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Middle East

European Commission proposes an EU Directive on public country-by-country reporting

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In brief

The European commission has developed a proposal[1] for a directive which, if approved by the European Parliament and Council of Ministers, will require public country-by-county reporting (CbCR) of tax and other financial data by large companies in the European Union (EU). The directive also covers non- EU headquartered groups with subsidiaries or branches in the EU.

The directive, if approved will have a major impact on Middle East based enterprises (i.e. non- EU headquarters) with a consolidated group level turnover in excess of EUR 750m, who have EU based subsidiaries and branches as part of their groups. Enterprises will need to consider the impact of disclosures not only to the tax authorities but also to public if the directive is approved.

In detail

The proposed directive will amend the existing EU Accounting Directive. The draft of the new directive was released on 12 April 2016 and follows on the heels of the proposed changes to Directive 2011/16/EU (DAC4)[2], to implement within the EU the OECD BEPS Action 13 CbCR requirement[3] regarding the disclosure of information to tax authorities.

The implementation of CbCR under OECD BEPS Action 13) which also covers transfer pricing master file and local file) by law or through administrative guidance is one of the four minimum standards in the package of measures endorsed by the November 2015 G20 Leaders' summit.

This paper summarises the contents of the draft directive on public CbCR with our thoughts on some of the key issues. The draft directive must be approved by simple majority in the EU parliament and then by qualified majority in Council. A qualified majority is reached if two conditions are met:

- 55% of Member States vote in favour - in practice this means 16 out of 28 and
- the proposal is supported by Member States representing at least 65% of the total EU population (but more than 35% will not block the vote unless at least Member State also vote against).

[1] http://ec.europa.eu/finance/company-reporting/docs/country-by-country-reporting/160412-proposal_en.pdf

[2] http://europa.eu/rapid/press-release_IP-16-159_en.htm

[3] OECD (2015), Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 Final Report, OECD Base Erosion and Profit Shifting Project, http://dx.doi.org/10.1787/9789264241480-en

Who must report?

- EU-headquartered groups with consolidated turnover in excess of EUR 750m
- medium and large-sized EU subsidiaries and branches that are part of groups with non-EU headquarters and consolidated turnover in excess of EUR 750m
- does not apply banks and other financial institutions reporting under Article 89 of CRD IV, provided such reporting covers all the group's activities
- companies reporting payments to governments under Chapter 10 of the EU Accounting Directive will also have to comply with the new public CbCR requirement.

Which countries does the reporting cover?

The reporting will cover all countries in which a group operates, regardless of whether the group has its headquarters inside or outside the European Union, as set out below (see also later paragraphs on the situation for groups with non-EU headquarters).

- The data listed below has to be disclosed by country for EU Member States.
- The data must also be disclosed separately for each jurisdiction that is included by the European Union on a list of tax jurisdictions that do not meet certain criteria for good tax system governance.
- The data may be aggregated for all other countries.

What must be reported?

1. a brief description of the nature of activities
2. the number of employees
3. the amount of the net turnover, in aggregate, including the turnover with related parties
4. the amount of profit or loss before tax
5. the current year current income tax accrued (excluding deferred tax and uncertain tax positions)
6. the amount of income tax paid in the year
7. the amount of accumulated earnings.

A narrative explanation at group level should be included to reconcile differences between the amounts of tax accrued and the amounts of tax paid.

The same groups or enterprises that have to comply with public CbCR will also, in principle, file a CbCR report under OECD BEPS Action 13.

Timing and next steps

- The proposal has to be amended and approved by both the European Parliament and the Council of Ministers before it is entered in the Official Journal of the European Union. It enters into force 20 days after being announced in the Official Journal.
- Member States have one year from the date of the directive's entry into force to transpose it into their domestic law.
- At the latest, the directive will apply to financial periods beginning on or after a date not later than one year after the transposition deadline.

Other points

The disclosure will have to be filed with the relevant business register and made available on a company's website for five years.

The impact assessment and explanatory notes that accompany the proposal suggest there should be a light touch involvement of a company's auditors, primarily to confirm that the report required by the directive has been made available and is accessible. The wording of the draft itself however requires the auditors to check if the report has been 'provided in accordance' with the directive, which could be read as requiring a more thorough audit process. The exact nature of the audit requirement is therefore unclear at this stage.

Summary of differences between public CbCR and CbCR under OECD BEPS Action 13

Not all of the data points that are reportable under OECD BEPS Action 13 have been included in the proposed public reporting. In its impact assessment[4], the Commission considered the risks and benefits of disclosing each data point that has to be reported under the OECD requirements. The impact assessment concludes that certain data points should not be made public, often because the relevance of the data to the objectives of the directive is not sufficient to justify the competitiveness risk associated with disclosing that data.

[4] http://ec.europa.eu/finance/company-reporting/docs/country-by-country-reporting/160412-impact-assessment_en.pdf

Based on previous comments, a number of stakeholders, including Members of the European Parliament, would prefer public disclosure that more closely resembles the OECD regime.

The main differences between the proposed directive and the OECD regime are:

- the proposal is for public reporting – reporting under OECD rules is private to tax authorities
- not all elements included in OECD CbCR are included in the public version (revenues are reported in total only and the disclosure does not include tangible assets or share capital)
- the wording of the items to be disclosed differs slightly between the two regimes
- public reporting is by country for EU Member States and for certain countries regarded by the Commission as having inadequate tax governance, but aggregates all other countries together. Under OECD rules, data has to be reported for each and every tax jurisdiction
- The Commission's impact assessment suggests that the intention is for companies to use their existing OECD data, but the draft legislation is not explicit on this
- Public CbCR includes a narrative explanation at group level for differences between tax paid and current tax accrued. This is not required under OECD CbCR.

Interplay with the master file and local file requirements under the OECD BEPS Action 13 requirements

In general, a group or enterprise that may have to comply with the public CbCR regime may also have to file reports under the three-tier OECD BEPS Action 13 requirements (master file, local file and Action 13 CbCR). Although the master file under BEPS Action 13 will not be made public, jurisdictions in which a local file is submitted or required may still request the master file.

Some EU Countries have already introduced, or have announced they will introduce, for reporting to tax authorities regulations along the lines of the full OECD BEPS Action 13 requirements including Austria, Belgium, Denmark, Finland, France, Germany, the Netherlands, Poland, Portugal, Slovakia, and Spain.

Implications for groups with non-EU headquarters

If there is no EU holding company within a group, each EU subsidiary will be required to publish a CbCR report, resulting in multiple reports. Under Article 48b (6), however, groups can avoid this multiple reporting if a report is published on the website of the non-EU parent company.

The draft directive appears to require each EU subsidiary to publish information relating to the whole group, information over which it may have no control. It is not clear if this is legally possible, and it is likely to be of particular significance with respect to the requirement to disclose information relating to non-EU countries that are regarded by the Commission as having poor tax governance.

The issue of access to information may be less important for groups that do not have a presence in countries regarded by the Commission as having poor tax governance. In this case the report would contain EU data, which is already disclosed publicly in each relevant Member State in statutory accounts, with the non-EU numbers arguably being balancing figures to agree to the group's consolidated accounts which in many, though not all, cases are likely to be publically available in the ultimate parent company's home jurisdiction.

Things to consider when producing the data

As with other CbCR regimes, a number of detailed questions inevitably will arise as companies consider how they would meet the reporting requirements. While the Commission has attempted to distinguish OECD CbCR and may believe it important for it to devise its own definitions, for purposes of administrative simplicity and cost, it would be helpful if the legislation adopted the OECD guidance for public CbCR. This seems to have been the Commission's intent, but it is not explicit in the draft legislation. A lack of clear alignment between the bases for preparing data under public CbCR and under BEPS Action 13 likely would increase the compliance burden for companies.

Overall, several issues need to be addressed, clarified or expanded upon both under public CbCR and under OECD BEPS Action 13, including:

- clarification of definitions
- interpretational guidelines
- common approach on language regime
- EU-law implications
- timing and implementation.

Specifically, there is a lack of detail in the draft directive which is likely to give rise to a number of issues similar to those seen with OECD CbCR, for example:

- how to deal with companies with companies that enter or leave the group part way through the year

- how to treat affiliated companies that are not fully consolidated (e.g. joint ventures)
- whether 'taxes paid' includes withholding taxes (as with OECD)
- whether dividends are excluded from revenues (as with OECD).

Even if these points are not addressed in detail in the proposal, then alignment with the OECD guidelines would reduce the compliance burden for companies. The Commission has said that it expects to release in due course further guidance on the detail of reporting, which may address some of these issues. Nevertheless, there is a risk that the directive could be interpreted in different ways in the different Member States.

The takeaway

This proposal would seem to represent another step on the path towards further transparency in tax matters by multinational enterprises.

Middle East based enterprises with EU based subsidiaries or branches need to consider carefully their response to further transparency and in particular to CbCR and the way it reflects the allocation of results across the value chain.

Although the requirements of the proposed public CbCR are less far-reaching than those of OECD BEPS Action 13, the debate may not stop here.

In considering CbCR, companies should also consider their communications under the master file as this will also encompass elements of CbCR.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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