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Tax Newsletter

Country-by-Country Reporting

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Overview

Australia is adopting key measures from the Organisation for Economic Co-operation and Development's (OECD)/G20 Base Erosion and Profit Shifting (BEPS) project, which is aimed at reducing international tax avoidance and increasing transparency. These measures will increase the level of disclosure by some Australian multinationals and change the way international dealings are taxed. The purpose of this article is to outline some of the measures that have been implemented by Australia to date.

To increase transparency for multinationals operating in Australia, Australia is adopting Country-by-Country (CbC) reporting, which implements Action 13 of the BEPS Action Plan. CbC applies to all Australian and Multinational Enterprises (MNE) with an Australian presence and global turnover of more than AUD 1billion (referred to as Globally Significant Enterprises 'SGE'). For tax years beginning on or after 1 January 2016, SGE will need to file CbC reports with the Australian Taxation Office (ATO). The ATO will use the information obtained through the CbC reports to make an informed transfer pricing risk assessment, and to facilitate a transfer pricing audit if necessary.

The reports required to be prepared are as follows:

1. A CbC report with information relating to the global allocation of the MNE's income and taxes paid, together with certain indicators of the location of economic activity within the MNE group;
2. A master file providing an overview of the MNE group business, including the nature of global business operations, the overall transfer pricing policies, and global allocation of income and economic activity; and
3. A local file focusing on specific transactions between the Australian entity and associated enterprises, the amounts involved in the transactions, and an analysis of transfer pricing decisions associated with those transactions.

1. CbC report

The ATO has indicated that it will accept CbC reports to be prepared based on OECD recommendations. OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (herein referred to as OECD guidelines) recommend that the ultimate parent entity of an MNE group should file the CbC report in their jurisdiction of residence. The reporter must be in a position to oversee and have access to information about the global operations of the MNE. In practice, business units in the countries in which the MNE operates may be called on to contribute local country information for completion of the CbC report. CbC reporting requires certain information for each entity in the global group (irrespective of jurisdiction) including:

- Revenue (segregated by third party and related party sales);
- Profit before tax;
- Accumulated earnings and capital;
- Tax paid (including withholding taxes suffered in other jurisdictions);
- Current year tax accrual (excluding deferred tax and provisions for uncertain tax liabilities);
- Number of full-time equivalent employees; and
- Net book value of tangible assets excluding cash and cash equivalents.

2. Master file

The OECD Guidelines advocate that the master file (and the local file) should be filed directly with the tax administrations in each relevant jurisdiction, as required by those administrations. However, the information required in master file is extensive and covers the operations of the MNE group as a whole. Similar to the CbC report, the preparer of the master file requires access to information about the MNE's global operations.

The ATO has not at present provided guidance on what an Australian parent of a MNE would need to provide in a master report to the ATO. However, based on the recommendation of the OECD, the master file should include:

- An organizational group structure chart for the global group;
- An overview of the global business model, profit drivers, geographic markets and supply chain value analysis;
- A broad outline of group intangible assets; and
- A section outlining all intragroup financing activities.

3. Local file

The local file provides more detailed information relating to specific intercompany transactions and focuses on the transfer pricing approach to transactions between a local entity and associated enterprises in different countries. The ATO has now finalised its design of the local file requirements and set out two types of local files that apply depending on the risk profile and Australian operations of the MNE:

- A short form local file applicable to very small taxpayers and taxpayers with immaterial related party dealings. The materiality thresholds for the short form file are very low so in practice few taxpayers are likely to qualify for this option unless they have minimal international related party dealings; and
- A (complete) local file for all other taxpayers.

The **short form local file** involves an outline of qualitative information on the reporting entity, including:

- A description and copy of the organisational structure of the reporting entity, including a description of the individuals to whom local management reports and the countries in which such individuals maintain their principal offices;
- A description of the reporting entity's business and strategy;
- A description of any business restructures affecting the reporting entity in the current or previous income year, and an explanation of its significance;
- A description of any transfers of intangibles in the current or previous income year, and an explanation of its significance; and
- A list of key competitors of the reporting entity.

In addition to the short form local file, a complete local file all includes the following information:

Part A

Details of all intercompany transactions, including the type of transaction, the value, the method used to test the arm's length principle, details of the counterparty and its jurisdiction of residence, and whether transfer pricing documentation have been prepared.

Part B

For material transactions (transactions not covered by the ATO's 'exclusion list'), the following need to be included:

- A copy of the underlying agreement for the transaction;
- The transfer pricing methodology relied upon by the foreign related party;
- A copy of any foreign APA or ruling for the transaction; and
- The reporting entity's financial statements.

Are there any exemptions?

While the ATO reiterated that exemptions will only be granted in limited circumstances, the ATO may exercise its discretion to provide exemptions in some circumstances. These **may** include:

- Information can be obtained through the "exchange of information" (EOI);
- The Australian tax payer does not engage in international transactions;
- The significant global entity is a sovereign wealth fund (particularly when the fund has received sovereign immunity status through a private binding ruling); or
- The parent entity (for inbounds) is not required to provide the CbC report and/or master file in its local jurisdiction.

Entities will need to apply in writing to the ATO for an exemption and explain the grounds on which an exemption is being requested. A general exemption is proposed for entities that are "exempt from income tax" (i.e. entities listed in Division 50 of the Income Tax Assessment Act 1997). When an exemption is not appropriate, entities may still be able to complete a simplified / short form "local file" depending on their circumstances.

Failure to lodge

Taxpayers that fail to adhere to their CbC reporting obligations will be exposed to administrative penalties. Currently the maximum 'failure to lodge' penalty is $5,400. The Government proposes to increase this to $450,000 from 1 July 2017. However, the true cost of non-compliance is likely to be a more aggressive approach adopted by the ATO in relation to the non-compliant taxpayers. Indeed, the ATO has indicated during its consultation process that non-compliant taxpayers will be viewed adversely in risk assessment and audit scenarios.

Other changes affecting SGE

Financial reporting

For income years beginning on or after 1 July 2016, a corporate tax entity that is a SGE is required to lodge general purpose financial statements with the Commissioner of Taxation. This will impact:

- Companies that do not have to lodge financial statements with ASIC (small companies and grandfathered companies).
- Companies (including branches of foreign companies) that currently lodge special purpose financial statements.
- Entities taxed as companies that do not need to lodge financial statements with ASIC (e.g. trading trusts and limited partnerships).

The general purpose financial statement will need to be submitted by the taxpayer to the Commissioner by the due date for lodging the entity's income tax return if these financial statements have not already been filed with the Australian Securities and Investments Commission (ASIC).

The ATO are currently determining whether they will accept General Purpose Financial Reports prepared for an overseas parent entity that include the Australian entity's results.

The ATO will be required to pass these financial statements onto ASIC, at which point they will be available to the public.

Multinational Anti-Avoidance Law (MAAL)

The MAAL is designed to counter tax structures that are perceived to avoid the existence of a permanent establishment in Australia and therefore Australia having a taxing right over some part of the profits of the non-resident entity selling into Australia. The MAAL is an anti-avoidance measure and therefore cannot be avoided through the application of Australia's tax treaties. It applies from January 1 2016 irrespective of when arrangements within its scope were entered into.

The proposed MAAL was originally announced as part of the 2015 May Budget, it was portrayed by the government as being targeted at a small group of multinationals primarily operating in the information and technology sector. However, the ATO recently stated that 170 Australian operations of multinational enterprises have either been approached by the ATO or have approached the ATO with a view to ascertaining whether the MAAL applies to them.

If the MAAL applies, the Commissioner has the standard powers to reconstruct the scheme to counter the tax benefit obtained. The Commissioner will assume that the foreign entity had a permanent establishment in Australia and that some or all of the activities of the foreign entity were undertaken by and attributable to that deemed permanent establishment. Arm's length profits will be subject to Australian corporate income tax, and administrative penalties of 100% will be applicable (if the entity does not have a RAP), alongside shortfall interest. Depending on how the reconstruction occurs, there may also be withholding taxes applicable to payments deemed to have been made by the deemed permanent establishment.

Stronger penalties

From 1 January 2016, the penalties imposed on SGEs that enter into tax avoidance or profit shifting schemes have been doubled. The amendments will not apply to taxpayers that adopt a tax position that is reasonably arguable.

What should you do?

- You should review whether or not you meet the annual global income threshold for additional compliance obligations as a SGE. This should now be assessed on an annual basis.
- If you are required to lodge transfer pricing documentation and CbC reports with the ATO, you should advise your parent company of the requirement. Preparatory steps should be initiated to prepare the documentation and the arm's length nature of the group structure and profit outcomes should be documented.
- You ought to review your organisation's current policies, and ensure that risk governance and transfer pricing policies applicable in Australia take account of the country-by-country reporting requirements.
- If you could potentially be affected by the MAAL measures, you should document your business model and highlight the commercial reasons, drivers and benefits supporting the use of particular models.
- For greater certainty, you may consider seeking a private binding ruling or where relevant, enter into an advanced pricing agreement with the ATO.

How we can help

- We can assist by reviewing your cross border operations and identifying any risks with respect to the Australian operations of your global groups.
- We can assist with the preparation of your general purpose financial statements, transfer pricing documentation and CbC reports.
- We can apply to the ATO for private binding taxation rules to confirm the application of the rules to your Australian Operations.

About Pitcher Partners

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- Property and construction
- Government and the public sector
- Agriculture
- Food and beverage
- Hospitality

$3.2bn
Worldwide revenue 2016 (USD)

147
Countries

30,000+
Partners and staff globally

100+
Partners nationwide

1,200+
People nationally

Sydney

240+
Total Sydney staff

28
Sydney partners

Firm locations

Pitcher Partners has the resources and depth of expertise of a major firm, but with a smaller firm feel. We give our clients the highest level of personal service and attention. That's the difference.

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