Home My Network Jobs Messaging Notifications Me Work Lear

Create your own newsletter

Start your own discussion with a newsletter on LinkedIn. Share what you know and build your thought leadership with every new edition.

Try it out

Country-by-Country Report

Edit article
View stats

Nithya Srinivasan
Founder & CEO - VSTN Consultancy - Transfer Pricing Experts

2 articles

March 1, 2023

Introduction

The Country-by-Country Report (CbC) was introduced through Action Plan 13 of the Base Erosion and Profit Shifting (BEPS) project of Organisation for Economic Co-operation and Development (OECD) and G20 countries. Action Plan 13 – "Transfer Pricing documentation and Country-by-Country Reporting" laid down the objectives of transfer pricing documentation viz., MNE Groups to articulate their transfer pricing positions, aid tax administrations to assess transfer pricing risks and deploy audit resources effectively & undertake audits in a more informed manner. These objectives were to be achieved through the three-tier documentation approach viz., Master File, Local file and CbC.

CbC captures key financial metrics of the Group jurisdiction wise and is aimed to provide insights for tax authorities for effective risk assessment. CbC provides a financial snapshot of the Group for the year across various jurisdictions. Existing data sources for tax authorities such as tax filings do not capture quantitative information at the Group level.

Therefore, it is key to understand how CbC can be harnessed in transfer pricing risk assessment.

CbC Contents

CbC has three parts or Tables. Table 1 captures the quantitative information for each of the tax jurisdiction of the Group, namely:

A. Performance / Results

- Revenues
- *Total Revenue*
- *Related Party Revenue*
- *Unrelated Party Revenue*
- Profit before Tax

B.Tax liability and outflow

Income Tax paid

Income Tax accrued

C. Capital employed

Stated Capital

Accumulated earnings

D. Substance

Number of employees

Tangible assets other than cash and cash equivalents

Table 2 lists all the entities of the Group and information presented include legal name, tax jurisdiction, entity & tax identification numbers, the main business activity(ies) undertaken

Table 3 is for additional information in connection with Table 1 and 2 i.e., to aid reading of the earlier two tables. For example, note on whether number of employees are full-time equivalent or includes employees working on contract basis.

Reading of CbC

Introduction

Like any other financial document/statement, it is essential to understand the background behind the compliance to maximise insights from the document. The intent of Action Plan 13 was to provide more quality information to tax

authorities to carry out transfer pricing assessments effectively. The issue was transfer pricing centred viz., purported manipulation through perceived emphasis on contractual allocation of functions, assets and risks rather than substance. This divorce was addressed through Action 8-10 "Aligning Transfer Pricing outcomes with value creation". Action Plan 8-10 provided additional detailed guidance on arm's length principle - to clearly clarify that economic reality should dictate results rather than paper reality, and Action Plan 13 provided tools to tax authorities (through CbC) to assess if arm's length principle were adhered to.

Weighing scale of Value creation and Outcome

Through the information in Table 1 and Table 2, CbC captures how the Group as a whole, across various jurisdictions, performs various functions, employs assets / resources and generates revenues and in that process creates value. From an economic / transfer pricing perspective, entities driving such value creation should house Group's residual profits (or losses), while the entities performing routine activities enjoy routine returns. Value creation (or its source – substance) and profitability / returns should be placed on each of sides of the weighing scale to evaluate the arm's length principle for the transactions within the Group. In the CbC report, profits represent outcomes and will have to be mapped with substance viz., employees / tangible assets and performing relevant functions (captured in Table 2), to understand if profits registered is commensurate with the substance. Using profitability and its ratio(s) with substance related indicators would indicate profits generated can be maintained / sustained in that jurisdiction.

Stepping backwards, in certain instances, mapping revenues with substance might be required. Revenues being recognised based purely on contractual arrangements might be accepted from an accounting perspective but would be inorganic from economic / transfer pricing perspective if it lacks the required substance to generate such revenues. Insights from such mapping can challenge the way Group transacts with its

customers in a fundamental way and could result in more than just reallocation of system profits. Concerns at the top-line level, translating to reallocation of revenues, in extreme cases, have other tax implications such as withholding of taxes, and is a serious red-flag for the Group as a whole.

The follow on of the above is piecing together of tax – accrued and paid. Any inverse relationship between profitability and tax accrued across jurisdictions will be flagged within tax authorities. Where the jurisdiction is not a low tax jurisdiction and the lower tax accrued is owing to tax breaks provided by jurisdiction's government for enticing higher investments, tax losses adjusted or deferred tax adjustments, might not be a major concern. However, in case of converse there is a high possibility that tax authorities perceive that profit shifting is being undertaken by the Group. Material differences between tax accrued and tax paid will a concern for tax authorities which might be investigated.

Group having presence in any tax haven jurisdictions and material revenue streams (both from unrelated and related parties) and profits will be red flag for tax administrators.

Group and Jurisdictional level: The micro – macro picture

Reading results from Group and jurisdictional level is required to eliminate both myopia and hypermetropia. Ensuring ratios and other indicators are read wholistically can give insight into level of consistency in activities from a Group perspective as well as tenability from a jurisdictional viewpoint. For example, how revenues or profits are distributed across the group would provide an understanding of where significant profits of the Group rests, and material variation in profitability from arm's length returns / consideration may be flagged by tax authorities. Reading of Group level indicators / ratios alongside relevant jurisdictional level indicators / ratios can provide deeper understanding of the Group operations or explain / rationalise the skewed ratios at either Group or jurisdictional level, which would otherwise be inexplicable.

Industry alignment

Various industries / sectors / sub-sectors operate in a similar fashion and has business / economic rationale as well as substance. Where the ratios and other analysis seem acceptable but are not in alignment with industry practices (such as supply chain), there is a possibility that tax authorities scrutinise the Group.

Other Key Points

Jurisdictional involvement

Though CbC is the obligation of the ultimate / surrogate parent, it is necessary that entities in the respective jurisdiction provide their inputs or are informed on the relevant CbC information. Mainly because any adverse ratios in a jurisdiction will be queried by the respective tax authorities to the said group entities. Consistency should be ensured in the activities performed by entities in other jurisdictions with those reported. Classic example is where captive subsidiaries performing IT services are disclosed as R&D services in the Group, which might be purely due to accounting positions taken at Group level. Several MNE have commenced automating the process of CbC, a welcome move. Nonetheless, other jurisdictions will have to be involved in initial mapping / setting-up process to ensure correctness of information being populated such as consistency in the positions taken by the Group as a whole.

Public CbC

The European Parliament has adopted public EU CbC reporting, effective by 2024, and EU Member States will have to adopt these reporting rules in domestic tax laws. The intention is to aid tax transparency and deter any corporate tax avoidance and aggressive tax-planning. Once these tax laws are live, CbC of each of the applicable MNE Group will be subject to public commentary and would be important to ensure accuracy of information (at the least) and be analysed from multi-jurisdictional perspective.

Year-on-Year analysis

Comparative charting of CbC of an MNE Group year-on-year throws light on any material movement in activities performed (functions), substance, accruing of revenues /

profits between jurisdictions. Especially post the pandemic there might be changes observed in CbC due to business reasons and it might be perceived as reallocation of functions and consequently profits. In such case internal documentation is to be maintained to capture such business reasons as well as why it should not be construed as restructuring, having further tax implications such as exit charges.

Pillar Two – Transitional Safe Harbour

The OECD has provided for a transitional Safe harbour rules w.r.t Pillar Two using CbC data to compute Group's revenue, income and simplified ETR. During the transitional period these rules lays down simplified mechanism to ascertain if top-up tax is payable or not. Since the safe harbour adopts CbC as the base, ensuring correctness of the CbC – both in form and substance will be even more critical.

Summary

CbC is a crucial document furnished / available with tax authorities across jurisdictions and is far from being yet another routine compliance of collating information. Group (including entities of other jurisdictions) should be cognizant of the implications on the submission of the CbC. Though ensuring arithmetic accuracy is required, understanding ramifications including possibility of any prospective tax litigation is vital.

Published by

Nithya Srinivasan

Founder & CEO - VSTN Consultancy - Transfer Pricing Experts

Published • 34m

2 articles

Country-by-Country Report (CbC)– Risk Assessment

As the due date for filing of #CbC for applicable #IndianHQ – FY 2021-22 (AY 2022-23) is approaching i.e., 31 March 2023, it is important to ensure accuracy of information flowing in CbC. However, an even more critical aspect is to understand how CbC will be consumed for #risk #assessment by tax authorities, which has tax implications across the jurisdictions it has presence. The article aims to broadly touch upon how a CbC can be read, from a risk assessment perspective, and other key points.

With various developments surrounding CbC such as public CbC, transitional CbC Safe Harbour for #Pillar Two, it is even more key to analyze CbC of Group to identify any risk flags and streamline the operations from a transfer pricing perspective to pre-empt any tax litigation. Though CbC is a post-mortem exercise, it would aid in course correction for the future years.

How VSTN can support:

1. Analyze CbC for MNE Groups (outbound and inbound where available) to

understand any flags from risk assessment perspective, through:
o Jurisdiction specific insights from analysis of both jurisdictional information and Group information at large.
o Year-on-Year comparison to understand any perceived movement in functions, activities or revenue / profits accruing and follow-on documentation to mitigate any risk of attribution of restructuring.
o Industry specific comparison and insights based on publicly available CbC information.
o Assisting in streamlining the Group's transfer pricing #policy
2. #Transfer Pricing Readiness for transitional CbC Safe Harbour for Pillar Two

In case of any support or clarifications on the above, please feel free to reach out to us at snithya@vstnconsultancy.com

#cbc #cbcr #pillar2 #riskassessment #safeharbor #BEPS # tax

Like Comment Share Sandeep Pareek and 2 others

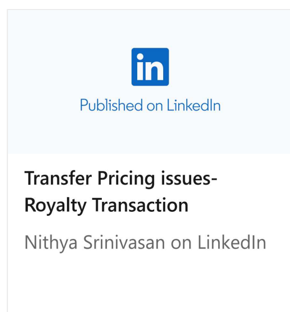
Reactions

0 Comments

Add a comment…

Nithya Srinivasan
Founder & CEO - VSTN Consultancy - Transfer Pricing Experts

More from Nithya Srinivasan



Transfer Pricing issues-Royalty Transaction
Nithya Srinivasan on LinkedIn

About
Community Guidelines
Privacy & Terms
Sales Solutions
Safety Center
Accessibility
Careers
Ad Choices
Mobile
Talent Solutions
Marketing Solutions
Advertising
Small Business
Questions?
Visit our Help Center.
Manage your account and privacy
Go to your Settings.
Select Language
English (English)

LinkedIn Corporation © 2023