
OECD releases updated guidance on Country-by-Country reporting

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In brief

On April 6, 2017, the Organisation for Economic Co-operation and Development (OECD) released additional guidance on implementation of Country-by-Country (CbC) reporting (the guidance), as set out in the Action 13 Report “Transfer Pricing Documentation and Country-by-Country Reporting.” Guidance was originally published in June 2016, was expanded upon in December 2016, and has been updated again in this latest version. The new content in this version primarily seeks to address concerns raised by the asset management industry in seeking to comply with the prior guidance. Nevertheless, the guidance has a broader impact.

The guidance includes clarifications on the definition of revenue, the treatment of minority interests in constituent entities, the accounting rules for determining the existence of and membership of a multinational enterprise (MNE) Group, and the definition of related parties. In particular, the guidance makes the following recommendations:

- *Definition of revenue* — Extraordinary income and gains from investment activities should be included in revenues in the CbC report, and may be included in revenues for purposes of applying the CbC report filing threshold.
- *Treatment of major shareholdings* — Applicable accounting rules at the Ultimate Parent Entity (UPE) level requiring either full consolidation or partial consolidation of a Constituent Entity, the minority interests of which are held by unrelated parties, will determine which portion of such entity’s revenue will be included for purposes of applying the annual revenue threshold and whether its financial data is included in the CbC report fully or on a pro-rated basis.
- *Determination of existence of and membership of a MNE Group* — Guidance is provided regarding which accounting standard’s consolidation rules should be referenced to determine the existence of and membership of a MNE Group, depending on whether the UPE is publicly traded.
- *Definition of related parties* — The term ‘related parties’ should be interpreted as the Constituent Entities listed in Table 2 of the CbC report.

Some recommendations are of particular importance for financial entities, including pension and sovereign wealth funds. As stated above, the guidance recommends that gains from investments be included in revenue. The guidance also recommends that the use of net revenue figures should be allowed for financial entities where gross amounts are not available. Finally, the guidance recommends the use of IFRS accounting standards for the determination of membership in a MNE Group under certain circumstances for investment entities and investee companies.

Definition of revenues

The guidance provides that extraordinary income and gains from investment activities are to be included in revenues in Table 1 of the CbC report. It further provides that whether extraordinary income and gains are to be included in revenues in determining whether an MNE has met the filing threshold for CbC reporting purposes (EUR 750 million/USD 850 million) is left to the discretion of the jurisdiction of the UPE.

For financial entities, the guidance provides that items considered similar to revenue under the applicable accounting rules should be included in revenues for CbC reporting purposes. Examples given are 'net banking product' and 'net revenues.' The guidance further provides that reporting these items on a net basis is acceptable, provided such reporting is consistent with the applicable accounting rules.

Observation: The lack of discussion of extraordinary losses or the ability to net losses against gains may result in varying positions taken by MNEs. Also, given that the CbC reporting filing threshold is applied on an annual basis, more MNEs may fall into and out of the filing requirement as a result of having to include extraordinary income/gains. The treatment of extraordinary income/gains as revenue will disproportionately impact financial entities, including pension and sovereign wealth funds with investment income.

The recommendation that financial entities that report revenue equivalent items on a net basis do not need to gross up these amounts, provided the net treatment is consistent with the applicable accounting rules, alleviates some concerns of funds and other financial entities.

Deference to accounting rules in the treatment of revenue from major shareholdings

For Constituent Entities where unrelated parties hold minority interests, the guidance defers to the applicable accounting rules in the jurisdiction of the UPE to determine what portion of the entity's revenues should be considered for purposes of the CbC report revenue threshold and the financial data included in the CbC report.

The guidance states that if the applicable accounting rules require that the Constituent Entity be fully consolidated, then 100 percent of the entity's revenue should be included in the revenue calculation for the CbC report filing threshold. Similarly, such entity's financial data that is included in the CbC report should represent the full 100 percent. In contrast, if the applicable accounting rules require proportionate consolidation, then the relevant jurisdiction may allow revenues to be pro-rated for the application of the CbC report filing threshold and in the presentation of revenues (and other financial data required) in the CbC report.

Observation: The OECD defers to accounting rules in the jurisdiction of the UPE for certain definitions and determinations. This streamlining of CbC reporting recommendations with existing accounting rules helps reduce some uncertainty about reporting requirements for MNE Groups.

Deference to accounting standards for determining the existence of and membership in a MNE Group

The guidance delineates which accounting standard consolidation rules should be used to determine the existence of and membership in a 'Group,' depending on whether the equity interests of the relevant

enterprise are (or would be) traded on a public securities exchange.

For publicly traded companies, the MNE Group must use the consolidation rules in the accounting standards already used by the Group.

For non-publicly traded companies, countries may allow the MNE Group to choose either the local GAAP of the jurisdiction of the UPE or IFRS as its governing accounting standards, as long as the MNE Group applies such standard across years and for other aspects of the CbC report requiring reference to the standard.

However, if the UPE's jurisdiction would require a particular accounting standard to be used for publicly traded enterprises, such consolidation package must be used in determining if a privately held enterprise must file a CbC report and for determining which entities must be consolidated.

In determining if investment entities are to be consolidated with investee companies, a jurisdiction may mandate the use of IFRS consolidation rules for the purpose of determining the membership of a Group.

Any deviations from the accounting standards generally followed by the MNE for the CbC report should be noted in Table 3 of the CbC report.

Observation: These recommendations should assist in determining whether there is an MNE Group, particularly with respect to non-publicly traded companies.

Definition of related parties for purposes of reporting related party revenues

Related parties, otherwise referred to as 'associated enterprises' in the Action 13 Final Report, are defined as the Constituent Entities listed in Table 2 of the CbC report.

Observation: It seems unlikely that this guidance will be applied in the United States, because it is inconsistent with how the term ‘related parties’ (i.e., controlled taxpayers) is defined in the Section 482 regulations. Under the final CbC reporting regulations issued by the IRS, a ‘constituent entity’ is any separate business entity of such US MNE group, except that the term constituent entity does not include a foreign corporation or foreign partnership for which the UPE is not required to furnish information under Section 6038(a) (determined without regard to Treas. Reg. secs. 1.6038-2(j) and 1.6038-3(c)) or any permanent establishment of such foreign corporation or foreign partnership. Because Section 6038(a) requires reporting only with respect to foreign business entities which a US person controls — defined by Section 6038(e)(2) to mean the ownership of stock representing more than 50 percent of the total combined voting power or value — foreign business entities that are not majority-owned by a US person under that definition of ‘control’ will not be considered ‘constituent entities’ of the US MNE group, even if their accounts would be required to be consolidated with the US UPE’s account under US GAAP.

Observation: US GAAP does require the consolidation of non-majority-owned entities in some cases based on the power to direct the entity’s most significant economic activities and the ability to participate in the entity’s economics, even in the absence of majority equity ownership. Consequently, a US UPE may control some entities for purposes of Section 482 for which it owns 50 percent or less of the total combined voting power or value, but which would not be considered to be constituent entities for purposes of CbC reporting.

The takeaway

The OECD continues to update its guidance on CbC reporting and likely will continue to do so periodically. The three iterations of the guidance released thus far help answer some of the questions raised during the drafting of the Action 13 Report, but which were left unanswered in the Final Action 13 Report released in late 2015.

The April updates to the guidance primarily seek to address concerns raised the asset management industry by clarifying certain definitions and pointing to relevant accounting rules and standards. These updates help reduce some uncertainty regarding the OECD’s position on the issues discussed. However, MNE Groups across all industries should confirm with local jurisdictions — both in the home jurisdiction of the UPE and in any additional foreign jurisdictions where a local filing might be required — what changes, if any, will be made to individual country regulations to conform with the policy recommendations in the guidance.

In the absence of such a commitment from an individual country, the guidance will not be binding on the jurisdiction and on the MNE Group’s CbC reporting requirements in that jurisdiction.

In the case that an individual country adopts the recommendations to the guidance, uncertainty remains on how the tax authorities might use and analyze financial data included in the CbC report. The OECD is working on additional guidance to address this issue, although it is not clear that it will be shared publicly.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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