

## CBDT issues guidance on confidentiality and appropriate use of CBC Reports

### Background

The 15-point Action Plan adopted by the Organisation for Economic Co-operation and Development (OECD) and G20 countries in order to address Base Erosion and Profit Shifting (BEPS) includes revised standards for transfer pricing (TP) documentation and Country-by-Country Reporting (CBC Report) under Action 13<sup>1</sup>. The BEPS Action Item introduced a three-tiered TP documentation consisting of a) Master File; b) Local File; and c) Country-by-Country Report (CBC Report), applicable for a fiscal year beginning on or after 1 January 2016.

Implementation of CBC Reporting is one of the four minimum standards within the BEPS Action Plan, required to be implemented by all jurisdictions that are members of OECD Inclusive Framework on BEPS, including India. While the objective of the CBC Report is to increase transparency and provide tax administrators useful information to identify cases of BEPS, it also drew concerns about the possibility of inappropriate use and confidentiality of information furnished in CBC Reports. Taking such views into account, the implementation of BEPS Action 13 was made subject to a peer review to ensure timely and consistent implementation. One of the key aspects covered by the peer review process is confidentiality and appropriate use of CBC Reports.

Adapting to the requirements set out under Action 13, the Finance Act, 2016, introduced the concept of Master File and CBC Report in the Indian TP regulations with effect from the fiscal year beginning 1 April 2016. Section 286 was inserted in the Income Tax Act, 1961 along with subsequent amendments in the Income Tax Rules 1962<sup>2</sup> (the Rules) to govern the provision of CBC Reporting in India. The first round of CBC Report where

applicable was due for filing by 31 March 2018 for the fiscal year 2016-2017.

Further, to aid the automatic exchange of the CBC Reports with other tax jurisdiction, India has signed Multilateral Competent Authority Agreement for automatic exchange of CBC Reports (CBC MCAA) and has active bilateral relationships with 50 countries<sup>3</sup>. Whereas the countries which have either not signed and/or ratified the Multilateral Convention or having done so they have not signed CBC MCAA, India endeavours to enter into bilateral Competent Authority Agreements for automatic exchange of CBC Reports (CBC BCAA)<sup>4</sup> with them.

The first annual peer review report<sup>5</sup>, recently published by the OECD, recommended India to take steps to ensure that the appropriate use condition is met ahead of the first exchange of CBC Report, expected to start from September 2018.

As summarised above, **to meet the minimum standard of BEPS Action 13 implementation, the CBDT has recently issued Instruction No. 2/2018 providing guidance on appropriate use of CBC Reports.** The CBDT instruction also provides guidance around maintaining confidentiality as well as prescribes a framework to monitor, control and review the appropriate use of information received from CBC Reports.

### Key insights from CBDT's instruction and consistency with OECD Guidelines<sup>6</sup>

The guidance detailed out in the CBDT instruction is broadly consistent with the OECD guidelines on the

<sup>1</sup> Transfer Pricing Documentation and Country-by-Country Reporting – Action 13 : 2015 Final Report, October 2015

<sup>2</sup> Rule 10DB along with new form 3CEAC, 3CEAD and 3CEAE

<sup>3</sup> As of June 2018, there are 70 CBC MCAA signatories and India is yet to have the active bilateral relationship with the balance 20 countries

<sup>4</sup> As reported in the OECD's Peer Review Report (Phase 1), India is expecting to enter into a bilateral CAA with one jurisdiction

<sup>5</sup> Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 1)- Inclusive Framework on BEPS: Action 13, April 2018

<sup>6</sup> BEPS Action 13 on Country-by-Country Reporting: Guidance on the appropriate use of information contained in Country-by-Country reports, September 2017 (OECD Guidelines)

appropriate use of information contained in CBC Reports (OECD Guidelines). The key points are summarised as under:

1. **Access to the CBC Reports:** It is clarified that all the CBC Reports either filed in India or exchanged by other jurisdictions shall be primarily accessed by the Competent Authority of India<sup>7</sup> and the Director General of Income Tax (Risk Assessment) (DGRA) in accordance with the provisions of the tax treaties and the Act respectively.

Further, the cases where any constituent entity (CE) is selected for scrutiny based on the risk assessment, the jurisdictional transfer pricing officer (TPO) will have access to the information related to such CE. To safeguard such use of information the standard operating procedure will be formulated by the Centralised Risk Assessment Unit (CRAU) of DGRA.

2. **Appropriate use of the CBC Reports:** In consistency with the OECD Guidelines, the CBDT has clarified that the TPO can use the CBC Reports' information primarily for the following three purposes:

- **High-level transfer pricing risks assessment:** In case the evaluation of CBC Report by CRAU indicates any potential risks on the TP arrangement between the Indian taxpayer with its associated enterprise, the CBC Reports may be used for planning a tax audit of the Indian taxpayer for the relevant assessment year. In such cases, the TPO using the information as a basis shall make further enquiries on the MNE group's TP arrangement and/or tax matters in the course of the audit, but the enquiry shall not only be restricted to the potential risks identified by the CRAU. The guidance issued by the CBDT also clarifies that the CBC Report information on its own shall not constitute conclusive evidence to propose the TP adjustment.

This seems consistent with the OECD Guidelines on appropriate use, which states that since CBC Report does not contain detailed information on a particular entity's income and expenditure or transactions it has entered into with third parties or related parties, risk allocations between entities, functions performed or the assets employed, it is not sufficient to draw reliable conclusions by the tax authorities and propose any adjustment merely on that basis.

- **Assessment of other BEPS related risks:** It is clarified that while CBC Reports may be used to identify indicators of possible tax risk unrelated to TP but a detailed enquiry should be conducted during the assessment to examine such risks and to arrive at a conclusion on potential tax BEPS<sup>8</sup>. However, the CBC Report information also does not constitute conclusive evidence that a group is engaged in other forms of BEPS.

In this regard, the OECD also clarifies in its September 2017 Guidelines that "*In practice, while CBC Reports may be used to identify indicators of possible tax risk, it will usually only be possible to understand the arrangements giving rise to that risk once further enquiries have been conducted. Further, the same way that CBC Report information on its own does not constitute conclusive evidence that transfer prices are not appropriate, it also does not constitute conclusive evidence that a group is engaged in other forms of BEPS*".<sup>9</sup>

The guidance issued by CBDT also provides a certain example of other BEPS related risk that may lead to a shift of profits that could result in no taxation of low taxation including practices. The examples include the use of a low-taxed branch of a foreign company, hybrid entities, hybrid financial instruments, conduit companies, derivatives to avoid withholding taxes, pricing of intangibles, interest deductions, etc.

- **Economic and statistical analysis:** CBC Reports may be used for economic and statistical analysis, in terms of understanding the use of CBC Report, identifying features, use, and risk of the CBC Report and tax system, in consistency with provisions of the tax treaties. Whereas the OECD states that CBC Report information may be used for the purposes of economic and statistical analysis to the extent this is permitted under the relevant tax treaty or TIEA, the conditions of which will protect the confidentiality of the information exchanged and prevent the information from being published.

<sup>7</sup> Joint Secretary, Foreign Tax and Tax Research Division – I and Joint Secretary, Foreign Tax and Tax Research Division – II

<sup>8</sup> As per the OECD Guidelines, 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

<sup>9</sup> Para 11 of the OECD's Guidelines on the appropriate use

**3. Inappropriate use of CBC Reports:** The guidance issued by CBDT explicitly provides two situations under which the use of CBC Report shall be considered as inappropriate:

- If the information is used as a substitute for a detailed TP analysis of international transactions and determination of arm's length price based on a detailed functional and comparability analysis; and
- If the information is used as the only evidence to propose a TP adjustment.

In this regard, the BEPS Action 13 Final Report as well as OECD Guidelines clarify that jurisdictions should not propose adjustments to the income of any taxpayer on the basis of an income allocation formula based on the data from the CBC Report<sup>10</sup> and that information contained in CBC Reports should not be used as a basis to adjust a taxpayer's income using global formulary apportionment.<sup>11</sup>

**3. Confidentiality of the CBC Reports:** All the CBC Reports received either through the exchange of information or filed with the DGRA under section 286(2) or section 286(4), are subject to requirements of the tax treaties and the Act, respectively. Accordingly, all the officers who handle the information contained in the CBC Reports are directed to strictly follow the detailed guidelines on maintaining confidentiality provided in Chapter VII of Manual on Exchange of Information.

**4. Monitoring, control and review:** On monitoring and control, the CBDT clarifies in its guidance that:

- Use of CBC Report information by the TPO shall be monitored by the jurisdictional CIT(Transfer Pricing) and breach of appropriate use, if any, to be informed to the Competent Authority of India who has to further disclose it to the Coordinating Body Secretariat of the OECD;
- Any concern is raised by the taxpayer on the inappropriate use of the information, shall be reported by the TPO to the jurisdictional CIT (Transfer Pricing) and if remain unresolved by the CIT, the same shall be disclosed to the Competent Authority of India.

- Also, the adjustment made based on inappropriate use of the information shall be promptly conceded by the Competent Authority of India in the Competent Authority proceedings (Mutual Agreement Procedure – MAP).

Further, it is clarified that the use of information shall be regularly reviewed by the CBDT through Competent Authority of India wherein the Principal CCIT (International Taxation & Transfer Pricing) shall submit a quarterly report to the CBDT in the prescribed format within 30 days from the end of the relevant quarter. The first review report is to be filed by 30 April 2019 for the quarter beginning 1 January 2019. The format of such review report is also specified in the guidance.

## Our comments

The CBDT has issued guidelines on the appropriate use of CBC Reports. Not only this guidance helps India meet the OECD's minimum requirements of confidentiality, consistency and appropriate use of the CBC Reports, it would also instill confidence of MNCs in Indian tax administration to handle CBC data with necessary safeguards and not making TP adjustment purely based on CBC Report.

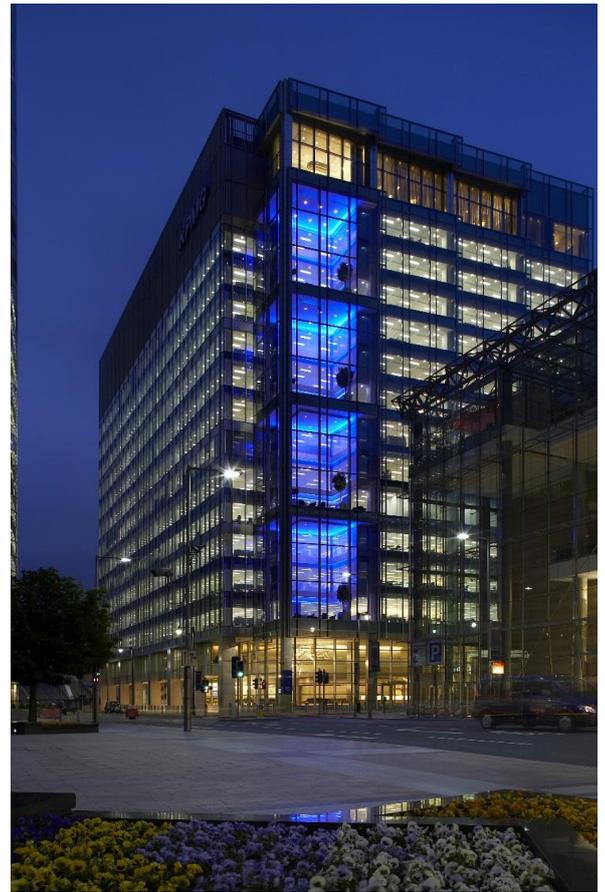
This is a welcome step towards India's commitment to the effective implementation of the recommendation of BEPS Action 13. While the actual implementation of this guidance would be keenly observed, the following key points should be noted:

- The guidance mentions that based on risk assessment, cases of constituent entities may be selected for transfer pricing scrutiny. The parameters of such risk assessment are currently not specified in the CBDT instruction and may be notified at a subsequent point of time.
- Currently, the detailed TP scrutiny is carried out under section 92CA of the Act by the TPO under a reference received from the AO. For TP audits of cases selected from CBC Report risk assessment, necessary amendments may be required under the existing provision.

<sup>10</sup> Para 59 of the BEPS Action 13: 2015 Final Report

<sup>11</sup> Para 6 of the OECD's Guidelines on the appropriate use

- The guidance specifies that the Competent Authority should promptly concede any adjustment, made based on inappropriate use of CBC information, in a Mutual Agreement Procedure. While this is consistent with the OECD Guidelines, the India tax administration may need to consider a similar approach for such cases even in the domestic litigation proceedings.
- This guidance paves the way for the exchange of CBC report by India. With this development, it can be expected that the TP scrutiny in the near future would be more detailed and thorough. Therefore, alternate dispute resolution mechanism such as bilateral APA and MAP seem preferable to achieve certainty.
- Apart from TP risk, other BEPS-related risks unrelated to transfer pricing would also be identified as part of the risk assessment. The indicative examples of such other BEPS related risk, already provided in the guidance issued by CBDT, should be noted.



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