing developed procedures for little or no gain would appear to be inefficient. It should not be forgotten that the CbC report is intended as a high level risk assessment and not an entity level risk assessment. However, care is needed to eliminate an aggregate profit view of multiple business units that have no economic connection to each other. The existence of a fiscal unity in a jurisdiction may require broader consideration.

Specific CbC reporting focussed systems have been developed to produce aggregate data (with the only commercial rationale being CbC report production) and, except where an MNE, a switch would incur a disproportionate cost.

As well as the disproportionate costs, adding additional data columns, such as envisaged in the consultation document, potentially encourages mis-use of interest/ royalty/ service fee information for other purposes. For high level risk assessment, this information is usually available in the MF/LF where it is relevant. Figures for 'deferred tax' should be available in the statutory accounts, although there can be confusion about this defined accounting term as compared to tax which has been postponed for some arbitrary reason. The treatment of losses used or carried forward can be particularly difficult.

While CbC reports are documentation requirements transposed in domestic law, only in some countries is the schema a legislative requirement. From an administrative, but certainly from a legal point of view, alignment of the content of the CbC report template and the inputs of the XML file would seem to be more efficient, but again may involve unnecessary systems change. Being able to output the contents of the report for easier review or re-use would be helpful. It could also lead to the need to change the official forms to be used and subsequent administrative or legal procedures to be followed.

The use of standardised industry codes encourages the idea that data for a large number of specific companies can be directly compared. The nature of the business being carried out should not be restricted to automated comparison of what are, in most countries and for most purposes, fairly non-standard criteria (and often done incorrectly). Countries use different codes now for different purposes and using any one as a standard or producing a new set for this purpose would seem to add little value.

Views seem mixed as to whether the addition of predetermined fields to Table 3, in addition to free text, would be useful. On the one hand, it could make the mandatory requirements more overt. On the other hand, some say it would involve yet more systems development, which is very burdensome and, since the examples shown in the consultation document nearly all rely on further free text information, it would not ease the burden that often already exists in constructing meaningful descriptions at this stage of the assessment. The extent of additional explanation in some areas is likely to be driven by the nature and reasons for questions from the tax administration and businesses are more likely to consider it justifiable if there is a clear cause.

Next steps

Ongoing developments in the context of cooperative compliance (and tax control frameworks), remind us that CbC reporting could be part of a broader exercise to help companies and tax authorities focus on where true tax risk lies.

Taxpayers also provide information to tax authorities through the reports mentioned above on the basis that those reports are confidential. Any concerns in relation to information remaining confidential may result in a more drawn out process.

If you would like to ask for additional information on, or explanation of, any of the points made above please do not hesitate to contact me or one of the contacts set out below.

Yours sincerely,

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