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Transfer Pricing: Country-by-country reporting

Time to take action

With country-by-country reporting likely to become a reality for many South African based multinational enterprise, the time to act is now.

OECD released guidance on implementation

The OECD released guidance on the implementation of transfer pricing documentation and country-by-country (CbC) reporting on 6 February 2015.

The guidance provides answers to taxpayers' questions on issues such as the timing of preparation and filing, the use of CbC reporting by jurisdictions, and the mechanisms for government-to-government exchange of CbC reports.

The OECD is still recommending the use of the Master file and the Local file, but mentions that these should be implemented through local country legislation or administrative procedures. The OECD also indicated that the Master file and Local file should be filed directly with the tax administration in each relevant jurisdiction as required.

With regards to the CbC report, it is stating explicitly that countries have to adopt the agreed disclosures.

In this regard, South African taxpayers and tax practitioners would welcome an indication from SARS regarding its view on whether SARS would expect taxpayers to follow these recommendations from the OECD.

Considering that South Africa closely follows OECD guidance in the area of transfer pricing (the TP practice note is based on the OECD Guidelines), it is highly likely that SARS will implement a system of CbC reporting.

Timing of preparing and filing the CbC report

The first CbC reports will be required to be filed for MNEs financial years beginning on or after 1 January 2016.

MNEs will be allowed one year from the close of its financial year to which the CbC report relates, to prepare and file the CbC report. That means a MNE with a 31 December year end will prepare its first CbC report to cover the period 1 January 2016 – 31 December 2016, and this should be filed by 31 December 2017.

It is possible that SARS may give South African taxpayers a longer deadline for the implementation of CbC reporting.

Materiality threshold

The guidance requires CbC reporting for MNEs with annual consolidated group revenues in the immediately preceding financial year of at least Euro 750million - this translates to approximately USD850 million, or ZAR9.8 billion.

MNEs achieving annual consolidated group revenues below the level stipulated above will not be required to submit CbC reporting (unless local rules stipulate a lower threshold).

As an example, an MNE with a 31 December year end, should therefore determine what its annual consolidated group revenue is during its financial year ending 31 December 2015, and, if below Euro750m, it will not be required to prepare and file the CbC reporting for its 2016 financial year.

The OECD is of the view that this threshold will exclude approximately 85% - 90% of all MNE groups from the requirement to file the CbC report. However, where MNE groups control approximately 90% of all corporate revenue, CbC reporting will still be required. This threshold was introduced to balance the reporting burden and benefit to tax administrations.

The OECD will review the appropriateness of the threshold as part of the 2020 review of implementation of the new reporting standard.

Considering the value of the ZAR against the Euro, it is quite possible that SARS may amend the applicable threshold to a lower amount as the one stipulated by the OECD.

Other considerations

- **Confidentiality of information**

  Countries participating in the BEPS project have agreed that they will have in place and be prepared to enforce legal protections of the confidentiality of the information in the CbC report.

  The OECD is trying to get countries who agree to share the CbC report to enter into bilateral or multilateral dispute resolution procedures if they do not have a treaty or other agreement that contains such a provision with the country that will receive the report.

- **Consistency**

  Best efforts should be used by jurisdictions to make it a legal requirement for MNE Groups' ultimate parent entity resident in that jurisdiction to prepare and file the CbC report, unless it is exempt.

  The standard template as provided in Annex III of Chapter V of the OECD TP Guidelines should be used.

- **Appropriate use**

  The guidance indicates that tax jurisdictions should commit to using the CbC report for assessing high-level transfer pricing and other BEPS risks, but should not propose adjustments to income on the basis of an income allocation formula based on CbC report data.

  However, jurisdictions would not be prevented from using the CbC report information as the basis for making additional inquiries into the MNEs transfer pricing arrangements, which is in fact the very goal of the OECD's current CbC initiative.

- **Framework for government-to-government mechanisms to exchange information**

  Tax jurisdictions should require in a timely manner CbC reporting from ultimate parent entities of MNE groups resident in their country.

- **Implementation**

  Countries participating in the OECD/G20 BEPS project have agreed to develop an implementation package for government-to-government exchange of CbC reports. A comprehensive report on the different elements e.g. key elements of domestic legislation required, automatic exchange of CbC reports under international agreement etc. will be developed by April 2015.

What action should be taken by South African based MNEs?

- **Perform own risk assessment**

  As a first step it would be recommended to determine, based upon the latest financial year consolidated group turnover, whether the MNE group headquartered in South Africa will meet or exceed the indicated threshold.

  On the assumption that the threshold is likely to be met or exceeded, it would be critical for MNE groups headquartered in South Africa to do a test on existing data, to identify potential risk areas that could be changed in time before 1 January 2016.

- **Consider system changes or tools to assist**

  On a more practical note, financial information relating to intra-group transactions needs to be collected and monitored with more scrutiny on a group level. MNE groups will most likely require technological implementation tools to carry out such monitoring and reporting. Advanced software tools that will interface with MNE groups' resource planning solutions are likely to facilitate the process of producing CbC report as per the OECD specifications.

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