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COUNTRY BY COUNTRY REPORTING – A UK PERSPECTIVE

By James Hill

Introduction

Base erosion and profit shifting (“**BEPS**”) has become a well publicised talking point amongst governments and in the media internationally. There is a political will for change, and the Organisation for Economic Co-operation and Development (“**OECD**”) has worked with the G20 countries to come up with the BEPS Action Plan¹. A detailed discussion of the BEPS Action Plan in its entirety is beyond the scope of this article (and, indeed, a detailed discussion would need a book, not an article). Rather, this article focuses on action 13 of the BEPS Action Plan - Guidance on Transfer Pricing Documentation and Country-by-Country Reporting² – and in particular the reaction to country-by-country reporting in the UK.

Action 13

Action 13 of the BEPS Action Plan was earmarked as an early deliverable, and was released as part of the 16 September 2014 package of measures published by the OECD. It is worth recounting what the OECD is seeking to achieve by country by country reporting. The Executive Summary of the OECD’s Guidance on Transfer Pricing Documentation and Country-by-Country Reporting (the “**Action 13 Guidance**”) states that: “providing [tax administrations] with adequate information to conduct transfer pricing risk assessments and examinations is an essential part of tackling the base erosion and profit shifting (BEPS) problem”.

No doubt many people would agree with that. The battleground, of course, is what constitutes “adequate” information. As discussed below, the concern is that the OECD requirements and member states implementation measures will go far beyond what is adequate and become too much of a compliance burden for multinational enterprises (“**MNEs**”).

The transparency landscape

Country by country reporting should be considered in context. First and most obviously, it sits as part of the OECD’s work and guidance on transfer pricing generally. The Action 13 Guidance contains revised standards for TP documentation and proposes that country by country reporting sits alongside a master file and local files to be provided by MNEs. Furthermore, aside from TP requirements, there are numerous other regimes which require information reporting which could be relevant for UK based MNEs.

The Extractive Industries Transparency Initiative (“**EITI**”). Countries can choose to adopt the EITI and if they do so, then all extractive industry companies that operate in that country have to report various items (via a template) to their government. The UK was admitted as a candidate country for the EITI on 15 October 2014 and now has 30 months to fully implement the EITI.



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COUNTRY BY COUNTRY REPORTING – A UK PERSPECTIVE

*The EU Transparency Directive*³. Amongst other things these require public and large private companies with activities in the extractive industry to report various payments made by country, by project and by government.

*The Capital Requirements Directive (CRD IV)*⁴. Since July 2014, banks and specific investment firms in EU member states are required to report information related to taxes, turnover and profits before tax by country, and the reported figures will also be audited.

Certain non-UK headquartered MNEs have been heavily (and, in the author's view, unfairly) criticised in the UK press in recent times in relation to their UK tax affairs, and none of the MNEs criticised are involved in the extractive or financial services industries. Thus, even though those industries have been the main focus of measures introduced so far⁵, the net will widen, and country-by-country reporting is part of that.

The UK dives in

In a letter to the G8 members on 2 January 2013, during the UK's G8 presidency, David Cameron said:

"We know that in a globalised world, no one country can, on its own, effectively tackle tax evasion and aggressive avoidance. But, as a group of eight major economies together, we have an opportunity to galvanise collective international action. We can lead the way in sharing the information to tackle abuses of the system, including in developing countries, so that governments can collect the taxes due to them."

3 2004/109/EC

4 2013/36/EU

5 In the US, the Dodd-Frank Act obliged SEC registered extractive industry companies to report their payments publicly. In July 2013, the US District Court for the District of Columbia vacated the SEC's resource extraction rules during a related law suit. It is expected that redrafted rules will be proposed, and on 18 September 2014, Oxfam America brought a suit against the SEC seeking a court order to compel it to re-adapt the rules.

On 20 September 2014, following the publication of the BEPS Action Plan and the release of the seven advance OECD reports (including Action 13), the UK government announced that it would formally commit to implementing the new country-by-country reporting template. Financial Secretary to the Treasury David Gauke MP said:

"We believe country-by-country reporting will improve transparency and help identify risks for tax avoidance. That's why we're formally committing to it. Reporting high level information using a standardised format across all jurisdictions will ensure consistency, give tax authorities the information they need and minimise the administration burden on business."

It is unsurprising that the UK was quick out of the blocks to announce its commitment to country by country reporting. After all, the UK Govt states that it initiated the country-by-country reporting template during its G8 presidency, and the OECD's transfer pricing guidelines are incorporated into UK domestic law⁶. Furthermore, the UK will have a general election next year and the current government appears keen to be seen to be taking action to clamp down on tax avoidance.

The country-by-country reporting template

There was significant debate after the release of the discussion draft of the template on 30 January 2014. The good news is that the draft template included in the Action 13 Guidance has significantly reduced the amount of information required (compared to the 30 January 2014 version), and provided more flexibility on how businesses could provide the information. Some would argue, however, that much of the information required still results in too heavy a compliance burden (see further below).

6 S164 TIOPA 2010

COUNTRY BY COUNTRY REPORTING – A UK PERSPECTIVE

The template is in 3 parts: Table 1 – the allocation of income, taxes and activities by jurisdiction (this will be the most contentious part), Table 2 – constituent entities per jurisdiction, and Table 3 – additional information. The data points (in each tax jurisdiction) in Table 1 are listed as follows: unrelated party revenues; related party revenues; profit before income tax; income tax paid (cash basis); current year income tax accrual; stated capital; accumulated earnings; number of employees; and tangible assets (excluding cash and equivalents). Table 2 requires data, again per tax jurisdiction, for: constituent entity resident in that jurisdiction, jurisdiction of incorporation for that entity (if different), and activity of that entity. Table 3 requires additional information that the MNE filing the report considers necessary or that would “facilitate understanding of the compulsory information provided” in Tables 1 and 2.

The instructions contain a number of interesting explanations and caveats. For example, all entities should be included as constituent entities even if they are excluded from financial statements on materiality grounds. Branches and PEs should be treated as a separate entity in the jurisdiction in which they are physically located, and they should be excluded from the jurisdiction in which the legal entity that they form a part of is located. In preparing the country-by-country template, the reporting company should use the same sources of data from year to year (if there is a change, the company should explain the reason for that change).

UK market reaction

UK business reactions to the template and the issue of country-by-country reporting have generally mirrored those in most G8 countries. Despite significant improvements since the January drafts, numerous concerns remain.

The correct use of the information. The Action 13 Guidance states: “the information in the country-by-country report should not be used as a substitute for a detailed transfer pricing analysis of individual transactions and prices based on a full functional analysis and a full comparability analysis.” However, there is a risk that tax administrations will use the country-by-country report as a prima facie indicator that something is amiss (in transfer pricing terms). The focus on the number of employees and the tangible assets in a given country is too narrow. The number of employees is purely a quantitative rather than a qualitative measure, and intangible assets, whether financial assets or IP related, are valid and important measures just as tangible assets may be. If the functional analysis that forms part of the master file/local file helps support the position maintained by the taxpayer, and that overturns any assumption drawn by a tax authority from a country by country report that there are not enough employees or tangible assets in a given jurisdiction, then what does the country by country report add in the first place?

The administrative burden. The Action 13 Guidance is at pains to point out that content required for reporting: “reflects an effort to balance tax administration information needs, concerns about inappropriate use of the information, and the compliance costs and burdens imposed on business”. However, it goes on to state that certain emerging market countries (Argentina, Brazil, China, Colombia, India, Mexico, South Africa, and Turkey) will likely require additional data in respect of related party interest payments, royalty payments and related party service fees. It could be argued that the template should be the maximum that participating countries can ask for (along with the master file and local files) as opposed to being the minimum. Further, greater effort perhaps could and should have been made to align the information required under country by country reporting with the various other

regimes referred to above, so that companies in the extractive industries (for example) don't have to comply with several different regimes with different reporting requirements which are all ultimately trying to achieve the same (or a similar) thing.

The Action 13 Guidance also states that where "a taxpayer reasonably demonstrates, having regard to the principles of these guidelines that either no comparable data exists or that the cost of locating the comparable data would be disproportionately high relative to the amounts at issue, the taxpayer should not be required to incur costs in searching for such data. Businesses will be concerned to ensure that the compliance burdens are proportionate." The Action 13 Guidance does not address the point that their will be compliance burdens (and costs) in reasonably demonstrating that the costs of locating the data are disproportionate!

Materiality. There is something of a mixed message on materiality from the Action 13 Guidance. The sections that deal with the master file and local file make it clear that materiality is a factor that should be taken into account and for the local files there should be materiality thresholds. However, it is made equally clear that the country-by-country report needs to cover all entities (including dormant entities, for example).

Penalties. The points above related to the administrative burden and materiality are of particular concern in the context of penalties for incomplete or inaccurate reporting.

Penalty regimes are governed by the laws of each individual country which means they could vary widely. It would be unfair, for example, for MNEs to incur penalties for a failure to report a dormant entity in a given jurisdiction – if the entity is (genuinely) dormant, how can it have any impact on the tax paid in that or any other jurisdiction?

Confidentiality. The Action 13 Guidance acknowledges that discussions about confidentiality are ongoing. In essence, there remains a lot of disagreement between OECD members, and with the business community, in relation to which administrations should have the country by country reports and how the information should be shared.

The overall conclusion on the Action 13 Guidance and template is that it is a material improvement from the January 2014 template, but there remains considerable uncertainty. Notwithstanding this, MNEs should start considering now how they will comply.

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