Tax Policy Bulletin

EU Parliament and Member States agree on public country-by-country reporting

22 June 2021

In brief

Committees of the European Parliament and the Council of the EU have agreed to compromise text on a Directive on public country-by-country reporting (‘Public CbCR’). The text will amend Directive 2013/34/EU, which deals with financial reporting of certain types of undertakings (the Accounting Directive).

The agreed changes will require multinational groups or standalone undertakings with a total consolidated revenue of at least €750m, in that and the previous financial year, whether headquartered within the European Union or not, to publicly disclose the corporate income tax they pay in each EU Member State plus in each of the countries that are either on the EU list of non-cooperative jurisdictions for tax purposes (‘the EU’s blacklist’) or listed for two consecutive years on the list of jurisdictions that do not yet comply with all international tax standards but have committed to reform (the ‘EU’s grey list’).

This Directive aims to make corporate tax in the European Union more transparent by introducing the same reporting obligations for European businesses and non-European multinational companies doing business in the European Union through their branches and subsidiaries. While some commentators believe the proposal does not go far enough (particularly regarding aggregated vs. disaggregated information), the proposal nevertheless is a significant step towards multinationals’ tax information becoming available for public scrutiny.

This Bulletin follows on from our previous communication on 11 March 2021.

In detail

Transparency as an EU tax policy objective

The Tax Package adopted by the European Commission on 15 July 2020 had as its core objectives the generation of fair, efficient and sustainable taxes. Tax good governance both within and outside the European Union was seen as the basis for meeting the objective of fair taxation. Transparency around taxes was believed to be a key to building this good tax governance foundation. And so, achieving greater transparency around taxes, particularly taxes paid by multinationals, is one of the EC’s key tax policy objectives.

The European Parliament and Council of the EU also rank corporate tax transparency highly as a deterrent to tax avoidance and evasion. The Code of Conduct Group (CoCG) (which sits under the Council of the EU) recently updated the 'blacklist' and the 'grey list'. The Parliament and Council see transparency as a key criteria when judging a country's tax regime.

Public CbCR in a broader context

The following are important factors in the overall context of increasing transparency requirements:

1. The Directive aims to enhance public scrutiny and debate regarding the level of tax compliance of certain multinationals. Extending the scope of the Accounting Directive to include the activities of branches opened in the EU by an undertaking located outside of the EU will make available to the public information that is generally not widely available at present.

2. The timing of the proposal is important given that there are increased expectations by wider groups of stakeholders of corporate entities to live up to good environmental, social and governance (ESG) values. With that backdrop, some multinational groups have already decided to voluntarily publish their details on their tax affairs. For these purposes companies may use the Global Reporting Initiative (GRI) standards or the World Economic Forum's International Business Council (IBC) recommendations on 'Measuring stakeholder capitalism' in which total taxes paid is a core metric.

3. In the United States, a bill which would direct the US Securities and Exchange Commission (SEC) to mandate public disclosure of CbC financial reports by corporations with annual revenues over $850 million recently passed in the House of Representatives by a one vote margin of 215-214. Because this measure would not affect federal revenues or spending, adoption by the Senate would require a bipartisan super-majority of 60 votes, which makes Senate passage highly uncertain. However, approval of the bill by a narrow majority in the House suggests that there is at least some measurable support for public reporting in the United States.

4. The recent Communication from the European Commission on the Business Taxation for the 21st Century, announced that related transparency measures would be proposed requiring large companies operating in the European Union to publish information on their effective tax rates, using the OECD/Inclusive Framework methodology of Pillar Two.

5. Finally, the Commission has been tasked with keeping under review the possibility of extending the Public CbCR so that third-country multinational enterprises may be required to disclose the information required under this Directive for non-EU and non-blacklist/grey list countries on a disaggregated basis in the future. One could assume that the remit of this Directive will be revisited as part of the provided review process, which would take place four years from the transposition date.

Background to the Directive

Amendments to the Accounting Directive were tabled in 2016 when the European Commission proposed changes to the disclosure of income tax information by certain undertakings and branches. At that time, the European Commission proposed that multinational groups that are required to file country-by-country-reports with a designated tax authority for wider sharing among various tax authorities also be required to disclose certain tax-related information publicly. Initially, the proposal failed to progress as the Member States could not reach agreement on the specifics. However, on 1 June 2021, the Council and Parliament reached a compromise deal. The text was officially adopted by Coreper (EU-27 Permanent Representatives to the EU) on behalf of the Council on 9 June and subsequently endorsed by the European Parliament's joint ECON-JURI committee meeting held on

14 June 2021. As a next step, the European Parliament is expected to vote on the proposed Directive in plenary in the first week of July.

The following information and insights are based on the Directive's compromise text as presented by the Council and subsequently reviewed and adopted by the Coreper group.

Scope of the proposed Directive

Under the Directive, a group parent with at least €750m consolidated revenues generally would be within the scope if it has at least one large or medium-sized EU entity. The definition of large or medium-sized entity is in accordance with Article 3 of the Accounting Directive (being a company that meets two of the following three conditions: a balance sheet greater than €4m, net turnover greater than €8m, or an average number of employees exceeding 50 or a branch which meets that turnover threshold). Anti-avoidance rules would prevent fragmentation of balance sheet results where the objective is to avoid the disclosure requirement. The disclosure requirement provides an exclusion when the subsidiaries and branches are located in the same Member State as the group parent.

To fall within the draft Directive's scope, the group would need to have generated €750m in consolidated revenues for each of the financial year in point and the previous financial year. Similarly, a group would fall outside the scope of the rules where the revenues did not exceed €750m per financial year over a consecutive two-year period. Standalone entities (undertakings which are not part of any group) with revenues exceeding €750m per financial year over a two-year consecutive period are also required to publicly disclose information under this Directive.

Revenues, for the purpose of the Directive, are defined as the net turnover per IFRS for undertakings applying this standard, and net turnover otherwise.

Where an EU Member State has not adopted the Euro, the €750m threshold would be converted to the country's national currency using the exchange rate at this Directive's date of entry into force (rounded by no more/less than 5% to achieve a round number). For non-EU countries, the exchange rate at the Directive's date of entry into force also will apply and the relevant threshold can be rounded to the nearest thousand.

The Accounting Directive already requires mining and forestry companies to report on the taxes, royalties and bonuses that they pay worldwide, while the EU's Capital Requirements Directive IV (CRD IV) requires credit institutions and investment firms to publish certain tax and financial data for each country in which they operate. The proposed Directive includes provisions to avoid the need for double-reporting by taxpayers already subject to the existing requirements.

Information to be disclosed and aggregation of information

The report should include the following details:

- Information concerning all activities of all the affiliated undertakings of a group consolidated by an ultimate parent undertaking or, depending on the circumstances, concerning all activities of a standalone undertaking. **This information is to be shown broken out by each individual EU Member State, on a disaggregated basis for the EU's blacklist and relevant EU grey list countries, and on an aggregate basis for other third countries.**

- The name of the ultimate parent undertaking or the standalone undertaking, financial year concerned, the currency used and, where applicable, a list of all its subsidiary undertakings consolidated in the financial statement of the ultimate parent undertaking, in respect of the relevant financial year, established in the

Union or in tax jurisdictions included in Annex I and Annex II of the Council conclusions on the EU list of noncooperative jurisdictions for tax purposes;

A. a brief description of the nature of their activities;
B. the number of employees on a full-time equivalent basis;
C. the revenues as per IFRS, or adjusted net turnover for those not applying IFRS (including revenues generated from intra group transactions);
D. the amount of profit or loss before income tax;
E. the amount of income tax accrued during the relevant financial year which is the current tax expense recognised on taxable profits or losses of the financial year by undertakings and branches in the relevant tax jurisdiction (but not to include deferred tax or provisions for uncertain tax liabilities);
F. the amount of income tax paid on a cash basis, which is the amount of income tax paid during the relevant financial year by undertakings and branches in the relevant tax jurisdiction (to include withholding tax paid by other undertakings with respect to payments to undertakings and branches within a group); and
G. the amount of accumulated earnings at the end of the relevant financial year.

To ensure that the disclosure requirement is proportional and to manage the risk of making sensitive and competitive information public, the information to be disclosed is limited only to what is required to enable effective public scrutiny. The above list of required information, being a complete and final list, would help in managing the administrative burden on taxpayers in determining what information to report. In anticipation of potential scrutiny between amounts disclosed under E and F above, the report may include a narrative explaining the material discrepancies that lead to differences between income tax accrued and paid.

If the relevant entity relies on publishing CbCR as submitted to its relevant tax authority, it would be deemed to have included the information listed above. However, if it seeks to rely instead on a GRI-compliant report, it needs to ensure that it has included the information as set out above as well as meeting the GRI standard.

Where a number of affiliated undertakings of an ultimate parent undertaking carry on activities in the same tax jurisdiction, the information attributed to that tax jurisdiction would be the aggregate information of all affiliated undertakings and branches in that tax jurisdiction.

Acknowledging that the EU list of non-cooperative jurisdictions is revised twice a year, guidance has been provided as to which of the EU's blacklist and which of the EU's grey list countries would be taken into account for disclosure purposes. Jurisdictions must have been on the EU's blacklist (Annex I to the list of non-cooperative jurisdictions) on 1 March of the financial year for which the report is prepared to be regarded as a non-cooperative jurisdiction for the purposes of this proposed Directive. Similarly, jurisdictions must have been included in Annex II to the EU grey list on 1 March of the financial year for which the report is prepared. Grey-listed countries must have been listed in Annex II on 1 March for two consecutive years for the purpose of this Directive.

Observation: Given that the list of non-cooperative countries is subject to frequent review, and that the criteria for countries to end up on the list are changing, groups should be aware that the list of countries requiring disaggregated information may vary from year-to-year. The requirement for grey-listed countries to be mentioned in Annex II on 1 March for two consecutive years may give rise to particular uncertainties as to the 'consecutive' nature of the listing.

The report would usually have to be on the parent's website and refer to one EU Member State where the branch or subsidiary has also made it available. This would remove the requirement for the non-EU parent to make a report available from each European branch and subsidiary. If an EU subsidiary is making the report, it would have to be on the website of that subsidiary or that of an affiliate. If an EU branch is making the report, it would have to be on the website of the branch, its home office or an affiliate. A Member State may ignore this website requirement if the report is filed on the State's corporate register and is accessible free of charge within the European Union (provided the relevant website references that location). The report should be made accessible at no charge in at least one of the EU's official languages within 12 months after the balance sheet date. The report should be available for at least five years.

The currency used in the report on income tax information shall be the currency of the consolidated financial statements of the ultimate parent undertaking (or that currency used for the financial statements of the subsidiary if it is publishing only its own Public CbCR).

Observation: Groups with undertakings or branches who are likely to be 'in scope' for purposes of Public CbCR, and therefore required to publicly disclose certain information, should consider carefully how they will approach this new obligation. Disclosing the right level of information may prove to be somewhat of a dilemma, as the release of limited information (the information required to be disclosed under the Directive) may not present a holistic view of the overall group's contributions to society. A lack of context may prove challenging for groups to control the narrative once the information is made public. Questions from stakeholders may arise regarding the information released. For this purpose groups could consider developing a tax (transparency) strategy for which they seek stakeholder input. As part of this strategy, groups might consider publishing information relevant to other taxes, apart from income tax, which would present a more rounded view of the group's contribution to society, including disaggregated CbC information on countries in which they have significant operations but that are not on the black or grey list.

Responsibility for making the information available

The responsibility for making the required information available in the prescribed manner rests with the group's ultimate parent undertaking in the first instance where that parent operates within the European Union. Where the ultimate parent undertaking is outside the EU, but it has subsidiaries or branches active within the EU, these subsidiaries or branches should publish and make accessible a report prepared by the ultimate parent undertaking. If they do not have access to this report, they should request from the parent sufficient information to be able to prepare and disclose their own report of their income tax information. If the parent does not make available all relevant information to the subsidiary or branch, the undertaking should use the information available and note in the report that the parent has not made available all information to them. The secondary responsibility for reporting is imposed only on large or medium-sized subsidiaries or branches of a comparable size (see above and by reference to Article 3 of the Accounting Directive as enacted).

The public disclosures, where these are made in a report by the subsidiary undertaking or branch, must follow a common EU template and be presented in a machine readable electronic format. There may be associated implementation challenges in preparing a machine-readable common electronic format until such time as the European Commission sets up a European Single Access Point (ESAP).

Deferral of disclosing certain information (commercially sensitive information)

It is recognised that publicly disclosing data to be included in the report on income tax information could, in certain cases, be seriously prejudicial to an undertaking's commercial position, as competitors could draw significant conclusions about its current activities. Therefore, undertakings should be able to defer disclosing certain information for a limited number of years, provided they clearly disclose the deferral along with a reasoned explanation in the report. The Directive provides that Member States may allow that any information thus omitted shall be made public in a later report no more than five years from the date of its original omission. Information pertaining to the EU's blacklist and the relevant EU grey list countries will not be subject to this deferral mechanism.

The Directive suggests that, during transposition, the Member State would decide on the conditions under which an undertaking might avail of this deferral. It would seem necessary that the undertaking would need to be able to demonstrate that disclosure of the information would be 'seriously prejudicial' to the commercial position of the undertakings to which it relates.

Observation: It is unclear what exactly is meant by 'seriously prejudicial,' and it is possible that the application of this deferral mechanism will differ from Member State to Member State, depending on the transposition of the Directive. The Directive provides that 'items of information' may be deferred, but this is not specific in terms of all disclosable information or only certain items. A scenario could arise where the disclosure of certain information could be deferred in one Member State but not another. There is no procedure within the Directive for omissions or arbitrage in the event of such differences.

Administration and failure to comply

Member States are required to ensure that the report and any corresponding statements are published by the relevant undertaking(s) in the prescribed format. They shall ensure that members of the administrative, management and supervisory bodies of the ultimate parent undertaking or the standalone undertakings have collective responsibility for ensuring that the disclosure requirements are met in line with the Directive. This obligation also extends to Member States to ensure that subsidiary undertakings and branches that are publishing their own Public CbCR have collective responsibility for ensuring that, to the best of their knowledge and ability, the report on income tax information is drawn up, published and made accessible in a manner that is consistent with or in accordance with the Directive.

Member States could require undertakings that are required to produce audited financial statements to have the statutory auditors state in the audit report whether an undertaking was required to draw up a report on income tax information, and if so, whether this report was published.

Penalties for non-compliance with the Directive disclosure requirements, as transposed by the Member States in their domestic legislation, will apply (in line with the obligation under Article 51 of the Accounting Directive to impose penalties). The Accounting Directive does not specify what the applicable penalties should be, rather it specifies that the penalties shall be "effective, proportionate and dissuasive" and the national transposing legislation shall "take all the measures necessary to ensure that those penalties are enforced".

The European Commission will review the application of the Directive four years after the transposition date, including a review of compliance with and impact of the Directive, a review of the deferral mechanism under the competition safeguard and a review of the aggregation basis of presenting information for third countries.

Timing

The compromise text will be subject to a vote by the European Parliament's plenary meeting in July, and then must be officially adopted by Council.

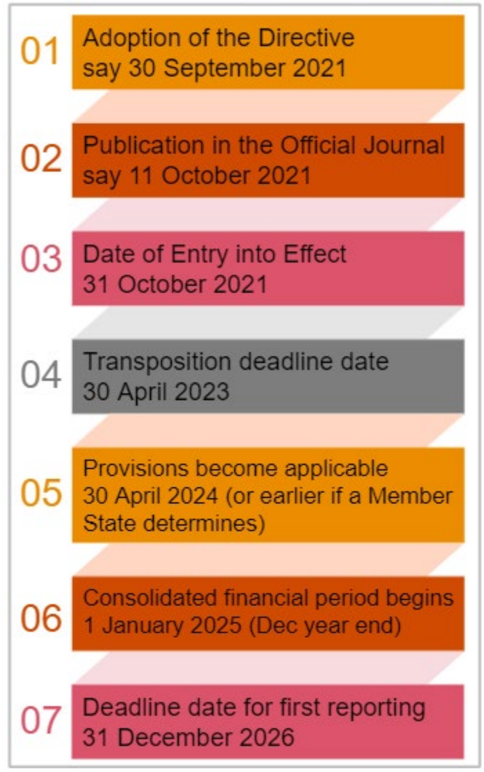
The Directive would enter into force on the twentieth day following its publication in the Official Journal of the European Union. Member states have 18 months from the date of entry into force to transpose the Directive into domestic legislation.

See the illustration of the expected timeline from the Directive's adoption to the deadline date for transposition by Member States and ultimately, the reporting deadlines relevant to in-scope entities.

The first period for required disclosure would depend on the undertakings' financial year end. Reporting would be required for financial periods beginning on or after **one year after the deadline date of transposition**. Reporting is required within 12 months of the financial year end, as stated on the undertakings' balance sheet.

Member States may transpose the Directive earlier than the transposition deadline date and may provide for an earlier effective date. This may impact the first reporting deadline for in-scope groups.

Illustration of implementation timeline



The takeaway

Complying with the additional Public CbCR requirements under the Accounting Directive should be considered in the context of broader consideration of a group's overall tax strategy and tax governance. Given that the overall tax strategy and ESG objectives are important to boards, tax directors should prepare to raise the proposed changes with their boards at an early stage, and certainly well in advance of the group's required deadline to disclose information.

Groups should also carefully consider how their CbC data may be interpreted. With advances in data analytics, interested stakeholders, including investors and NGOs, can analyse the data and compare it with other publicly available data. In order to build an explanation of any potential issues associated with increased public disclosure regarding their tax position, groups should start to develop their tax (transparency) strategy now.

Let’s talk

For a deeper discussion of how the EU Directive on public country-by-country reporting might affect your business, please contact:

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