KPMG

TAX FLASH NEWS

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OECD - BEPS Action 13 - Guidance on the Implementation of Country by Country Reporting

Background

The Organisation for Economic Cooperation and Development (OECD) and G-20 countries have committed to implement Country by Country (CbC) reporting, as set out in the Action 13 Report "Transfer Pricing Documentation and Country-by-Country Reporting". India also has introduced CbC reporting requirement in section 286 of the Indian Income-tax Act, 1961 w.e.f. financial year (FY) 2016-17. The first round of CbC Reports where applicable will have to be filed with the Indian tax authorities by 30 November 2017. In this regard, OECD has been striving to provide guidance notes that could be referred to by countries for their regulations. In April 2017, OECD has released additional guidance[1] to use in implementing CbC reporting. The guidance addresses the issues relating to (a) definition of items, (b) entities to be reported (c) filing obligation and (d) sharing mechanism for the CbC report.

Highlights of the document

A. Issues relating to the definition of items reported in the CbC report

1. Definition of revenue

Should extraordinary income and gain from investment activities be included in the column "Revenues" in the CbC report?

Clarification – Related party, unrelated party and total revenue to include extraordinary gains and gains from investment activities. It is pertinent to note that under accounting rules, inter-company revenues are eliminated on consolidation while they are reported separately for Table 1 of CbC Report.

KPMG Example - Revenue to now include sale of materials, inventories and properties, sale of services, royalty income, interest income, extraordinary income, gain from investment activities and other items. It would specifically not include dividend received from constituent entities.

(Original definition obtained from Guidance on Transfer Pricing Documentation and Country-by-Country Reporting, 2014 Deliverable)

[1] OECD Guidance on the Implementation of CbC Reporting dated April 2017

2. Definition of related parties

Which entities are considered to be related parties for purposes of reporting related party revenues?

Clarification - Interpretation of Table 1:

Tax jurisdiction	Revenues			Profit/ Loss before Income tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated capital	Accumu-lated earnings	Num-ber of Empl-oyees	Tangible Assets other than Cash & Cash Equival-ents
	Unrelated Party	Related Party	Total							
Australia		Sum of Entity 1 and Entity 2								

The coloured column would now be interpreted as "Constituent Entity" which includes the entities listed in Table 2.

Country	Constituent entities resident in country	Activities										
		R&D	Purchasing & Procurement	Manufacturing & Production	Sales, marketing & distribution	Administrative, management & support services	External service business	Regulated financial services	Insurance	Holding company	Dormant	Others
Australia	Entity 1				Y							
	Entity 2				Y							

B. <u>Issues relating to the entities to be reported in the CbC report</u>

1. Application of CbC Report to investment funds

How should the CbC reporting rules be applied to investment funds?

Clarification -

Para 55 of the Action 13 Final Report, Transfer Pricing Documentation and Country-by-Country Reporting states that "In particular, no special industry exemptions should be provided, **no general exemption for investment funds should be provided**, and no exemption for non-corporate entities or non-public corporate entities should be provided" from filing the CbC report.
Governing principle would be → accounting consolidation rules.

OECD Examples –

Investment Co and Investee Co:

- If Investment Co would not consolidate with Investee Co as per accounting consolidation rules → Investee Co not a Constituent Entity and not part of MNE Group

Investment Co and Subsidiary:

- If Investment Co consolidates with Subsidiary; → subsidiary company a Constituent Entity and part of MNE Group

Investee Co and X Co:

- If Investee Co controls X Co and in combination forms an MNE group → if revenue threshold breached (currently EUR750 million) → CbC Report to be filed

2. Application of CbC reporting to partnerships

How should a partnership which is tax transparent and thus has no tax residency anywhere be included in the CbC report? How should a reverse hybrid partnership, which is tax transparent in its jurisdiction of organisation but considered by a partner's jurisdiction to be tax resident in its jurisdiction of organisation, be treated?

Clarification -

Governing principle → accounting consolidation rules. If the partnership firm is consolidated by way of accounting consolidation rules, then it would form part of the MNE Group for CbC Reporting purposes.

OECD Examples -

Situation A:

In case partnership is not tax resident:

- Table 1 of CbC Report → to include a line for "stateless entities"
- Table 2 of CbC Report → to include a line for "stateless entities" and a sub-row for all stateless entities
- Table 2 of CbC Report → in the field "Tax Jurisdiction of organisation or incorporation if different from Tax Jurisdiction of Residence" to indicate jurisdiction under whose laws the partnership is formed

Situation B:

In case a partner of a partnership firm is a constituent entity → include their share of the partnership's items in Table 1 in their jurisdiction of tax residence

Situation C:

A partnership may also be an ultimate parent entity (UPE) → in case a stateless partnership → jurisdiction under whose laws the partnership is formed is the governing jurisdiction

3. Accounting principle/standards for determining the existence of and membership of group

To determine the existence of a "Group" and the membership of the Group under Article 1.1 of the model legislation in the Action 13 report:

a) If the equity interests of the relevant enterprise* are traded on a public securities exchange, should the applicable accounting standards be the accounting standards that currently apply to that enterprise for consolidated financial statement purposes?

b) If the equity interests of the relevant enterprise* are not traded on a public securities exchange, can the applicable accounting standards be chosen provided that the choice is either (i) local GAAP in the jurisdiction of the enterprise assumed to be listed or (ii) International Financial Reporting Standards (IFRS), and provided the method chosen is used consistently?

***Relevant enterprise would be the UPE under Article 1.6 of the model legislation in the Action 13 report.**

Clarification – Governing principle → consistency of application of accounting standards

KPMG Examples -

Situation A:

Company X is a listed company → uses accounting standards as prescribed in local regulations → same accounting standards to be used

Situation B:

Company X is an unlisted company → uses accounting standards as prescribed in local regulations → plans to use IFRS for CbC Report purposes → not permitted, accounting standards to be used consistently across the years

Situation C:

Company X is an unlisted company → uses accounting standards as prescribed in local regulations for listed entities → plans to use same accounting standards for CbC Report purposes → permitted (mandatory to use prescribed standard)

Situation D:

Company X is an investee company, Company Y is the investment company → the jurisdiction's consolidation rules require Company Y to be consolidated with Company X → the jurisdiction may mandate the use of IFRS consolidation rules for the purpose of determining the membership of the Group

4. Treatment of major shareholding

Where there are minority interests held by unrelated parties in a Constituent Entity, should the previous year's consolidated group revenue include 100 percent of the Constituent Entity's revenue for the purpose of applying the 750 million Euro threshold (or near equivalent amount in local currency as of January 2015) to identify an Excluded MNE Group, or should the revenue be pro-rated? Further, should the entity's financial data that is included in the CbC report represent the full 100 percent or should it be pro-rated?

Clarification –

- In presence of minority interests, if the local accounting regulations require full consolidation of an entity → 100% of entity's revenue to be included
- In presence of minority interests, if the local accounting regulations require proportionate consolidation of an entity → entity's revenue can be taken at proportionate levels.

Nature of relationship	Indian GAAP	Ind AS
Subsidiary	> 50% equity ownership or > 50% control of the Board → **Full line by line consolidation**	If entity is under control → **Full line by line consolidation**
Joint Arrangements	Joint Control by Equity → Proportionate line by line consolidation Joint Control by Operations → **Proportionate line by line consolidation**	Joint Control by Equity → no line by line consolidation Joint Control by Operations → **Proportionate line by line consolidation**
Associates	Significant influence → no line by line consolidation	Significant influence → no line by line consolidation

It may be interpreted that an entity would be considered as a Constituent Entity only when line by line consolidation is done i.e. in situations highlighted in blue.

C. Issues relating to the filing obligation for the CbC report

1. Impact of currency fluctuation on the agreed EUR750 million filing threshold

If Country A is using a domestic currency equivalent of EUR750 million for its filing threshold, Country B is using EUR750 million for its filing threshold, and as a result of currency fluctuations Country A's threshold is in excess of EUR750 million, can Country B impose its local filing requirement on a Constituent Entity of an MNE Group headquartered in Country A which is not filing a CbC report in Country A because its revenues, while in excess of EUR750 million, are below the threshold in Country A?

Clarification -

- As per Action 13 Report, the threshold would be at EUR750 million or a near **equivalent amount in domestic currency as of January 2015**
- An MNE Group that complies with the local threshold (near equivalent amount in domestic currency as of Jan 2015) of the Ultimate Parent tax jurisdiction, **should not be exposed to the local filing** in any other jurisdiction that is using a threshold denominated in a different currency
- Periodic revision in order to reflect the currency fluctuation if threshold denominated other than in Euro is not required
- The current EUR750 million (near equivalent amount in domestic currency as of January 2015) threshold **may be included in the review of the CbC Report minimum standard to occur in 2020 (i.e hold good till 2020)**

KPMG Example –

In January 2015:
Threshold as prescribed by OECD = EUR750 million
Prevailing fx rate (INR – Euro) = 70
Near equivalent threshold in INR = INR5250 crores (assume to be the threshold prescribed by India)
While evaluation for FY 1617:

Interpretation 1:
Revenue of X Ltd = INR6000 crores
Prevailing fx rate (INR – Euro) = 82
Revenue of X Ltd = EUR731 million
Since X Ltd does not cross the threshold of EUR750 million = no preparation and filing obligations for X Ltd.

Interpretation 2:
Revenue of X Ltd = INR6000 crores
Prevailing fx rate (INR – Euro) = 82
Near equivalent threshold in INR (750*82) = INR6150 crores
Since X Ltd does not cross the above near equivalent threshold of INR6150 = no preparation and filing obligations for X Ltd.

Interpretation 3:
Revenue of X Ltd = INR6000 crores
Near equivalent threshold in INR (as determined in January 2015) = INR5250 crores
Since X Ltd crosses the near equivalent threshold in domestic currency as on January 2015 = preparation and filing obligations for X Ltd.

As per the clarifications in this section, Interpretation 3 is to be followed.

2. Definition of total consolidated group revenue

For the purpose of determining whether an MNE Group is an Excluded MNE Group, are extraordinary income and gains from investment activities included in total consolidated group revenue?

Clarification -

- The definition to be followed is as per applicable accounting rules of the jurisdiction of the UPE
- For financial entities, some of the items reported might be 'net amount' as per the applicable accounting rules (like interest rate swap)

D. <u>Issues relating to the sharing mechanism for the CbC report</u>

1. Transitional filing option

Can MNE Groups with an UPE resident in a jurisdiction whose CbC reporting legal framework is in effect for Reporting Periods later than 1 January 2016 voluntarily file the CbC report for fiscal periods

commencing on or from 1 January 2016 in that jurisdiction? What is the impact of such filing on local filing obligations in other jurisdictions?

Clarification -

- Jurisdiction of the UPE has not been able to implement the CbC Report requirement as of 1 January 2016
- Other jurisdictions of the constituent entities introduce a local filing obligation with no transitional benefits
- Jurisdiction of the UPE to accommodate voluntary filing for fiscal period commencing from 1 January 2016 – **'parent surrogate filing'**
- Where surrogate filing is available, it would mean that there are no local filing obligations for the MNE in any jurisdiction where its Constituent entity exists and the following conditions are met:
  i. The Ultimate parent has made the CbC report available as per the Action 13 reporting requirement deadline (12 months after the last day of the Reporting Fiscal Year of the MNE Group)
  ii. By the first filing deadline of the CbC report, the jurisdiction of the tax residence of UPE must have its laws in place to require a CbC report (though might not require to file it in the Reporting Fiscal Year under consideration)
  iii. By the first filing deadline, Qualifying Competent Authority Agreement (QCAA) must be in effect between the tax jurisdiction of the UPE and the Local Jurisdictions
  iv. There is no reporting of systemic failure by the jurisdiction of the tax residence of UPE to the Local Jurisdictions
  v. Notification rules have been provided for
- Countries confirming that they will have parent surrogate filing available include Hong Kong, Japan, Liechtenstein, Nigeria, Russian Federation, Switzerland and United States.

2. CbC report notification requirement

Article 3 of the Action 13 model legislation for CbC reporting includes an option for jurisdictions to require notifications to be sent to the country tax administration identifying the Reporting Entity for the MNE Group. Where a Constituent Entity of an MNE Group is required to notify its tax administration of the identity and tax residence of the Reporting Entity (including the Surrogate Parent Entity) of the MNE Group by 31 December 2016 (with respect to the 2016 fiscal year), would it be consistent with the Action 13 minimum standard for jurisdictions to provide some transitional relief during the period in which domestic CbC legal frameworks and Qualifying Competent Authority Agreements are still being put in place?

Clarification -

- Many MNEs might not have identified the Reporting Entity and hence faltering on the notification requirement of some of the tax jurisdictions of its Constituent Entities
- Transitional relief option to be made available (it is expected not to be frustrating the policy intention of the Action 13 minimum standard)
- Jurisdictions are required to bring their QCAA into effect as soon as possible

Our comments

The first compliance deadline for Indian taxpayers is November 2017. While the guidelines from the CBDT are awaited, the above document issued by OECD provides much needed clarifications.

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri
Vadodara 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

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