In its meeting on 8 March 2016, the ECOFIN has agreed on a directive that shall implement the recommendations of the OECD for more transparency in international tax matters. As a result, multinational enterprises will have to provide additional information for financial years starting on or after 1 January 2016.

**CONTEXT**

The Economic and Financial Affairs Council (ECOFIN) of the EU has agreed to request member states implementing their domestic tax laws mandatory Country-by-Country Reporting (“CbCR”) requirements for multinational enterprises (“MNEs”) that are resident in their jurisdiction. This is the first of four measures of the anti-tax avoidance package released by the European Commission on 28 January 2016. The EU’s anti-tax avoidance package goes back to work undertaken by the OECD in the years 2013-2015 in the OECD/G20 Base Erosion and Profit Shifting (“BEPS”) Project, with final reports published in October 2015. Action 13 of the OECD BEPS Project ended in recommending a three-tiered set of transfer pricing documentation, comprising a Master file, a Country file and a CbCR.

The directive the ECOFIN has agreed upon now is a modification of the existing Directive on Administrative Cooperation ("DAC1") dated 15 February 2011. DAC1 has been amended three times before, including the automatic exchange of advance cross-border rulings and advance pricing arrangements between tax authorities of EU member states, which will become effective as per 1 January 2017 ("DAC3").

The mandatory CbCR requirement ("DAC4") is yet pending the European Parliament’s opinion.

**SCOPE OF APPLICATION**

DAC4 applies to “… a collection of enterprises related through ownership or control such that it is either required to prepare consolidated financial statements for financial reporting purposes ... or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.”. Such group of enterprises furthermore consists of two or more enterprises resident in different tax jurisdictions or of one enterprise with business operations via a permanent establishment in another tax jurisdiction.

Excluded are MNE groups with a consolidated annual revenue of less than €750 million.

**WHAT IS NEW ?**

In accordance with the model legislation and the reporting tools recommended by the OECD, the CbCR under DAC4 consists of a template with three tables. Format and content of the tables follows exactly the recommendations of the OECD. The mandatory CbCR requirement ("DAC4") is yet pending the European Parliament’s opinion.

As a result, the EU code of conduct for transfer pricing documentation will remain as it is, for now. Hence, following the masterfile approach will remain an option but will not be mandatory for MNE groups headquartered in the EU. However, if that option is selected, it shall be applied in a consistent manner across the EU entities of the MNE group.

**WHAT REMAINS AS IT IS ?**

The final OECD/G20 report on Transfer Pricing Documentation and Country-by-Country Reporting recommends revised standards for transfer pricing documentation, besides CbCR. MNEs shall prepare a Master file that provides a high-level overview of the MNE group and a Local file that provides more detailed information about the cross-border intercompany transactions realized by the local country affiliate. Chapter V of the OECD Transfer Pricing Guidelines is replaced entirely by the new wording recommended in the final report.

The so-called masterfile approach, as it is recommended by the OECD now, exists within the EU already since the respective code of conduct (Council document 2006/C 176/01) has been put in place in 2006. Even though there are still open questions about the practical application and the acceptance of the Code of Conduct in some member states, especially in relation to domestic transfer pricing regimes, it was obviously not perceived necessary - at this stage - to adopt the OECD’s recommendation for MNE groups resident in an EU member state.
participating in the ordinary operating activities);
- the net book value of tangible assets (which excludes cash and cash equivalents, intangibles or financial assets).

In table 2 of the CbCR, per tax jurisdiction, each constituent entity being resident in that tax jurisdiction has to be reported with its legal entity name, as well as any tax jurisdiction of organization or incorporation that is different to the residency of the constituent entity. Furthermore, each constituent entity’s main business activity(ies) has to be indicated by ticking one or more of the appropriate boxes provided with the table. Finally, the irrevocable of the template shall provide any additional information the reporting MNE deems necessary to explain the information provided in the other two tables.

Neither the OECD recommendations nor DAC4 requires that MNEs reconcile the figures they submit to tax authorities.

WHO REPORTS?

DAC4 is binding for all EU member states, with 7 of them not being a member of the OECD. Each member state shall take measures to enact DAC4 via its domestic tax legislation by 31 December 2016 at the latest. These measures shall oblige MNEs to file reports for fiscal years commencing on or after 1 January 2016, within 12 months after the respective fiscal year has expired.

In principle, the reporting obligation has to be fulfilled by the ultimate parent entity towards the tax authority of the parent’s residence. However, a surrogate parent entity shall fulfill the reporting obligation with the tax authority of its residency, if:
- it is a constituent entity resident in an EU member state; and
- the jurisdiction of the ultimate parent entity does not require CbCR, does not have a qualifying competent authority agreement in effect with a respective EU member state or does not provide CbCR to other tax authorities automatically.

In case multiple constituent entities of a MNE group fulfill the requirements for being a surrogate parent entity, they may designate one of these for filing the report.

The tax authority receiving the CbCR shall submit it to the other tax authorities concerned (as it appears from the report) within 15 months after the respective fiscal year of the MNE group has expired. In other words, a tax authority has at least 3 months time to make the information available to the other tax authorities.

OPEN QUESTIONS

The appointment of a surrogate parent entity will most likely become relevant, at least at an initial stage when not all (non-EU) countries will have domestic CbCR requirements and the agreements with other tax authorities will not yet be in place. In particular, it appears certain that the US Treasury Department will not establish CbCR effective prior to 1 July 2016. MNE groups headquartered in Japan have to report only from 1 April 2016 onwards, and Canada may face a delay in implementing CbCR, to name a few examples. However, according to the council’s press release on the meeting that took place on 8 March, filing reports will be mandatory in such situations only from fiscal year 2017 onwards, whereas reporting for fiscal year 2016 would be optional.

But - as experience form the past with the implementation of other directives shows - it should also not be taken for granted that each of the 28 EU member countries will have all domestic legislation and processes in place on 31 December 2016.

Luxembourg has not yet made public any measures for implementing CbCR. However, there is also no reason to doubt that DAC4 will be adopted in a timely manner.

Many countries sanction the failure to comply with domestic transfer pricing regimes. DAC4 does not provide for any penalties, but leaves it up to the member states if and which transfer pricing penalties will apply if MNE groups do not comply with their obligation to prepare CbCR.

It is part of the public debate about anti-tax avoidance measures whether tax practices and reporting of MNEs shall be made public. The automatic exchange of information between tax authorities is based on the confidentiality of the data provided by MNE groups. However, the European Commission currently conducts an impact assessment on whether CbCR shall be made publicly available, and the results are expected for end of March 2016.

HOW CAN BDO HELP YOU?

Whilst collecting the data available internally and structuring the information for the CbCR, headquarters of MNE groups as well as their subsidiaries may be faced with operational and organizational questions or with questions about the content of DAC4. BDO is there to help you efficiently dealing with such queries.

MNE groups may also take the opportunity and use CbCR for their own transfer pricing risk assessment. BDO is happy to assist with interpreting the data collected in order to perform such risk assessment and to solve areas of risk identified, such as documentation gaps or inconsistencies.

If you would like to discuss in more detail, please contact one of the following persons:

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