COUNTRY-BY-COUNTRY REPORTING: WHERE ARE WE GOING?

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Far from its humble beginnings as a tax form, the Country-by-Country ("CbC") report attracted further notoriety and criticism on April 12, when the European Parliament amended the E.U. single-market legislation to include reporting of activity in tax haven jurisdictions that will be identified and listed. As countries introduce legislation to require the filing of CbC reports for tax purposes and companies work toward meeting new compliance requirements, we are reminded of one of the many Yogi-isms (from baseball legend Yogi Berra): "You've got to be very careful if you don't know where you're going because you might not get there." E.U. legislation now risks derailing the consensus, fostered by the O.E.C.D.'s B.E.P.S. Project, between the world's tax authorities.

Originally intended as the remedy to the financial information shortage that tax authorities experienced while auditing multinational companies, CbC reporting was first introduced as one of three updated tiers of transfer pricing documentation in the O.E.C.D./G-20 final report on B.E.P.S. Action 13, released on October 5, 2015. A CbC report is a tax-authority-generated form that must be filed by the ultimate parent company in its country of residence, in cases where the revenue of a consolidated group exceeds the equivalent of €750 million (U.S. $850 million). The form reports, on a country-by-country basis, items such as related and unrelated party revenue, profit before income tax, income tax paid on a cash basis, income tax accrued, stated capital, accumulated earnings, number of employees, non-cash tangible assets, jurisdictions of organization and residence, and primary business activity by entity.

CbC report data is intended to be used by tax authorities for three purposes:

- To perform high-level transfer pricing risk assessments and assist with audit selection
- To detect any other potential tax issues (again, in the context of audit selection)
- To perform statistical analysis of the extent of base erosion and profit shifting activity by taxpayers and the effect that new legislation has on curtailing such activity

Initial concerns by business groups over the inappropriate use of CbC report data – for the purpose of proposing adjustments to the income of a taxpayer based on an allocation formula, such as would result from the irresponsible use of a profit split transfer pricing methodology – resulted in clear guidance from the O.E.C.D., which circumscribed tax authority usage of CbC report data.[1]

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1 O.E.C.D., *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13-2015 Final Report*, O.E.C.D./G-20 Base Erosion and Profit Shifting Project, (Paris: O.E.C.D. Publishing, 2015), para. 59.

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CbC reports are to be filed with the tax authority in the jurisdiction of the ultimate parent and exchanged with other tax authorities. The conventions for exchange of information set out in that jurisdiction’s network of income tax treaties and other exchange of information agreements (“T.I.E.A.’s”). An electronic XML schema was recently released by the O.E.C.D. to enable tax authorities to exchange data in a common format. This schema follows the example of the Common Reporting Standard used in the international exchange of banking information.[2]

Heralded by civil society groups and tax authorities alike as one of the great successes of the B.E.P.S. Project, the CbC report has inspired concern from the private sector. Business groups voiced concerns about potential damage from lapses in tax authority data security and misuse of CbC report information both within and outside tax authorities. Specific business groups, such as defense contractors, are seeking exemptions from certain CbC reporting requirements to guard against the exposure of information vital to national security interests. U.S. CbC reporting, proposed under Prop. Treas. Reg. §1-60384-15 on December 23, 2015, was accompanied by assurances from the Department of the Treasury that data security breaches by foreign treaty partners would result in the suspension of U.S. cooperation in the exchange of CbC report information.

The issue of public CbC reporting has been addressed by the B.E.P.S. Project and subsequent legislation enacted in O.E.C.D. Member and Observer states. China and India have been active in shaping public reporting policy, having been strong Observer State voices throughout the B.E.P.S. Project and adopters of CbC reporting for tax purposes. CbC report data was intended to be treated confidentially by tax authorities and not used for any purpose except for the administration of taxation. Nevertheless, public CbC reporting has been championed by the European Parliament, and certain E.U. Member States, and has received renewed attention following the publication of the Panama Papers by the International Consortium of Investigative Journalists.

At the heart of the debate between E.U. Member States and the European Parliament is the question of whether state tax authorities can be entrusted with the sovereign task of modifying taxpayer behavior or whether further public pressure must be applied from outside the income tax system. The legislation proposed on April 12 makes it clear that the European Parliament believes tax policy objectives cannot be achieved without resorting to the stronger disincentive of public disapproval.

Notable in the proposed legislation is the requirement that an E.U. branch or medium- or large-sized E.U. subsidiary of a non-E.U. parented company must report its activities using the CbC model; display this report on the website of the subsidiary or branch; and note, on the relevant audited financial statements, where reporting has not been completed in accordance with the legislation. Albeit reduced, responsibility for the reporting requirement falls ultimately to the “members of the administrative management and supervisory bodies”[3] or “the legal representative,” leading to potential director and officer liability.

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2 The Common Reporting Standard is discussed in the lead article in Insights Vol. 3 No. 1.

3 European Commission, *Proposal for a Directive of the European Parliament and of the Council Amending Directive 2013/34/EU as Regards Disclosure of Income Tax Information by Certain Undertakings and Branches*, (2016), para. 10.

The amendment proposed on April 12 establishes a forthcoming list of tax havens for which reporting by jurisdiction will apply – distinct from the reporting on the aggregation of tax profile attributes of companies resident outside the E.U. Tax haven countries on the "Common Union list of certain tax jurisdictions" do not comply with the following criteria:

- Transparency and exchange of information standards, including information exchange on request and automatic exchange of financial account information
- Fair tax competition standards
- Standards set up by the G-20 and/or the O.E.C.D.
- Other relevant standards, including international standards set up by the Financial Action Task Force[4]

Companies are required to prepare and display the CbC report not later than 12 months after the balance sheet date. The effective date of the legislation depends on the date of enactment but will most likely apply to the first financial year beginning not later than one year after the E.U. directive is adopted or transposed into Member State law.

As an unintended consequence, these provisions bring about public exposure of certain portions of the CbC report, which are prepared for tax purposes and would otherwise have been guaranteed confidential treatment by tax authorities when exchanged between Competent Authorities, as set out in many tax treaties and T.I.E.A.'s. Significant controversy is expected to surround the issue of public CbC reporting, with opposition arising from the tax authorities of E.U. Member States and from the I.R.S. and Treasury – already vocal critics of the E.U. State Aid cases that have been brought against many of the largest U.S. multinationals.

For E.U. subsidiaries of U.S.-based groups, placing the reporting obligation on the local European company is an attempt to circumvent provisions in U.S. tax law that make a Federal employee's[5] unauthorized disclosure of tax return information a Federal crime.[6] When information is provided by the I.R.S. to a foreign government, there are limitations on the use to which the information can be put. The parties are prohibited from using any information received for any purpose other than the administration of taxes. Any information received from the U.S. is to be treated as secret, in the same manner as information obtained under the domestic laws of that state, and may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment; collection; or administration of, enforcement or prosecution in respect of, or determination of appeals in relation to the taxes covered by this convention.[7]

4 *Id.*, art. 48c.

5 Code §6103(a).

6 Code §7213 makes a willful and unauthorized disclosure of tax return information a felony punishable upon conviction by a fine in any amount not exceeding $5,000, or imprisonment of not more than 5 years, or both, together with the costs of prosecution.

7 Preamble to REG–109822–15, 80 Fed. Reg. 79,795 (December 23, 2015) related to Prop. Treas. Reg. §1.6038-4.