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Tax insights

Draft legislation on Country-by-Country and transfer pricing documentation

Snapshot

In Australia's May 2015 'BEPS Budget', the Treasurer committed Australia to action on several key BEPS initiatives. Following on from the Budget announcements, the Treasury released exposure draft (ED) legislation on 6 August 2015 which will give effect to the OECD standards under Action 13 on Country-by-Country (CbC) reporting as well as the transfer pricing (master file / local file) documentation.

The measures apply to entities within a group with annual global revenue of AU$1 billion or more.

As drafted, all Australian companies, whether Australian owned or subsidiaries of multinational companies (MNCs) will be required to file CbC and transfer pricing reports with the Australian Taxation Office (ATO) unless granted an exemption. There are a number of areas of uncertainty in relation to the ED which require further clarification.

Taxpayers should carefully consider:

- The availability of required data and related systems for CbC, master and local file reporting processes; and
- The new transfer pricing documentation requirements and their impact on current structures and policies.

In addition, the Australian Government also released an ED to impose stronger penalties in relation to tax avoidance and profit shifting. Submissions on the EDs are due by 2 September 2015.

Recapping the OECD position

The OECD has previously issued several documents relating to the Action 13 deliverable, including:

- 16 September 2014 report – Guidance on Transfer Pricing Documentation and Country-by-Country Reporting;
- 6 February 2015 report - Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting; and
- 8 June 2015 report - Country-by-Country Reporting Implementation Package.

A previous Tax insight which discusses the implications of the CbC reporting developments can be found here.

The OECD CbC reporting template requires affected MNCs to report key financial data annually for each tax jurisdiction in which they do business, including:

- the amount of revenue (related party and unrelated party);
- profits or losses;
- income tax paid and taxes accrued;
- number of employees;
- stated capital and retained earnings; and
- tangible assets.

In addition, MNCs are also required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities which each entity conducts.

In respect of the filing of the CbC report, the default position of the OECD is that the regime should operate such that:

- where a parent of a MNC group is required to file the CbC report in its home country, it is expected that it will do so;
- the tax authority in that country will enter into arrangements to exchange the CbC report with other countries in which the group operates; and
- the home country tax authority will in fact exchange the CbC report.

It is only where the above conditions are not met that the "backup filing requirements" are activated, such that a particular country, in which a subsidiary of the MNC operates, can obtain the CbC report directly from that subsidiary.

In respect of the transfer pricing documentation, the OECD model is that the master file and local file transfer pricing documentation be filed directly with the tax authorities in **each** relevant jurisdiction.

Australia's approach

CbC reporting

In respect of CbC reporting, the ED starts from the position that all Australian owned groups, as well as an Australian subsidiary (or permanent establishment) of a MNC, must lodge the CbC report with the ATO before the end of the next income year. **It is only if the Australian subsidiary is exempted, either specifically or by a legislative instrument dealing with a "class of entity", that the Australian subsidiary is not required to file the CbC report.**
The explanatory material (EM) indicates that such an Australian subsidiary **"may"** be exempted from filing only if all of the following conditions are met:

- the parent of the MNC is resident in a particular country;
- the parent files the CbC report in that country;
- the tax authority in that country enters into arrangements to exchange the CbC report; and
- that tax authority in fact does exchange the CbC report.

The end point of the OECD and the Australian approaches should be the same, provided that the ATO does grant exemptions in appropriate circumstances and on a timely basis**.** However as drafted, **unless and until such an exemption is granted that covers that Australian subsidiary, it will be required to lodge the CbC report with the ATO.**

Master file and local file

Consistent with the OECD Model, each Australian entity (whether Australian owned or foreign owned) and PEs of foreign residents will be required to lodge a **master file** with the ATO. The EM indicates that it is likely that the ATO will specify that where there are multiple group entities in Australia, only one entity will be required to lodge the master file.

Each Australian entity and PEs of foreign residents will be required to lodge a local file with the ATO. It is intended that much, but not all, of the content of the **local file** will be drawn from the documentation that is already required under Australia's transfer pricing rules in Division 815 of *the Income Tax Assessment Act, 1997.*

Other matters

The ED proposes that affected taxpayers are required to lodge a statement with the ATO in the "approved form". The ED does not prescribe the specifics that will be required to be reported. The approved form will be developed and issued by the ATO. We assume that the "approved form" will essentially replicate the OECD reporting template for CbC reporting, master file and local file.

It is proposed that an administrative penalty, not linked to tax payable, be imposed for failure to lodge the approved form. However such a failure to lodge will have no bearing on a taxpayer's position under the existing law that requires meeting the documentation requirements in Division 815 in order to have a reasonably arguable position.

Deloitte perspective

The ED raises a number of important issues for taxpayers:

- It is clear that the documentation and reporting burden for MNCs operating in Australia will increase significantly as a result of this measure. There will be many practical challenges for MNCs in navigating the different requirements of existing Australian documentation and proposed OECD master file and local file requirements. Although there will be many similarities between, for example, the OECD local file and the Australian documentation requirements, there are likely to be differences. Ensuring consistency of information across all documents will be challenging;
- In addition, the different dates for preparation / filing of such documents (e.g. s815-B documentation should be prepared before lodgement of the tax return for an income year while master file / local file is expected to be filed by the end of the next income tax year) will cause practical challenges for taxpayers;
- The conditions under which exemptions from CbC reporting obligations are available should be more definitive. In the case of the example given in the EM where the CbC report is provided by the parent and is the subject of effective exchange, it should be clear that the Australian subsidiary is not required to lodge the CbC report (the EM indicates that filing "may not be required"). If the legislation proceeds on this basis, it will be important that clear guidelines are given in the EM and accompanying ATO guidance as to when an exemption will be granted;
- There will likely be differences in the timing of adoption of CbC reporting across jurisdictions. In this context, an Australian subsidiary may have to provide a CbC report (or master file report) where, for example, its parent's home jurisdiction has not yet legislated for CbC reporting;
- There is debate in the US as to whether and how the CbC and transfer pricing reporting regime is to be introduced. US Treasury had indicated that the US would be an early adopter and would implement via regulation, however, more recently Congress has challenged this and indicated that CbC reporting may require legislative action by Congress. If so, this could delay implementation in the US. Such delays could well expose the Australian subsidiaries of US MNCs to CbC reporting requirements to the ATO, pending any possible future CbC filing requirements in the US;

- The Australian approach in respect of an Australian subsidiary of a foreign headquartered MNC potentially being required to file the group CbC and master file report may have timing impacts at the parent level and could accelerate the application of CbC and master file reporting to the group. For example, if a parent entity is based in a country that intends to first introduce reporting from say, 2018, the group may nonetheless be required to meet the requirements earlier than 2018, based on the Australian implementation date;
- The EM notes the Commissioner's discretion to grant a master file exemption to individual entities within an Australian group from the requirements to provide a under the proposed legislation. We hope such an exemption should be automatically available to members of a group, such that it is clear that the master file obligation rests solely with one company in the group;
- The role of the single entity rule in the context of consolidated or MEC groups should be clarified.
- It is critical that the specific information requirements for the approved form are finalised as soon as possible as MNCs will be required to commence relevant data gathering from as early as 1 January 2016.

Timing

The new CbC and transfer pricing reporting rules will apply to income years starting on or after 1 January 2016, and will require the relevant documentation be lodged with the ATO by the end of the following year of income (e.g. lodgment will be due with the ATO by 31 December 2017 in respect of the year commencing 1 January 2016, or lodgment with the ATO by 30 June 2018 in respect of the year commencing 1 July 2016).

Next steps for taxpayers

While the first filings are still some way off, taxpayers should now begin preparation for these new CbC and transfer pricing documentation requirements. The increased flow of information with tax authorities is likely to drive considerable audit activity across many jurisdictions.

Some suggested actions in the short-term include:

- Ensuring that parent company planning for data gathering takes into account the Australian implementation date;
- Ensuring that appropriate systems are in place to capture and report relevant data before the start of the first affected year;
- Anticipating potential audit enquiries that may be triggered by data contained in the CbC and transfer pricing documentation;
- Reviewing existing transfer pricing policies, structures and documentation and consider approaches to deal with any inconsistencies.

Getting started with Deloitte's reporting tool

Deloitte has developed its CbC Digital Exchange tool (CDX). CDX is a web-based tool which facilitates efficient and flexible collection of the required business data from various sites around the globe.

Further, in preparing for lodgement of the CbC report, CDX analyses the key CbC metrics and allows the visualisation and evaluation of global data through the lens of the receiving Revenue Authorities.

Key CbC metrics can be clearly and effectively communicated to internal stakeholders via the various CDX reports, allowing any potential implications to be highlighted early in preparing for the commencement of the new CbC reporting rules.

New penalty regime

The Government also released an ED to impose stronger penalties to combat tax avoidance and profit shifting. The amendments do not apply to taxpayers who have a "reasonably arguable position".

The new penalties will apply to tax benefits obtained on or after 1 July 2015, regardless of when the relevant scheme was entered into.

The table below shows the new penalties that apply to taxpayers which exceed the global revenue threshold and which enter into a tax avoidance and profit shifting scheme. Penalties are expressed as a percentage of the tax shortfall:

Behaviour	Base penalty	Aggravating factors	Disclosure during examination	Disclosure before examination
Tax avoidance schemes	*100%*	*120%*	*80%*	*20%*
If position is reasonably arguable	*25%*	*30%*	*20%*	*5%*
Profit-shifting schemes	*50%*	*60%*	*40%*	*10%*
If position is reasonably arguable	*10%*	*12%*	*8%*	*2%*

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