

## OECD Releases Country-by-Country Reporting Implementation Package; US Implementation Unclear

The Organisation for Economic Co-operation and Development (the OECD) has released its “Country-by-Country Reporting Implementation Package” (the Implementation Package).<sup>1</sup> This is the third in a series of three deliverables that the OECD issued during the past nine months to roll-out a new global regime of country-by-country (CbC) reporting of financial and tax information by certain multinational enterprises (MNEs).

CbC reporting is the key, and most controversial, aspect of a series of recommended changes to global transfer pricing documentation rules that the OECD has proposed as part of its Base Erosion and Profit Shifting (BEPS) Action Plan. While the Implementation Package concludes most of the OECD’s BEPS project work on CbC reporting,<sup>2</sup> the process of implementation is really just beginning as the focus will now shift to local implementation in countries around the world, including the United States.

### Overview

Action 13 of the OECD BEPS Action Plan contemplated that the OECD would develop new rules to fundamentally change the focus of the transfer pricing documentation from the pricing of specific transactions between specific related parties (e.g., Entity A sells widgets to Entity B) to the total global value chain of a multinational enterprise.<sup>3</sup> Among other proposed changes, the Action Plan contemplated implementing CbC reporting, or “a requirement that MNE’s provide

all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.”

In accordance with its Action 13 mandate, the OECD proposed a draft CbC template in a Discussion Draft dated January 20, 2014, as part of a new proposed transfer pricing documentation package that includes both a “Master File” (a high-level overview of the entire MNE group) and a “Local File” (a jurisdiction-specific document similar to documentation under current rules).<sup>4</sup> The original proposed CbC template would have required reporting of certain aggregate financial and tax data on a country-by-country basis as well as a further itemization of this data by legal entity and reporting of certain transaction-level data such as royalties, service fees and interest payments. The Discussion Draft proposals, especially the CbC template, were sharply criticized by taxpayers, business groups and their advisers in thousands of pages of comments that focused largely on three main concerns: administrative burdens, confidentiality and the potential for misuse (such as use for formulary apportionment).<sup>5</sup>

Subsequently, the OECD published a final CbC template in its September 16, 2014, report entitled “Guidance on Transfer Pricing Documentation and Country-by-Country Reporting” (the September 2014 Report). Information required to be reported on the final

CbC template on a country-by-country basis includes revenues (which need to be broken down between related and unrelated party revenues), profit (loss) before income tax, income taxes paid and accrued, stated capital, accumulated earnings, number of employees and tangible assets. As compared with the original Discussion Draft version, the final template is less onerous in terms of the amount of information required to be reported, having removed entity-by-entity reporting and six columns of transaction-level reporting.

The September 2014 Report contained generalized statements emphasizing confidentiality, consistency in local implementation, and that the CbC reports are to be used for high level risk assessment only and not as the basis for making transfer pricing adjustments. However, it provided little detail on what specific safeguards would be adopted. Guidance was deferred until 2015 on implementation issues, including whether the CbC report would be filed only in the parent's jurisdiction and shared with subsidiary jurisdictions only under treaties (the approach preferred by the US Treasury Department and considered less objectionable by most taxpayers because it better safeguards confidentiality) or locally in each jurisdiction in which the MNE operates (the approach preferred by certain governments and NGOs).

On February 6, 2015, the OECD released a second final deliverable on CbC entitled "Guidance on Implementation of Transfer Pricing Documentation and Country-by-Country Reporting" (the February 2015 Guidance), which addressed many of the practical aspects of implementing CbC reporting and other aspects of the transfer pricing documentation project that were left unaddressed in the September 2014 Report. As provided in the February 2015 Guidance, the OECD recommended that CbC reporting be implemented on the following terms and conditions:

- CbC reporting would be required for fiscal years beginning on or after January 1, 2016. The first reports (for 2016) would be due on December 31, 2017.
- MNEs with annual revenues under €750 million (or local currency equivalent) would be exempt from the CbC reporting requirement.
- Both the Master File and Local File would need to be filed locally in each legal entity's jurisdiction.
- As a general rule, the CbC report would only be filed with the parent company's taxing authority. However, the report would be subject to automatic exchange of information (EOI) with subsidiary countries' jurisdictions subject to conditions of confidentiality, consistency (e.g., no special local requirements or added columns) and appropriate use (e.g., not used for formulary apportionment).
- If a country does not adopt a CbC reporting requirement for parent companies in its jurisdiction, or procedures for EOI are not in place, the taxing authorities of each subsidiary would be entitled to receive the CbC report through "secondary mechanisms." Possible secondary mechanisms referenced in the February 2014 Guidance included direct local filing or filing with a company a tier down in the corporate group, though definitive guidance on these mechanisms was deferred.

The February 2015 Guidance adopted the approach preferred by the US Treasury Department, and considered less objectionable to most taxpayers, of parent-only filing as a *general rule*, but it left open, pending further guidance, the scope of the exceptions in which local filing would still be required. Moreover, the February 2015 Guidance did adopt a local filing requirement for the Master File, which, while perhaps less sensitive than the CbC report, nevertheless could contain highly confidential business information that a subsidiary in a MNE

and its tax authority may not otherwise have access to in the ordinary course of business.

## The Implementation Package

The OECD's CbC Implementation Package, released on June 8, 2015, provides model legislation for countries to use in adopting CbC reporting, as well as three model Competent Authority Agreements designed to facilitate implementation of the exchange of CbC reports. The model legislation adopts the material terms of CbC implementation reflected in the February 2015 Guidance (e.g., the filing time frames and small MNE exemption), and, in addition, contains a detailed secondary mechanism for resident subsidiaries to file the CbC report locally in any of the following situations:

- The ultimate parent company is not obliged to file in its jurisdiction (e.g., because the jurisdiction has not adopted CbC reporting);
- There is no competent authority agreement in place that would require the ultimate parent's jurisdiction to provide the CbC report to the subsidiary's jurisdiction; or
- There is a systemic failure between the parent's and subsidiary's jurisdiction to exchange CbC reports after agreeing to do so.

In effect, it appears that the general rule requiring only the parent company to file the CbC report would apply *only if* (i) the parent company's jurisdiction has adopted CbC reporting in its domestic laws, *and* (ii) the parent company's jurisdiction has negotiated a comprehensive network of competent authority agreements with other OECD and G20 countries in which its subsidiaries operate. In efforts to limit the scope of local filing (at least somewhat), the Implementation Package allows multiple subsidiaries operating in a single jurisdiction to designate one subsidiary to file on behalf of all the others in that jurisdiction. The Implementation Package would also allow MNE groups to elect a "Surrogate Parent Entity" located in a jurisdiction that has adopted CbC to

file on behalf of the ultimate parent's jurisdiction in cases where the ultimate parent is not required to file the report. Despite these accommodations, gaps in implementation in domestic laws and competent authority agreement networks could conceivably make widespread local filing the norm, rather than the exception, as a practical matter.

In addition to model legislation, the Implementation Package contains three substantially similar model competent authority agreements: one based on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, a second based on a bilateral Double Tax Convention and a third based on a Tax Information Exchange Agreement (TIEA).

The model competent authority agreements would require the CbC reports to be automatically exchanged within 18 months of the end of the tax year to which the CbC report relates in the first year that the competent authority agreement is in effect, and within a 15-month period in each subsequent year. Under the model legislation, the CbC reports would be required to be filed with the parent's, Surrogate Parent's or local entity's jurisdiction (as the case may be) within 12 months after the end of the year to which the CbC report relates; in effect, this would provide the receiving jurisdiction up to 6 months (first year) or 3 months (each subsequent year) to fulfill its exchange obligations. In addition, the model Competent Authority agreements contain detailed provisions on confidentiality and appropriate use, including a provision limiting permissible uses to assessing high-level transfer pricing and BEPS related risks and, where appropriate, economic and statistical analysis. The model agreements explicitly provide that transfer pricing adjustments will not be based on the CbC report, although enforcement of this provision may be infeasible in practice given the ease with which tax administrators could develop

minimum alternative evidence to justify an adjustment motivated by the CbC report.

## Prospect for Adoption in the United States

The Treasury Department has indicated that it will implement CbC through regulations, and that the adoption of CbC by the United States does not require legislative changes. Specifically, Treasury has indicated that it can rely on section 6038 of the Internal Revenue Code for the authority necessary to implement CbC. However, there are questions as to whether Treasury does in fact have the authority to implement CbC solely by regulation.

Although section 6038 provides Treasury with the authority to collect a variety of data, it does not explicitly authorize Treasury to collect some of the information required for the full implementation of CbC. For example, section 6038 does not clearly authorize Treasury to collect information on profits or losses or employees, each of which is explicitly required under CbC. In addition, section 6038 does not provide any authority for Treasury to share that information with other countries. Although US tax treaties permit Treasury to share certain information with the treaty partner the scope of the information sharing in CbC may exceed what Treasury is authorized to provide to the treaty partner. In addition, the United States does not have tax treaties, or even TIEAs with some G20 countries. Thus even if tax treaties or TIEAs are sufficient to authorize the sharing of CbC information, for countries that do not have such an agreement with the United States some other authorization for the sharing of that information would need to be identified.

In addition, leading members of the US Congress have recently questioned Treasury's authority to implement CbC without new legislation. These concerns were articulated in a letter from Senate Finance Committee Chairman Orin Hatch and House Ways & Means Chairman Paul Ryan to Treasury Secretary Lew.

Specifically, the two Chairmen state in their letter that "We believe the authority to request, collect, and share this information with foreign governments is questionable."<sup>6</sup> The letter makes a number of requests for information from Treasury and further states that "In the event we do not receive such information, Congress will consider whether to take action to prevent the collection of the CbC and master file information."

Notwithstanding the concern raised by Congress, Treasury is likely to proceed with implementing CbC. While Congress may react by more forcefully objecting to this action, either by putting public pressure on Treasury or through the introduction of legislation, Congress would have a difficult time succeeding in any efforts to block Treasury from implementing CbC. The President would likely veto any legislation that would block implementation of CbC and it is unlikely that such legislation could obtain enough votes to successfully override a Presidential veto.

However, should significant disagreements between Congress and Treasury develop over the implementation of CbC it could impact Congress's views about, and willingness to implement, other BEPS recommendations that would require legislative changes. Thus, a dispute over implementation of CbC could signal wider opposition to the broader BEPS agenda by the Congress.

In addition, there is some question as to whether the IRS will have the resources necessary to implement CbC given recent reductions in its budget. IRS Commissioner Koskinen has publicly indicated that absent increases in the agency's budget it may struggle to implement CbC.<sup>7</sup>

If Treasury does not implement CbC reporting—because legislation to block implementation was successful, in response to pressure from Congress or potential legal challenges, or due to budgetary constraints at the IRS—US-based MNEs could still be subject to CbC reporting if

other OECD or G20 countries adopt CbC reporting. This is because the OECD model legislation contains secondary filing mechanisms would require direct filing by local subsidiaries or the appointment of a “Surrogate Parent” in a country that has adopted CbC.

While, as a technical matter, the secondary mechanisms may result in the effective implementation of CbC even if Treasury cannot provide that information, it does not address the potential political fall out among other BEPS participating countries if Treasury does not implement CbC directly. The failure of Treasury to implement CbC could raise questions among other countries about the willingness or ability of the United States to participate even minimally in implementing the BEPS recommendations. This gives rise to the question of whether other countries could react by slowing or delaying their implementation until they have more assurances of US participation. Thus, the failure of Treasury to implement CbC reporting could have broader consequences for the broader adoption of BEPS recommendations globally.

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## Endnotes

<sup>1</sup> The Implementation Package can be accessed at <http://www.oecd.org/ctp/transfer-pricing/beps-action-13-country-by-country-reporting-implementation-package.pdf>.

- <sup>2</sup> The OECD is still to release an XML schema and related user guide to accommodate the electronic exchange of CbC reports, but these are relatively insignificant elements of the overall project.
- <sup>3</sup> See “The OECD’s Action Plan on Base Erosion and Profit Shifting,” Mayer Brown Legal Update (30 Jul. 2013) available at <https://www.mayerbrown.com/The-OECDs-Action-Plan-on-Base-Erosion-and-Profit-Shifting-07-30-2013/>.
- <sup>4</sup> See *OECD Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 Jan. 2014); “Significant Progress Made on the OECD’s BEPS Action Plan,” Mayer Brown Legal Update, available at <https://www.mayerbrown.com/Significant-Progress-Made-on-the-OECDs-BEPS-Action-Plan-02-28-2014/> (28 Feb. 2014). The Discussion Draft initially proposed that the CbC report be a part of the “Master File” rather than a separate filing.
- <sup>5</sup> Comment letters on the Discussion Draft are available at: <http://www.oecd.org/ctp/transfer-pricing/comments-discussion-draft-transfer-pricing-documentation.htm>.
- <sup>6</sup> Available at <http://waysandmeans.house.gov/hatch-ryan-call-on-treasury-to-engage-congress-on-oecd-international-tax-project/>.
- <sup>7</sup> See, e.g., Questions for the Record “Internal Revenue Service Operations and the President’s Budget for Fiscal Year 2016” (3 Feb. 2015), available at [http://services.tax.org/taxbase/eps\\_pdf2015.nsf/DocNoLookup/13070/\\$FILE/2015-13070-1.pdf](http://services.tax.org/taxbase/eps_pdf2015.nsf/DocNoLookup/13070/$FILE/2015-13070-1.pdf).

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