Impact of Country-By-Country Reporting on Multinational Enterprises

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Perhaps the most challenging component of the Base Erosion and Profit Shifting (BEPS) initiative adopted by the OECD and G20 countries, Action 13 (Country-by-Country Reporting), represents a fundamental change to the landscape of international tax and transfer pricing for large multinational enterprises (MNEs).

Country-by-Country Reporting (CbCR) provides a template for MNEs to annually report certain tax information with respect to their business in each tax jurisdiction in which they operate. CbCR aims to create a network of real-time sharing and access to taxpayer’s data and information in what potentially could be a new era of tax transparency.

Fundamental Changes

CbCR generally applies to MNE groups with total consolidated group revenue of €750 million, although specific jurisdictions may adopt an alternative threshold. For example, in its final regulations (T.D. 9773), the United States has adopted a group annual revenue threshold of $850 million, intended to be the US equivalent of €750 million.

The OECD’s final CbCR Action Report has no legal authority per se, and is intended to serve as a basis for interested jurisdictions to adopt and implement the recommended approach set out therein.

As a result, domestic legislation is required to be passed by jurisdictions intending to implement CbCR, and this may differ among the various jurisdictions involved.

For example, the UK adoption of CbCR applies to accounting periods commencing on or after January 1, 2016, and companies will have 12 months from the end of the relevant accounting period to file a report with HMRC.

Conversely, the US CbCR rules apply to US MNE groups for their first taxable years that begin on or after June 30, 2016. The effective date of the US final regulations creates a so-called “gap year” in which US-parented MNEs may be subject to CbCR in foreign jurisdictions, but not in the United States, with the result that US-parented MNEs could be required to report their CbCR file directly to foreign jurisdictions (and not to the Internal Revenue Service (IRS)) during the gap year.

To alleviate this situation, the IRS has permitted US-parented MNEs to voluntarily file their CbCR report with the IRS on Form 8975 (forthcoming) (although MNEs must always consider whether or not voluntary filing with the IRS in this manner discharges their obligation to file a CbC report in their local jurisdiction).

Sensitive taxpayer information in CbCR reports remains confidential and access is limited to tax authorities in the respective jurisdictions in which the MNE operates. It is possible, however, to hypothesize a future disclosure or publication of sensitive taxpayer information in a CbCR report, either due to political pressure in a domestic context or an international context (e.g., State aid investigations), other external influences (e.g., WikiLeaks, LuxLeaks, etc.), or even in the course of litigation (e.g., where a CbC report becomes a matter of public record by virtue of having been filed in court proceedings). For example, the United Kingdom has enacted legislation that provides the UK tax authorities with a power (as yet unexercised) to require publication of CbC reports in the future. The UK government has indicated that it does not expect the power to be exercised unless there is
multilateral agreement on the publication of CbC reports. MNEs may therefore want to consider the impact of such a disclosure or publication on the operation of their business.

New Approach to Tax Planning?

CbCR aims to shine a light on perceived “dark corners” of the international tax arena. As CbCR requires disclosure of their effective tax rate on a country-by-country basis, the adoption of CbCR could trigger a sea change in MNEs’ approach to tax planning.

Tax authorities will likely focus on specific “at-risk” areas of tax planning. In particular, transfer pricing arrangements and IP holding company structures, two key areas of focus for the OECD, are at risk of scrutiny by tax authorities. Other arrangements, including hybrid structures, financing structures (including cash pool arrangements) and commissionaire structures may be subject to heightened scrutiny in the light of the BEPS initiative and CbCR (see Action Reports 2 (Hybrid Mismatch Arrangements), 4 (Limiting Base Erosion Involving Interest Deductions and Other Financial Payments) and 7 (Preventing the Artificial Avoidance of Permanent Establishment Status)).

It remains to be seen what methods tax authorities will employ to assert challenges to MNEs’ tax planning strategies in light of CbCR. However, given the pressure points discussed above, the practical effect of CbCR may be a shift from one-sided transfer pricing methodologies (e.g., cost-plus arrangements) to increased reliance on profit split methodologies, as well as a shift toward the use of jurisdictions with preferential tax regimes and incentives (in favor of arrangements that create “nowhere income”).

Preparing for CbCR

MNEs should prepare for CbCR by collecting information with respect to their global organizational structure and identifying potential tax risks.

When material changes occur in international tax laws, regulations or guidelines, the changes inevitably open incremental planning opportunities for MNEs, even as some existing strategies are sought to be eliminated. Accordingly, an important element of the MNE responsive process should be identification and exploration of opportunities to preserve current tax planning strategies or to develop new ones – in essence, CbCR can be viewed as an opportunity for forward and pro-active thinking as much as anything else.

An important component of this process is the preservation of attorney-client privilege, given the potential sensitivities in identifying “at-risk” areas of an MNE’s structure. It is therefore advisable for MNEs to include legal counsel on any in-house team that is tasked with preparing for CbCR.

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