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International Tax

European Union Tax Alert

15 April 2016

European Commission decision on public tax transparency

On 12 April 2016, the European Commission proposed measures to introduce public reporting requirements for the largest companies operating in the EU. The measure proposes amendments to the EU directive on financial disclosures and can be accessed at http://ec.europa.eu/finance/company-reporting/docs/country-by-country-reporting/160412-proposal_en.pdf

Overview of process and background

In the Commission's view "greater transparency of companies is needed to enable public scrutiny of whether tax is paid where profits are produced". Although the G20/OECD's base erosion and profit shifting (BEPS) project includes a requirement to implement country-by country (CbC) reporting to tax authorities (under BEPS Action 13), which the Commission intends to adopt on a pan-European basis though a directive, this proposal is separate and requires public reporting for companies operating in the EU. The proposal states that "information should be based on the reporting specifications of BEPS' Action 13 and should be limited to what is necessary to enable effective public scrutiny".

The announcement follows a consultation over the summer of 2015, and a proposal for public CbC reporting was expected.

The proposal, assuming it is adopted, will be implemented through amendments to the Accounting Directive 2013/34/EU as regards disclosure of income tax information. As such, the measures are not tax matters, which require unanimous agreement from member states, but will instead require qualified majority approval – broadly approval by 55% of member states representing at least 65% of the European populus. The Council is expected to discuss the proposal in June, and the proposal will also need approval from the European Parliament. If the proposal is adopted it will have to be transposed into national legislation for each member state within one year following its entry into force.

Public country-by-country reporting

The rules will apply to EU-based parent companies of multinational groups (MNCs) with more than €750 million in net turnover. MNCs headquartered in a

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third country will also be subject to the rules where the group has more than €750 million in net turnover and it operates in the EU through medium or large subsidiaries or branches (based on existing EU thresholds). Accordingly, companies accounting for about 90% of corporate revenues in the EU are expected to be subject to the rules.

It is proposed that the report will cover information relating to the ultimate parent undertaking of the MNC, including activities of all affiliated undertakings consolidated in the ultimate parent undertaking's financial statements, being:

- brief description of the nature of activities
- number of employees;
- net turnover (including related-party revenue);
- profit or loss before income tax;
- income tax accrued (current tax expense),
- income tax paid; and
- accumulated earnings.

Information must be provided separately for each EU member state, and in the aggregate outside the EU.

The ability to aggregate information for operations outside the EU is removed in respect of operations based in third countries which the Commission consider "do not respect international tax good governance standards". Under the proposal, information must be provided on an individual country basis for those territories.

Further work will be undertaken to draw up a common list of tax jurisdictions which are considered not to comply with international tax good governance standards. The criteria will be based on the External Strategy for Effective Taxation, released on 28 January 2016, and the Commission intends that this work should be completed by the end of 2016. Tax jurisdictions will be assessed on compliance with: transparency and exchange of information; fair tax competition; standards set up by the G20 and/or OECD; and other relevant standards, including international standards set up by the Financial Action Task Force.

Information must be provided in the currency used in the consolidated financial statements. Explanations must be provided at the corporate group level where there are material discrepancies between the taxes accrued and the taxes effectively paid.

The consolidated report on income tax information must be published on a business register and made accessible to the public on a corporate website in at least one of the official languages of the EU, although the proposals are silent as to when reports must be published. Reports will remain accessible for at least five consecutive years.

For EU-parented MNCs, the reporting obligation sits with the EU-based parent company. An MNC whose ultimate parent is based in a third country has the option of publishing its report on income tax information on the parent's corporate website and allowing one of its EU subsidiaries to file the report with an official business register in the EU. Alternatively, the EU based medium and large subsidiaries (or branches of a comparable size where no such subsidiaries exist) will each be required to publish the report of the ultimate parent.

The disclosure must be reviewed by the reporting entity's statutory auditors to assess compliance, and comment by exception in audit reports. It does not appear that an audit of the underlying information will be required.

Penalties for failure to comply with the Directive are left to member states, in accordance with the Accounting Directive. The proposal refers to "effective, proportionate and dissuasive penalties".

The proposal applies to all industry sectors (including extractive and logging industries already subject to the quite different rules on public reporting of payments to governments). However, an exemption clause avoids double reporting for financial institutions already subject to the public reporting rules in EU banking legislation.

Comments

In 2015, the Commission conducted a public consultation on corporate tax transparency in the EU. It is fair to note that the businesses, professional firms and professional bodies responding did not favour public CbC reporting. However, equally unsurprisingly, nongovernment organizations (NGOs) responding did favour its introduction, as does the European Parliament, which has an equal role with the Council of Ministers in legislating in this accounting area. This proposal reflects the outcome of this work.

The Commission considers that the proposal is proportionate and will not jeopardise competitiveness. Business are likely to remain concerned that a competitive disadvantage may arise and that an additional administrative burden will be imposed.

Although separate from BEPS Action 13 (and the draft directive implementing Action 13 across Europe), alignment of the data points to most of those required by Action 13 is helpful; it is to be hoped that the first publication date will be after the Action 13 report is delivered. However, MNCs may be disappointed that the Commission intends to require publication of turnover split between related party and third party sales.

MNCs will need to give careful thought as to whether to provide additional information to explain the tax position set out in their report more completely. Some may wish public information to be subject to some form of external scrutiny.