



OECD releases additional implementation guidance on CbC reporting and appropriate use of information in CbC reports

Global Transfer Pricing Alert 2017-038

The OECD on 6 September released [additional guidance on the implementation of the country-by-country \(CbC\) reporting requirement](#) introduced in the BEPS Action 13 final report. In addition, the OECD released [guidance on the appropriate use of information contained in CbC reports](#) (CbCRs).

The new guidance consolidates and expands on all of the implementation guidance issued by the OECD since the release of the Action 13 final report. Also included in the text of the new guidance, therefore, is the additional implementation guidance issued on: (i) 29 June 2016; (ii) 5 December 2016; (iii) 6 April 2017; and (iv) 18 July 2017.¹ Because the 6 September release includes all the information found in the prior four releases, when consulting OECD additional guidance on the Action 13 final report, it will only be necessary to refer to the 6 September guidance going forward.

New implementation guidance

The new implementation guidance addresses four specific issues:

¹ For prior coverage, see Global TP Alerts [2016-023](#), [2016-038](#), and [2017-030](#) and [The Arm's Length Standard, June 2017](#).

- Items reported as revenues in Table 1 of the CbCR, when financial statements are used as the source of the data to complete the CbC template;
- Income taxes paid in advance in Table 1 of the CbCR;
- Treatment of tax refunds in Table 1 of the CbCR; and
- Transitional relief for multinational enterprise groups (MNE groups) with a short accounting period that starts on or after 1 January 2016 and ends before 31 December 2016.

Definition of revenues for Table 1 of the CbCR (new)

The 6 September guidance addresses which items should be reported as revenues in Table 1 of the CbCR. The guidance explains that, when financial statements are used as the source of the data to complete the CbC template, all revenue, gains, income, or other inflows shown in the financial statement prepared in accordance with the applicable accounting rules relating to profit and loss (such as the income statement or profit and loss statement) should be reported as “Revenues” in Table 1.

For example, if the income statement prepared in accordance with the applicable accounting rules shows:

- Sales revenue;
- Net capital gains from sales of assets;
- Unrealized gains;
- Interest received; and
- Extraordinary income

Then the amount of those items reported in the income statement should be aggregated and reported as revenues in Table 1.

The 6 September guidance further explains that comprehensive income/earnings, revaluations, and/or unrealized gains reflected in net assets and the equity section of the balance sheet should not be reported as Revenues in Table 1. Finally, the guidance states that the amount of any income items shown on the income statement need not be adjusted from a net amount.

Members of the Inclusive Framework on BEPS – over 100 countries and jurisdictions that collaborate on the implementation of the BEPS project -- are expected to implement this guidance as soon as possible, taking into account their specific domestic circumstances. The OECD recognizes that some MNE groups may need time. As a result, the 6 September guidance states that jurisdictions may allow some flexibility during a short transitional period. For US MNEs, the guidance appears to be consistent (or at least not in conflict) with the CbC regulations in Treas. Reg. §1.6038-4, so no change may be needed for implementation in the United States.

How to treat taxes paid in advance in Table 1 of the CbCR (new)

The new implementation guidance also addresses how to report the income tax for a fiscal year that has been paid in advance. Specifically, it addresses whether the amount reported in the "Income Tax Accrued-Current Year" column should be linked to the amount reported in the "Income Tax Paid (on Cash Basis)" column of Table 1.

According to the new implementation guidance, the amount listed in the column "Income Tax Accrued-Current Year" is the amount of accrued current tax expense recorded on taxable profits or losses for the reporting fiscal year of all constituent entities resident for tax purposes in the relevant tax jurisdiction, irrespective of whether or not the tax has been paid (for example, based on a preliminary tax assessment).

The guidance further explains that the amount listed in the column "Income Tax Paid (on Cash Basis)" is the amount of taxes actually paid during the reporting fiscal year, which should include not only advance payments fulfilling the relevant fiscal year's tax obligation but also payments fulfilling the previous year(s)' tax obligation (for instance, payment of the unpaid balance of corporate income tax accrued in relation to the previous year(s), including payments related to reassessments of previous years), regardless of whether those taxes have been paid under protest. The new implementation guidance concludes by saying that the amount of "Income Tax Accrued-Current Year" and "Income Tax Paid (on Cash Basis)" should be reported independently.

For example, assume that an MNE group accrues \$100 of taxes in year 1 and \$150 of taxes in year 2, but pays \$75 of taxes in year 1 and \$175 of taxes in year 2 (that is, \$25 for the year 1 obligation and all \$150 of the year 2 obligation). The relevant columns of the MNE group's CbCR would read as follows:

<u>Example 1</u>	<u>Year 1</u>	<u>Year 2</u>
Income Tax Accrued-Current Year	\$100	\$150
Income Tax Paid (on Cash Basis)	\$75	\$175

In the alternative, assume instead that the MNE group accrued \$100 in taxes in year 1 and \$150 in year 2, but then paid \$125 in year 1 and \$125 in year 2 (that is, all \$100 of its obligation in year 1 and \$25 in advance for year 2 and then the remaining \$125 in year 2). The relevant columns of the group's CbCR would read as follows:

<u>Example 2</u>	<u>Year 1</u>	<u>Year 2</u>
Income Tax Accrued-Current Year	\$100	\$150
Income Tax Paid (on Cash Basis)	\$125	\$125

The amounts of "Income Tax Accrued-Current Year" and "Income Tax Paid (on Cash Basis)" would thus be reported independently.

As with the first issue discussed above, Inclusive Framework members are expected to implement this new guidance as soon as possible, taking into account their specific domestic circumstances. The OECD recognizes that MNE groups may need some time to take the guidance into account. As a result, the new guidance states that jurisdictions may allow some flexibility during a short transitional period. For US MNEs, the guidance appears to be consistent with the CbC regulations in Treas. Reg. §1.6038-4, so no change may be needed for implementation in the United States.

How to treat refunds in Table 1 of the CbCR (new)

The 6 September guidance addresses how tax refunds should be reported. In general, an income tax refund should be reported in the column entitled "Income Tax Paid (on Cash Basis)" in the reporting fiscal year in which the refund is received. The new implementation guidance states that an exception to this may be permitted when the refund is treated as revenue of the MNE group under the applicable accounting standard or in the source of data used to complete Table 1.

Inclusive Framework members again are expected to implement this guidance as soon as possible. The OECD recognizes that MNE groups may need time to take the guidance into account. As a result, the 6 September guidance says that jurisdictions may allow some flexibility during a short transitional period, during which the OECD encourages taxpayers to provide the following statement voluntarily in Table 3, if relevant: "Tax refunds are reported in Revenues and not in Income Tax Paid (on Cash Basis)."

Short accounting periods (new)

Finally, as a transitional measure, the 6 September guidance states that jurisdictions may allow the reporting entity of an MNE group with a short accounting period beginning on or after 1 January 2016 and ending before 31 December 2016 to file the CbCR in accordance with the same timelines as for MNE groups with a fiscal year ending on 31 December 2016. The date by which the CbC report is to be exchanged would be similarly extended. The guidance concludes by stating this transitional relief would not frustrate the policy intention of the Action 13 minimum standard.

Guidance on appropriate use of information in CbC reports

According to the BEPS Action 13 final report, a jurisdiction's ability to obtain and use CbCRs is conditional on it using CbCR information appropriately. For these purposes, appropriate use is restricted to:

- High-level transfer pricing risk assessment;
- Assessment of other base erosion and profit shifting related risks; and
- Economic and statistical analysis, when appropriate.

The BEPS Action 13 final report makes clear that information contained in CbCRs should not be used by itself as a basis for proposing changes to transfer prices or adjusting a taxpayer's income using global formulary apportionment.

The appropriate use guidance clarifies how tax authorities may use CbC information by defining the term "BEPS-related risk." In addition, the guidance expands on the consequences of noncompliance with the appropriate use condition and sets out steps a jurisdiction may take to ensure the appropriate use of CbCR information.

The meaning of "BEPS-related risk"

The guidance explains that the term "assessment of other BEPS-related risks" should be understood to refer to the high-level assessment of tax risks that may result in the erosion of a country's tax base. The guidance notes that, in practice, it will usually be possible to understand a tax arrangement giving rise to that risk only when further inquiries have been made. Nevertheless, the guidance reiterates that CbCR information should be limited to use in risk assessment, and only as a basis for making those further inquiries (and economical and statistical analysis, when appropriate).

Consequences of noncompliance with the appropriate use condition

The Action 13 final report includes a number of consequences for a jurisdiction resulting from noncompliance, or possible noncompliance, with the appropriate use condition. These consequences are given effect through the model competent authority arrangements (CAAs) that are used in implementing CbC reporting.

The consequences are as follows:

- Appropriate use as a condition for receiving and using CbCRs.
- A commitment by competent authorities to disclose breaches of appropriate use to the Coordinating Body Secretariat (for exchanges pursuant to the multilateral CAA) or other competent authority (for exchanges pursuant to the model bilateral CAAs, such as the exchanges the United States will engage in).
- A commitment by competent authorities promptly to concede inappropriate adjustments in competent authority proceedings.
- The ability of competent authorities to suspend the exchange of CbCRs temporarily following consultation in cases of noncompliance.

With respect to the first consequence, the appropriate use guidance explains that a jurisdiction may not require local filing, unless: (i) that jurisdiction satisfies the appropriate use condition; and (ii) the other conditions of local filing in the BEPS Action 13 final report are met. When a jurisdiction imposes local filing in circumstances that are not permitted under the BEPS Action 13 final report, this will be identified during the jurisdiction's peer review evaluation.

With respect to the second consequence, when the notification is made to the Coordinating Body Secretariat (that is, in the case of an exchange pursuant to the multilateral CAA), the secretariat will notify all competent authorities that have an exchange relationship under the multilateral CAA with the competent authority that provided notice of the noncompliance.

The appropriate use guidance also explains that any noncompliance with the appropriate use condition will be considered “significant non-compliance.” When a competent authority determines that there is or has been significant noncompliance in another jurisdiction, that competent authority may temporarily suspend the exchange of CbCRs by giving notice in writing. Nevertheless, the guidance further states that the competent authority should, before suspending the exchange of CbCRs, consult with the competent authority in the other jurisdiction on whether significant noncompliance has occurred.

Approaches to determine appropriate use of CbCR information

The appropriate use guidance lists steps that jurisdictions may take, if necessary, to implement the appropriate use restriction into their domestic rules and processes. The guidance states that a jurisdiction should be able to answer in the affirmative six basic questions, which are provided in a checklist, that assess the robustness of its processes to ensure compliance with the appropriate use condition, or should expect to be able to do so before the first exchange of CbCRs takes place.

The appropriate use guidance recognizes that, in practice, jurisdictions may be able to rely on existing policies and procedures. In such a case, the initial step will likely entail confirming that CbCR information is covered by these policies and procedures. As a result, additional steps to ensure compliance with the appropriate use condition may be reasonably modest.

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