The Use of Country-by-Country Reporting for Tax Risk Assessment: Challenges and Potential Solutions

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Table of Contents

Issue 1 – 2020

1. Introduction 2

2. The Use of CbCR for Tax Risk Assessment 3
- 2.1. OECD's guidance on conducting tax risk assessment 3
- 2.2. Tax risk assessment processes used: An example 3
- 2.3. The CbCR outcome analysis: When a call for action is needed 7

3. Challenges in Using a CbCR for Tax Risk Assessment 7
- 3.1. Introduction 7
- 3.2. Issues with the implementation of the CbCR 8
- 3.3. Issues with the design of the CbCR 9
- 3.4. Issues with the use of a CbCR 9

4. Potential Solutions 11
- 4.1. The use of other sources of information 11
- 4.2. CbCR and the use of data analytics 11
- 4.3. Multilateral risk assessments and the ICAP 12
- 4.4. CbCR and MNE value chains 15
- 4.5. CbCR and blockchain 16

5. Conclusion 19

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The Use of Country-by-Country Reporting for Tax Risk Assessment: Challenges and Potential Solutions

Serena Picariello and Vikram Chand*

This article provides some considerations on the use of the country-by-country reporting for tax risk assessment through an in-depth review of the potential issues associated with the implementation, design and appropriate use of the country-by-country report. After providing a broader conceptual framework that outlines the general benefits of incorporating the report into a tax authority's risk assessment framework, the article specifically suggests potential areas for improvement in respect of how to address the different issues and examines whether modifications should be made to the standard, especially in light of the forthcoming 2020 review. Such recommendations are addressed to tax administrations and multinational enterprise groups, since inefficient use will be burdensome for both parties The analysis also takes into consideration the recent public consultation draft issued by the OECD.

1. Introduction

With the adoption by almost 90 countries[1] of the final legislation to require multinationals to file country-by-country reports (CbCRs) and the first automatic exchange happening in June 2018, most multinational enterprises (MNEs) have already submitted their CbCRs with 2016, 2017 and 2018 data and will file 2019 data before the end of this year.

The CbCR is intended to provide increased transparency to tax authorities by presenting a breakdown by jurisdiction of where revenues and profits, taxes paid and specific economic data (e.g. stated capital, full-time employees (FTEs), and tangible assets) are located.

The CbCR data will be used by tax authorities to perform high-level tax risk assessments based on the guidelines established in the OECD Handbook on Effective Tax Risk Assessment (HETRA).[2] The HETRA provides tax authorities with guidance on how the CbCR should be included in their tax risk assessment framework and how data should be interpreted. However, the OECD has acknowledged that using a CbCR for tax risk assessment purposes is not free of potential unforeseen circumstances that will likely lead to increased tax audits and controversy.[3]

The purpose of section 2. of this article is to provide an example of how a CbCR may be used as a high-level risk assessment tool and what type of information can be derived through specific ratios that tax authorities may calculate based on CbCR data.

Section 3. subsequently recognizes that the use of CbCRs for tax risk assessment may pose numerous challenges. The potential risks for the misinterpretation and misuse of data are also outlined in this section. It is contended that the information contained should be used with caution by tax authorities and not be considered conclusive evidence to propose transfer pricing adjustments based on the formulary apportionment of income.

Building on the analysis in sections 2. and 3., section 4. provides a number of potential suggestions on how to address the various red flags arising from CbCR information, especially regarding the forthcoming 2020 review, to evaluate whether modifications should be made to the CbCR standard.[4] Such recommendations

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1. OECD, *Public consultation document: Review of Country-by-Country Reporting (BEPS Action 13)*, p. 9 (OECD 2020) [hereinafter Public Consultation on CbCR]. As of January 2020, 90 members of the Inclusive Framework had implemented country-by-country reporting (CbCR) legislation, while 25 other countries had draft CbCR legislation. For further details, *see also* OECD, *Action 13: Country-by-Country Reporting* (OECD 2019), available at https://www.oecd.org/tax/beps/beps-actions/action13/ (accessed 18 Nov. 2019).
2. OECD/G20, *Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment* (OECD 2017) [hereinafter HETRA]. Furthermore, the OECD is currently developing a Tax Risk Evaluation & Assessment Tool to support tax administrations – especially in developing countries – in interpreting and reading CbCRs. *See* Public Consultation on CBCR, id., at p. 11.
3. TPA Global, *How to run Value Chain Analysis in 2018? 3 Practical Case Studies* (7 June 2018), available at https://www.tpa-global.com/nieuws/2018-04-26/how-to-run-value-chain-analysis-in-2018-3-practical-case-studies (accessed 19 Nov. 2019).
4. The OECD has mandated that countries participating in the BEPS Project carefully review the implementation of the new standards no later than the end of 2020, with the intention of reassessing whether further modifications are required. Currently, OECD Working Party (WP) 6 and WP10 are reviewing the CbCR standard by taking into account sev-

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are addressed to tax administrations and MNE groups, since inefficient use of the CbCR will be expensive for both parties.

2. The Use of CbCR for Tax Risk Assessment

2.1. OECD's guidance on conducting tax risk assessment

One of the conditions underpinning the obtainment and use of CbCRs is that a jurisdiction must use the information appropriately.[5] "Appropriate use" of the CbCRs allows the data to be used for:

- high level transfer pricing risk assessment;
- assessment of other base erosion and profit shifting-related risks; and
- economic and statistical analysis, where appropriate.[6]

The CbCR is a beneficial tool for tax administrations, insofar as it provides them the unprecedented opportunity to obtain a comprehensive overview of the global footprint of MNE groups in their own jurisdictions. However, the CbCR should preferably be read along with the Master File (MF),[7] the Local File (LF) and all of the appropriate information that is available for conducting a proper transfer pricing analysis, insofar that the CbCR does not substitute a detailed functional and comparability analysis and does not represent conclusive evidence that the transfer prices are not appropriate.[8]

In September 2017, the OECD released the HETRA, which provides tax authorities guidance on how they should read the information obtained through the CbCRs that are produced by MNEs (or received from foreign tax authorities) for the purpose of conducting high-level tax risk assessments.

In the HETRA, it is outlined that "risk assessment tools should be used to select and to de-select taxpayers for further investigation, possibly including tax audit or other compliance activity. They should not be used as a substitute for such activity, for the purposes of making tax adjustments or for directly assessing taxes".[9]

A CbCR may be employed for high-level risk assessment, but should not be utilized as the sole basis for proposing changes to transfer prices or adjusting a taxpayer's income allocation using formulary apportionment approaches.[10] Since the CbCR information does not contain the value chain analysis of the MNE or the functional analysis of a particular entity, its data may lead to ambiguous conclusions in an attempt to identify income-shifting.

Furthermore, transfer pricing adjustments based only on a CbCR will likely be overturned in competent authorities' processes, and the tax authorities may face exclusion from the receipt of future CbCRs.[11]

2.2. Tax risk assessment processes used: An example

The OECD identifies the steps[12] to follow when conducting an initial risk assessment using a group's CbCR, which may be summarized as follows:

- high-level review of the CbCR;
- calculation of the key ratios using the information contained in Table 1. The ratios are based on the tax risk indicators identified in the HETRA;[13] and

eral matters, among which are the inclusion of additional/different data, the adoption of the BEPS Action 13 implementation package, the appropriateness of the current revenue threshold, as well as filing and dissemination mechanisms. As part of the 2020 review, the OECD has recently published a public consultation document in order to obtain input from all stakeholders in relation to three key aspects: (i) the implementation and operation of BEPS Action 13; (ii) the scope of CbCR; and (iii) the content of a CbCR. *See* Public Consultation on CBCR, *supra* n. 1, at pp. 2-3. Furthermore, the 2020 review of CbCR was a topic discussed at the 73rd International Fiscal Association (IFA) Congress held in London on 8-12 September 2019. Seminar G, "Tax transparency/enhanced cooperation/CbCR experience", focused on the role of CbCR as a new source of tax information, leveraging the experience gained by tax administrations and MNE groups since the introduction of that reporting standard. For a more comprehensive overview of the 2019 IFA Congress and its scientific programme, *see* https://www.ifa.nl/congresses/ifa-2019-london (accessed 18 Nov. 2019).

5. OECD/G20, *Transfer Pricing Documentation and Country-by-Country Reporting - Action 13: 2015 Final Report*, pp. 56-59 (OECD 2015), Primary Sources IBFD [hereinafter *Action 13 Final Report*]. The "appropriate use" condition is given effect through art. 6(1) of the model legislation and section 5(2) of the multilateral and model bilateral competent authority agreements.
6. *Action 13 Final Report*, id., at p. 25.
7. Question no. 3 of the Public Consultation on CbCR assesses the implications of jurisdictions implementing Master File requirements not in line with BEPS Action 13. This situation is likely, since, as of the time of writing, the implementation of BEPS Action 13 is not uniform: only 47 countries have implemented Master File/Local File requirements into their national legislations in compliance with BEPS Action 13, while four countries have draft bills and 12 counrties have the intention to implement such requirements. *See* KPMG, *BEPS Action 13: Country implementation summary*, available at https://home.kpmg/content/dam/kpmg/us/pdf/2020/02/tnf-beps-action-13-february7-2020.pdf (accessed 9 Feb. 2020). Another potential issue could be whether, for example, the ultimate parent entity (UPE) jurisdiction has no mandatory Master File (e.g. transfer pricing documentation is prepared on a voluntary basis), and only partial Master Files (i.e. for sub-groups) will be available. This could result in information gaps and inconsistency in the information provided to tax administrations.
8. *Action 13 Final Report*, *supra* n. 5, at p. 25.
9. HETRA, p. 14.
10. *Action 13 Final Report*, *supra* n. 5, at p. 25.
11. A. Lobb & C. Silverthorne, *First automatic CbC report exchanges to trigger tax authority risk assessments*, International Tax Review (13 Aug. 2018), available at https://www.internationaltaxreview.com/article/b1fygh1ykmx14h/first-automatic-cbc-report-exchanges-to-trigger-tax-authority-risk-assessments (accessed 31 Jan. 2020).
12. HETRA, p. 121.
13. The HETRA provides a list of 19 tax risk indicators that may be detected by using information contained in CbCRs. None of them should be considered proof of the presence of a tax risk in a jurisdiction as long as the taxpayer is able to justify the result of the ratio analysis. For more details, *see* HETRA, p. 40. For a more detailed analysis of how tax authorities can use CbCRs to supplement their existing tax risk assess-

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Table 1 – Overview of allocation of income, taxes and business activities by tax jurisdiction

ABC Group					
FY 16					
Currency: EUR					
Revenue (million EUR)					
Tax jurisdiction	**Unrelated revenue**	**Related revenue**	**Total**	**Profit/loss before income tax**	**Number of employees**
Country A	100	250	350	120	100
Country B	50	120	170	30	230
Country C	72	72	144	1	400
Country D	45	6	51	5	150
Country E	10	50	60	25	50
Country F	48	2	50	5	170
Country G	0	15	15	13	2

– interpretation of the outcomes of the analysis in order to identify potential areas of risk, alternative explanations for the various risk indicators and further information or enquiries that may be required.

In order to provide the readers with a comprehensive understanding of the assessment process, the following paragraph provides an example of how a CbCR is likely to be used by a tax administration for tax risk assessment purposes.[14]

ABC Group is an MNE group involved in the manufacture and sale of goods for which the parent entity is resident in Country A. Since, in the preceding fiscal year[15] (i.e. 2015), ABC Group had an annual consolidated group revenue above EUR 750 million,[16] it was subject to CbCR filing requirements for fiscal year 2016. Country A's Tax Administration received the first CbCR of ABC Group (as illustrated in Table 1 and Table 2) on 31 December 2017 and shared it by 30 June 2018 with the other interested tax administrations through the exchange-of-information mechanisms.[17]

The analysis below illustrates the steps that tax authorities could take when conducting the initial risk assessment and what information can be derived from the analysis of the tax risk indicators.

Step 1: Review of the information received in its raw form

In this phase, the tax authority will attempt to achieve a high level overview of ABC Group, for which its parent company is a resident for tax purposes in Country

ment and the challenges that may arise in the process, *see* C. Silberztein & O. Le Naourès, *Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment*, 25 Intl. Transfer Pricing J. 1 (2017), Journal Articles & Papers IBFD.

14. For simplification reasons, for the purpose of this example, only the CbCR for FY 2016 is used (so no comparison with other FYs is possible), and to account for the fact that the initial review is conducted through automated processes in many jurisdictions, the free text contained in Table 3 is not analysed. Therefore, this example relies only on information contained in Table 1 and Table 2.
15. In order to avoid an excessive compliance burden for MNE groups that exceed the threshold only for a single fiscal year, the Public Consultation on CbCR, *supra* n. 1, at p. 27 considers different options (e.g. the use of average consolidated group revenue or a wider timeframe). The aim is to to avoid putting in place systems to file CbCR for 1 fiscal year, since it is likely that the MNE group will never have to do so again, or only rarely.
16. The appropriateness of the exisiting revenue threshold is currently being analysed, as the OECD is considering enlarging the scope of CbCR. The aim is to increase the number of MNE groups subject to the standard, since, as stated in para. 37 of BEPS Action 13, this threshold excludes approximately 85-90% of MNE groups; *see* Public Consultation on CbCR, *supra* n. 1, at p. 21. Another aspect that is currently under review is the definition of an MNE group: some stakeholders and tax authorities are concerned that the current definition does not cover all combinations of enterprises that may pose a transfer pricing or other BEPS risk. The issue is whether to also include in the scope of the CbCR MNE groups that are under common control and, in aggregate, have consolidated group revenue above the CbCR threshold. The potential benefits of this approach relate to an enlargement of the scope of the CbCR to also include – if certain conditions are met –situations currently excluded that do pose a potential transfer pricing risk, for example, when an individual holds business interests in several groups that are separately not subject to CbCR requirements because they do not exceed the revenue threshold. However, this approach also presents several challenges. For example, the UPE might not be in possession of information regarding other groups under common control of an individual(s), and therefore, it may encounter difficulties in determining whether it is required to file the CbCR. *See* Public Consultation on CbCR, *supra* n. 1, at pp. 17-20.
17. As of January 2020, there have been over 2,400 bilateral exchange relationships activated with respect to jurisdictions committed to exchanging CbCRs, including exchanges between (i) the 84 signatories of the CbC Multilateral Competent Authority Agreement; (ii) EU Member States under Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 146 (2016), Primary Sources IBFD; and (iii) signatories of bilateral competent authority agreements for exchange under double tax conventions or tax information exchange agreements, as well as 41 bilateral agreements with the United States. For the complete list of bilateral exchange relationships that are currently in place for the automatic exchange of CbCRs between tax authorities, *see* OECD, *Country-by-Country exchange relationships* (last updated 2020), available at https://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm (accessed 31 Jan. 2020).

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Table 2 – List of all the constituent entities of the MNE group included in each aggregation per tax jurisdiction

ABC Group											
FY 16											
Tax jurisdiction	**Constituent entity**	**Research and development**	**Holding or managing intellectual property**	**Purchasing or procurement**	**Manufacturing or production**	**Sales, marketing or distribution**	**Admin., mgmt. or support Services**	**Provision of services to unrelated parties**	**Internal group finance**	**Insurance**	**Holding shares or other equity instruments**
Country A	ABC Holding AG		x						x		x
	ABC Machinery AG	x		x	x		x				
	ABC Distribution AG					x		x			
Country B	ABC Holding Gmbh										x
	ABC Machinery Gmbh				x						
	ABC Distribution Gmbh					x		x			
Country C	ABC Machinery Co. Ltd				x						
	ABC Distribution Co. Ltd					x		x			
Country D	ABC Distribution S.l.					x		x			
Country E	ABC Distribution Srl					x		x			
Country F	ABC Distribution Sas					x		x			
Country G	ABC Finance Ltd.									x	

Table 3 – Potential tax risk indicators

	Proportion of revenues from unrelated parties	Proportion of revenues from related parties	Revenues generated per employee	Pre-tax profit generated per employee
	Unrelated-party revenues/total revenues	Related-party revenues/ total revenues	Total revenues/number of employees (million)	Profit before tax/number of employees (million)
Country A	29%	71%	3.50	1.20
Country B	29%	71%	0.74	0.13
Country C	50%	50%	0.36	0.00
Country D	88%	12%	0.34	0.03
Country E	17%	83%	1.20	0.50
Country F	96%	4%	0.29	0.03
Country G	0%	100%	7.50	6.50

A. In 2016, the group was comprised of 12 entities in seven jurisdictions. As per Table 2, the group is structured as follows:

- holding companies (Countries A and B);
- entity in charge of procurement (Country A);
- a research and development company (Country A);
- an intellectual property (IP) holding company (Country A);
- entities engaged in manufacturing activities (Countries A, B and C);
- entities engaged in sales (Countries A, B, C, D, E and F);
- a group finance company (Country A);
- group service companies (Countries A, B, C, D, E and F); and
- a captive insurance company (Country G).

Step 2: Ratio analysis

For simplification reasons, it can be assumed that tax authorities will focus only on the risk indicators in Table 3.

Step 3: Interpretation of the ratio analysis

Countries A, E, and G have the highest total revenues/ number of employees and profit before tax/number of employees. Even though no fixed conclusion can be

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Figure 1 – Total revenues/number of employees (in millions)

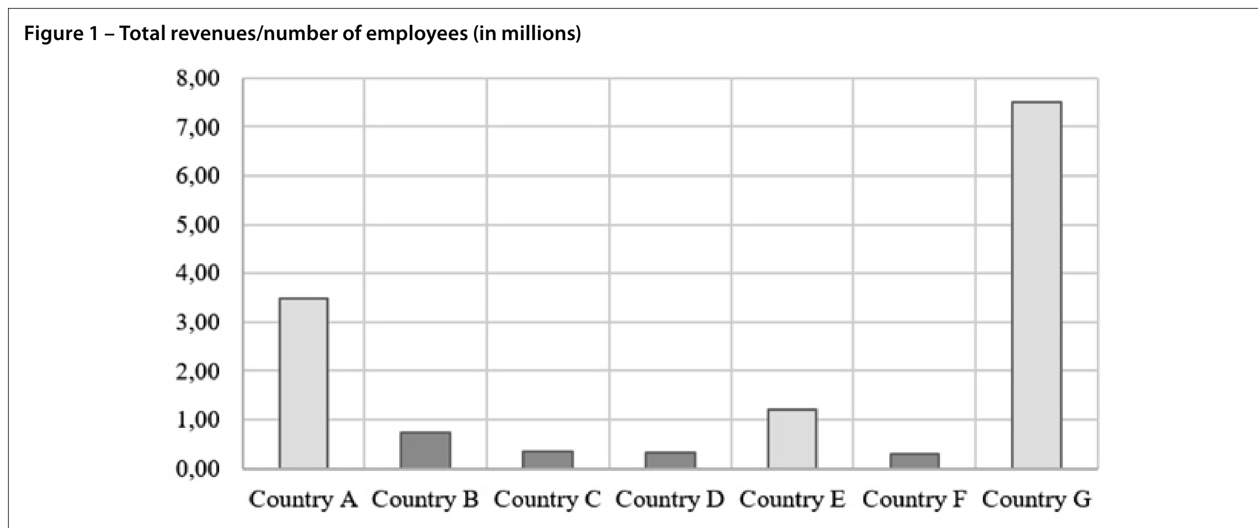
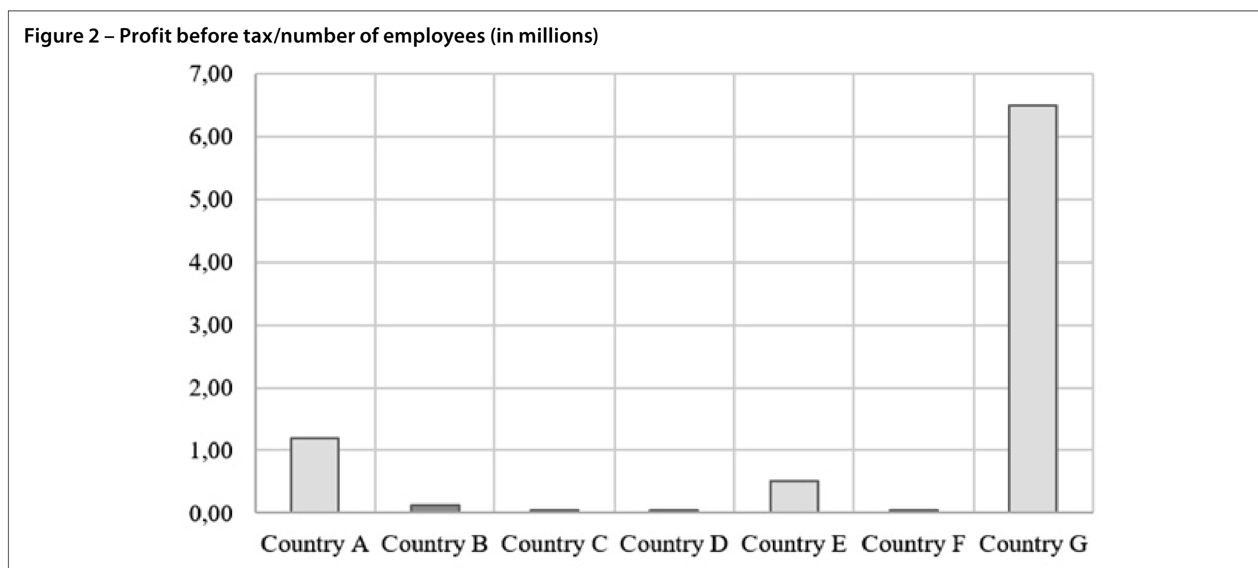


Figure 2 – Profit before tax/number of employees (in millions)



drawn, this could raise a number of concerns, as the profits for these jurisdictions may appear to be disproportionate to their level of economic activity and substance.

Country G may raise a potential risk flag, since it could be argued that the captive insurance company lacks enough substance. Since captive insurance arrangements have been exploited for profit shifting, such transactions are likely to be carefully scrutinized. However, in order to determine the arm's length share of profit to allocate in the jurisdiction where the captive insurance company is resident, a key consideration should pertain to the personnel employed. Since it is not a capital-intensive activity, it is more relevant to ascertain the functions performed and the risks assumed by the FTEs, in particular, whether the entity employs appropriate and skilled personnel who perform/manage the decision-making activity associated with the insurance or investment risk.[18] Depending on its functional profile, the entity could be a service provider and, thus, entitled to cost-plus remuneration. However, if it performs key functions and has the financial capacity to bear the risks, it may be entitled to an insurance and investment-related return,[19] which would justify a greater share of profits being allocated to the jurisdiction where the entity is resident.

Regarding Country A, since the data in Table 1 are aggregated per jurisdiction, it is unclear which entity is responsible for the outcomes of the ratio.[20] The case

18. V. Chand, *Transfer Pricing Aspects of Captive Insurance Arrangements: Recommendations to the OECD*, 2 IFF Forum für Steuerrecht, p. 154 (2017).

19. V. Chand & K. Otto, *Transfer Pricing: Accurate Delineation of the Captive Insurance Arrangement – Is the OECD Guidance Clear on this Matter?*, Kluwer International Tax Blog (26 Sept. 2018), available at http://kluwertaxblog.com/2018/09/26/transfer-pricing-accurate-delineation-captive-insurance-arrangement-oecd-guidance-clear-matter/ (accessed 18 Nov. 2019).

20. The 2014 public consultation on BEPS Action 13 included a template for Table 1, with finacial information to be reported for each constituent entity in an MNE group. The OECD acknowledges that preparing Table 1 on an entity-by-entity basis may be useful for risk assessment purposes, but it may also raise other challenges (e.g. it may represent an addition-

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may not be evident from the aggregated data in the CbCR when an entity with a high profit before tax but only a small number of employees (e.g. the IP holding company) is resident in the same jurisdiction where other entities in the group with a large number of employees (e.g. manufacturing entities) are resident.[21] Furthermore, it is likely that some tax authorities will diligently search for the allocation of a higher share of profits in countries with a low effective tax rate and limited business activity.[22] For example, tax authorities may conclude that the MNE group engages in profit-shifting activities in the event that certain indices (e.g. profit before tax/number of employees) are significantly higher in low-tax jurisdictions.

Country E is an outlier in comparison to the other countries in which entities performing sales activities are located. Furthermore, the entity in Country E receives most of its revenues from related parties, as the ratio of related-party revenue divided by the total revenue is 83%. Consequently, the tax authority whose entities have related-party transactions with the entity in Country E may attempt to claim a portion of the extra profit. However, it should be noted that, from the mere information contained in the CbCR, it is not possible to assess the entity characterization (e.g. whether the local entity is a limited-risk distributor or a full-fledged distributor or performs support functions) in order to understand whether the entity is entitled to a large share of profit. In order to obtain further information on the functional profile of the entity, tax authorities must scrutinize further documentation. In fact, a tax authority should be aware that reasons for outliers and justifications for the CbCR outcomes might already be addressed in the other two layers of documentation (i.e. the MF and LF).

2.3. The CbCR outcome analysis: When a call for action is needed

The intent of conducting a high-level risk assessment is to determine whether a particular taxpayer or arrangement might represent a tax risk to a specific jurisdiction.

The risk assessment may result in a range of potential outcomes.[23] Essentially, the results of the risk assessment could be that (i) no material risk indicators are identified; (ii) indicators are identified, but they are not sufficient to suggest a material risk in the jurisdiction; or (iii) a potential tax risk exists.

In the first two cases, no further action is required, and no further information will be requested. Even though an MNE group's CbCR does not provide a comprehensive description of all of a group's activities and transactions, this is not a sufficient reason for requesting additional information. The only exception is when the CbCR (as well as the other available data) suggests the presence of a potential tax risk.[24]

On the other side of the spectrum, when risk indicators are identified, the CbCR should be subject to an additional review in order to establish whether the concerns are incorrect or can be explained by taking into account other available information.[25] However, an MNE merely taking advantage of differences in domestic tax law and limited business activity coupled with high profits in a jurisdiction is not sufficient a priori to justify a transfer pricing adjustment based on the formulary apportionment of income.[26]

Furthermore, it is advisable that tax authorities do not analyse each indicator individually. They should instead combine and weigh the indices to have a more accurate representation of the MNE's tax risk[27] and refrain from drawing simplistic conclusions. To avoid wasting the limited state resources, tax authorities should initially attempt to understand the possible business reasons underlying the factors that appear to pose a potential tax risk and, where needed, consider consulting other tax authorities or even resort to multilateral audits or joint controls involving the MNE group.[28]

The example of a CbCR assessment described in this section is aimed at providing an example of the conclusions that can be drawn from the use of the risk indicators and identifying potential limits to the use of a CbCR as a high-level risk assessment tool. These unexpected issues will be presented in detail in section 3.

3. Challenges in Using a CbCR for Tax Risk Assessment

3.1. Introduction

A CbCR provides tax authorities access to an unprecedented amount of information to be exploited when conducting high-level tax risk assessments. Nevertheless, the use of a CbCR poses some significant challenges: like any tool, it is characterized by several limitations that should be taken into account.[29]

al burden for the MNE groups that need to collect further information). Therefore, an amendment of Table 1 to include entity-by-entity data is currently being discussed. *See* Public Consultation on CbCR, *supra* n. 1, at pp. 38-40.

21. HETRA, p. 101.
22. V. Wöhrer, *What is the cost of transparency? Does it outweigh the benefits obtained from greater transparency?*, Singapore Management University School of Accountancy Research Paper No. 2018-S-72, p. 42 (1 Jan. 2018), available at ssrn.com/abstract=3104974 (accessed 13 Feb. 2020)).
23. HETRA, p. 112.
24. Id.
25. Id., at p. 113.
26. *Compare* Wöhrer, *supra* n. 22.
27. HETRA, p. 40.
28. Id., p. 115.
29. Id., p. 84.

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The key challenges related to the CbCR as a risk assessment tool can be classified into three areas of potential risks:

- issues with the implementation of the CbCR (*see* section 3.2.);
- issues with the design of the CbCR (*see* section 3.3.); and
- issues with the use of the CbCR (*see* section 3.4.).

3.2. Issues with the implementation of the CbCR

Apart from the difficulties encountered by MNE groups[30] when gathering data and the potentially significant compliance costs (especially in the first year), there are several limitations related to the data included in the CbCR that are likely to result in misleading outcomes.

The OECD has published a report on the implementation of the CbCR[31] in order to ensure that there are no unfair practices, to provide more certainty and to assist in gathering homogenous data.

However, a number of intrinsic limitations remain.[32] Some issues related to how the data is to be compiled relate to:

- the use of aggregated data per jurisdiction;[33]
- stateless entities;[34]
- financial accounting rules overriding tax reporting;
- merger/demerger transactions; and
- changes in the accounting standards used.

The above-mentioned limitations could potentially result in many false positives[35] when attempting to identify income-shifting phenomena.[36] Notwithstanding the guidance provided by the OECD regarding the implementation of the CbCR, the potential mismatches increase the burden on MNEs to be compliant with the CbCR legislation and make it difficult for tax authorities to analyse a CbCR in relation to local tax returns or consolidated financial statements.[37]

Furthermore, due to the lack of harmonization of the data and no reconciliation of the amounts included

30. MNE groups have experienced practical difficulties in filing the requested information in the CbCRs. In fact, tax administrations have encountered a number of concerns with the data received because the CbCRs filed to date contain errors that might compromise the use of the information for high-level risk-assessment. The most common errors are, for example, differences between the jurisdictions listed in Table 1 and those listed in Table 2, information on sources of data not included where this is required and the total tevenues being either higher or lower than the total of the unrelated party revenues and related party revenues. For further details, *see* OECD, *Common errors made by MNEs in preparing Country-by-Country reports* (OECD 2019), available at https://www.oecd.org/tax/beps/common-errors-mnes-cbc-reports.pdf (accessed 12 Feb. 2020).
31. OECD/G20, *Guidance on the Implementation of Country-by-Country Reporting – BEPS Action 13* (OECD 2019).
32. M. Hanlon, *Country-by-Country Reporting and the International Allocation of Taxing Rights*, 72 Bull. Intl. Taxn. 4/5, p. 209 (2018), Journal Articles & Papers IBFD.
33. The Public Consultation on CbCR, *supra* n. 1, at pp. 41-45 considers substituting the aggregate tax-jurisdiction-wide information (aggregate data) with consolidated tax-jurisdiction-wide information (consolidated data) in Table 1.
34. Entities that are deemed trasparent for tax purposes (e.g. partnerships) have been largely used for tax planning purposes. In fact, as these entities may pose a different level of potential BEPS risks, they may be further scrutinized by tax authorites during the risk assessment. Given the above, the OECD is considering changing the way in which constituent entities that are not resident in any tax jurisdiction for tax purposes are categorized and the way in which the related information is reported in Table 1. *See* Public Consultation on CbCR, *supra* n. 1, at pp. 53-59.
35. The term "false positive" is used to indicate the risk of flags being raised for taxpayers and arrangements that are not, in fact, high risk. *See* HETRA, p. 14.
36. *Compare* Hanlon, *supra* n. 32.
37. T. Meijer, S. Kerkvliet & B. van Stigt, *Country-by-Country Reporting – All Smoke and Mirrors or the BEPS Project's First Success?*, 24 Intl. Transfer Pricing J. 6, p. 433 (2017), Journal Articles & Papers IBFD. The OECD has left several aspects open to the taxpayer's discretion with reference to the financial data to be reported in Table 1. For instance, multinational enterprise (MNE) groups can select the source of data at their own discretion without reconciling the financials. It is possible, under certain circumstances, to use consolidated data instead of aggregate financial data for a tax jurisdiction. The items to be reported are ambiguously defined, and the application of different accounting standards may have a significant impact on the figures of items such as revenues and tangible assets. Even though the rationale behind the lack of stricter and imperative rules for the population of the CbCR's tables is due to an attempt to minimize the compliance burden for taxpayers, a ratio analysis per the HETRA will likely result in a flawed risk assessment. Furthermore, the link between the financial data that is used for accounting or tax purposes and CbCR data is even more ephemeral, for example, in the case of permanent establishments. The OECD guidance states that permanent establishment (PE) data should be reported for CbCR purposes in the tax jurisdiction where the PE is situated, despite the fact that the earnings of a PE are allocated to the head office's jurisdiction for accounting purposes. For a more detailed analysis of the inconsistencies related to financial information that is requested for CBCR purposes, *see* S. Bremer, *Transfer Pricing Documentation: Master File, Local File and Country-by-Country Reporting*, in *Fundamentals of Transfer Pricing: A Practical Guide* p. 239 (M. Lang et al. eds., Kluwer Law International 2019). Furthermore, Question 4 of the Public Consultation on CbCR asks for comments in relation to the case in which an MNE group for CbCR purposes can be constituted by a single enterprise with one or more foreign PEs. This could be, for example, the case of an MNE group operating in the banking sector when, for regulatory reasons, the bank operates in other countries via branches rather than through subsidiaries. Under the current definition of a "group", it is doubtful whether the MNE group should file a CbCR. A change in the definition will allow, for CbCR purposes, the consistent treatment of enterprises that carry out business through PEs with those that conduct business through subsidiaries. However, in relation to Question 5 of the Public Consultation on CbCR, one of the potential challenges could be the gathering of all information required for Table 1 in relation to the PEs, since in many jurisdictions, it is not necessary to have separate financial statements. *See* Public Consultation on CbCR, *supra* n. 1, at p. 15.

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therein, the use of a CbCR for industry/sector[38] comparisons may not be the most appropriate option.[39]

3.3. Issues with the design of the CbCR

Another issue relates to the design of the CbCR with respect to the information requested from an MNE. Items such as intangible assets (e.g. patents and trademarks), debt, intercompany interest and royalty payments are excluded.[40] On a related note, the European Commission recently published a study on the relevance of aggressive tax planning (ATP) structures.[41] The report stresses that ATP structures are accomplished through three primary channels: (i) interest payments; (ii) royalty payments; and (iii) strategic transfer pricing. Whereas the scope of the CbCR as a tool for BEPS risk assessment is to detect income/profit-shifting strategies, it appears that the omitted items can limit the CbCR's power to detect ATP structures.

It is worth mentioning that, in the 2014 Discussion Draft on Transfer Pricing Documentation and CbC Reporting,[42] Table 1 required MNEs to disclose information regarding not only the number of employees, but also the total employee expenses, including all non-cash payments or benefits, such as employee option schemes.[43] Based on the BEPS Action 13 Final Report and related guidance, the mere number of employees will be used to compute some indices to run the risk assessment analysis, even though they do not reflect what the OECD refers to as "where the value is created". From the result of these indices, it cannot be inferred as to in which jurisdiction/entity "significant people functions" are located.[44]

Furthermore, information on specific entities may be concealed in jurisdiction-level information in Table 1,[45] even though Table 2 provides information regarding the main activities of a specific entity. This could result in false positives if, for example, several entities within the same MNE group are resident for tax purposes in the same jurisdiction (as previously shown in section 2.2.).

Another issue is the use of Table 3 in risk assessments.[46] While Table 1 and Table 2 contain mainly quantitative information that is easier to analyse with automatic systems, Table 3 does not have standardized content; it allows for the provision of additional information to facilitate the understanding of the information included in the first two tables.[47]

MNE groups should take advantage of Table 3, for example, to be proactive and to explain potential risk indicators that may arise during the risk assessment phase. However, the free text that it contains will represent a challenge for a tax authority's capacity to perform "text mining" of data for identifying keywords that can flag a number of potential tax risks.[48]

3.4. Issues with the use of a CbCR

As mentioned in section 2.1., the appropriate use of information contained in CbCRs is an underpinning condition for obtaining and using them.

In 2018, the OECD released the first annual peer review of 95 jurisdictions, which reflected the status of the local implementation of CbCR provisions as of January 2018.[49] The second annual peer review (Phase 2)[50] was published in September 2019 and examined the exchange-of-information framework and appropriate use in more detail. In fact, the focus

38. Questions 38-40 of the Public Consultation on CbCR deals with the potential inclusion of industry codes in Table 2. Furthermore, some jurisdictions have published statistics with the gathered CbCR data. For example, the US Internal Revenue Service presented the 2017 tax statistics divided into six tables, one of which is categorized by "Major Industry Group". *See* US: Internal Revenue Service, *SOI Tax Stats - Country by Country Report*, available at https://www.irs.gov/statistics/soi-tax-stats-country-by-country-report (accessed 9 Feb. 2020). However, the data collected shall not be used as a benchmark during risk assessment, because they merely represent industry-unadjusted returns.
39. HETRA, p. 26.
40. It should be noted that, in the 2014 Discussion Draft on Transfer Pricing Documentation and CbCR Reporting, *infra* n. 42, Table 1 also included information on (i) Royalties Paid/Received to/from Constituent Entities; (ii) Interest Paid/Received to/from Constituent Entities; and (iii) Service Fees Paid/Received to/from Constituent Entities. In the Public Consultation on CbCR, *supra* n. 1, at pp. 46-51, the OECD argues that the inclusion of such items would enhance a tax administration's ability to conduct a high-level transfer pricing risk assessment. However, a potential drawback is the risk of duplicating info already available in the Local Files, with the result of a useless compliance burden for the taxpayer.
41. European Commission, *Aggressive tax planning indicators: Final Report*, Working Paper 71 (2017).
42. For more information, *see* OECD, *Public Consultation: Discussion Draft on Transfer Pricing Documentation and CbCR Reporting* (OECD 2014), available at https://www.oecd.org/tax/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf (accessed 18 Nov. 2019).
43. Id., at p. 20.
44. TPA Global, *10 Practical Tips to Manage (tax risk) and File your Country-by-Country Report before year end!* (19 Oct. 2017), available at https://www.tpa-global.com/dv/movie39768/10-practical-tips-to-manage-tax-risk-and-file-your-country-by-country-report-before-year-end (accessed 18 Nov. 2019).
45. HETRA, p.101.
46. Id., at pp. 103-104.
47. Questions 29-30 of the Public Consultation on CbCR, *supra* n. 1, at p. 45 explore the possibility to include predetermined fields in Table 3.
48. Id., at p. 38.
49. OECD/G20, *Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 1): Inclusive Framework on BEPS: Action 13* p. 7 (OECD 2018). The three phases of the peer review are structured into annual reviews that began in 2017, 2018 and 2019, respectively. Each phase focuses on different key aspects of jurisdictions' implementation, namely the domestic legal and administrative framework, the exchange of information framework and the confidentiality and "appropriate use" conditions.
50. OECD/G20, Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 2): Inclusive Framework on BEPS: Action 13 (OECD 2019).

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Table 4 – Fulfilment of the "appropriate use" condition

Jurisdictions compliant with the appropriate use condition[53] **(57)**
Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, China (People's Rep.), Colombia, Costa Rica, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Guernsey, Hong Kong (China), Hungary, Iceland, India, Indonesia, Ireland, the Isle of Man, Italy, Japan, Jersey, Korea (Rep.), Latvia, Liechtenstein, Lithuania, Luxembourg, Malaysia, Malta, Mauritius, Mexico, Monaco, the Netherlands, New Zealand, Nigeria, Norway, Poland, Portugal, Russia, San Marino, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, United Kingdom, United States, Uruguay
Jurisdictions non-compliant but not exchanging CbCRs in 2019 (40)
Andorra, Angola, Aruba, Barbados, Belize, Benin, Botswana, Brunei, Darussalam, Cameroon, Congo, Côte d'Ivoire, Democratic Republic of the Congo, Djibouti, Egypt, Gabon, Georgia, Haiti, Israel, Kenya, Liberia, Macau (China), Maldives, Mongolia, Montserrat, North Macedonia, Oman, Panama, Paraguay, Saint Lucia, Sierra Leone, Serbia, Senegal, Seychelles, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, Zambia
Non-compliant jurisdictions[54] **(8)**
Chile, Kazakhstan, Pakistan, Papua New Guinea, Romania,[55] Saudi Arabia, Sri Lanka, Vietnam
Non-reciprocal jurisdictions[56] **(11)**
Anguilla, Bahair, the Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Curaçao, Peru, Qatar, Turks and Caicos, United Arab Emirates

of Phase 2 regards the first international exchanges of CbCRs by mid-2018 and the related work to ensure that CbCRs are kept confidential and used appropriately.

The second peer review examined 116[51] jurisdictions and assessed whether they took steps[52] to ensure that the "appropriate use" condition was satisfied prior to the exchanges of information.

The 116 jurisdictions are listed in Table 4 below and are divided into four categories.

Despite the OECD's efforts, there is an actual risk that, in practice, tax authorities may improperly exploit the information that is received, for example, by making adjustments to an entity's income base on an income allocation formula contingent upon CbCR information (or with minimal other information).[57]

The OECD listed a series of consequences for non-compliance (or potential non-compliance) with the "appropriate use" condition.[58] In particular, in the event of a jurisdiction's significant non-compliance, the other competent authority may temporarily suspend the exchange of CbCRs by giving notice in writing, following a consultation with the competent authority of the other jurisdiction to assess whether the non-compliance has actually occurred. For such an assessment, the outcome of a jurisdiction's peer review evaluation of appropriate use – as long as it is based on objective criteria – may be the starting point.[59]

The multilateral and bilateral model qualifying competent authority agreements provide that competent authorities shall commit, among other things, to disclosing breaches of appropriate use to the coordinating body secretariat or other relevant competent authority, together with any remedial actions and measures taken in respect of the non-compliance.[60] In this case, the competent authority shall allow a corresponding adjustment to offset the prior inadequate adjustment.[61]

The OECD's solution (i.e. the notification of improper use of the CbCR, filed by either the non-compliant jurisdiction or the other contracting state(s)) is considered to be quite impractical. The jurisdiction that fails to comply with the "appropriate use" condition has no interest in disclosing the breach. Besides, it is not clear

51. However, the second annual peer review does not include the following jurisdictions that are members of the Inclusive Framework: Antigua and Barbuda, Armenia, Burkina Faso, Cape Verde, the Cook Islands, Dominica, the Dominican Republic, the Faroe Islands, Greenland, Grenada, Morocco, Saint Kitts and Nevis and Saint Vincent and the Grenadines.
52. Jurisdictions should have mechanisms (such as legal or administrative measures) in place to ensure that CbCRs that are received through exchange of information or Local Files (i) are only used to assess high-level transfer pricing risks and other BEPS-related risks and, when appropriate, for economic and statistical analysis; (ii) cannot be used as a substitute for a detailed transfer pricing analysis of individual transactions and prices based on a full functional analysis and a full comparability analysis; (iii) are not used as the sole conclusive evidence that transfer prices are or are not appropriate; and (iv) are not exploited to make adjustments to the declared income of any taxpayer on the basis of an allocation formula. *See* OECD/G20, *Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 1): Inclusive Framework on BEPS: Action 13* pp. 7 and 16, para. 12(a) of the terms of reference (OECD 2018).
53. Costa Rica and Nigeria are two non-reciprocal jurisdictions; however, they have issed local guidance in order to fulfil the "appropriate use" condition.
54. This category includes all of the jurisdictions from the peer review that do not have measures in place for appropriate use in all six areas.
55. Romania is a non-reciprocal jurisdiction; however it has local filing requirement. It is therefore recommended that Romania takes steps to ensure that requirements under the terms of reference in respect of appropriate use are met.
56. Non-reciprocal jurisdictions are countries that have committed to sending CbCRs to their exchange partners but will not receive CbCRs from their exchange partners. See OECD, Country-by-Country exchange relationships, available at https://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm (accessed 31 Jan. 2020).
57. *Compare* Hanlon, *supra* n. 32.
58. OECD/G20, *BEPS Action 13 on Country-by-Country Reporting – Guidance on the appropriate use of information contained in Country-by-Country reports* p. 12 (OECD 2017).
59. Id., at p. 19.
60. Id., at p. 16.
61. Id., at p. 12.

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how the other contracting states will be able to prove that there was improper use of the information.[62]

The risk of improper use of a CbCR will lead to a significant increase in controversy. It is expected that some jurisdictions will attempt to make an adjustment based exclusively on CbCR information, or at least request much more information (possibly with substantial information requests based on the CbCR).[63] One of the potential consequences is that MNEs will consider such actions "too small" to enter into a dispute, and thus, they may experience double or multiple taxation.[64]

4. Potential Solutions

CbCRs are a beneficial tool for ascertaining whether MNE groups are engaging in BEPS-related activities. There are several advantages of incorporating a CbCR into a tax authority's risk assessment framework; however, there are still areas for potential improvements.

4.1. The use of other sources of information

A CbCR should be considered only one of the several tools in a tax administration's toolbox; however, the risk of drawing overly simplistic and inaccurate conclusions may be averted only if it is used along with other information.[65] Potential data sources to be used are the following:

- information held by the tax authority (e.g. tax returns, transfer pricing documentation, including the MF and LF, domestic rulings or advance pricing agreements (APAs));
- information available from other government sources (e.g. customs information);
- information received from other tax authorities (rulings, unilateral APAs, information relating to the International Compliance Assurance Programme (ICAP; *see* section 4.3.), multilateral audits or joint controls, etc.)
- other cooperative compliance approaches, including tax control frameworks;
- publicly available information (e.g. financial reports for listed groups or annual reports); and
- commercially available information (e.g. rating agencies' information and commercial databases).

It should be noted that some tax authorities are likely to have only limited access to additional sources, especially when they are not publicly available. The tax authority in the residence jurisdiction of an MNE group's ultimate parent entity (UPE) may have access to useful information due to the presence of a group's management functions being in its jurisdiction (e.g. finance, audit and tax). On the other hand, tax authorities in other jurisdictions will encounter additional obstacles when attempting to obtain valuable information on the activities and financial positions of other entities within the group, sometimes even of entities located in their own jurisdictions.[66] Tax authorities use alternative sources of information to derive a better understanding of the activities that are performed locally (e.g. checking LinkedIn profiles and LinkedIn job advertisements that the company publishes locally). However, if the local entity is unable to obtain the information internally and is only subject to LF requirements, the tax authority located in that jurisdiction could overly rely on CbCR information. Furthermore, not all tax administrations consistently link data from other sources to their CbCR assessments.[67]

A CbCR should only be used as an initial filter, and thus, before drawing any conclusions, other sources of information should be analysed, particularly transfer pricing documentation.[68] It should be noted that a CbCR is one part of a three-tiered approach to transfer pricing documentation. It cannot be read in isolation, but must be examined in combination with at least an MF and LFs. These latter files could help establish whether the representation in the CbCR is consistent and appropriate, which limits the risk of a misconstrued analysis.

4.2. CbCR and the use of data analytics

90% of the overall data currently available worldwide has been generated in the past 2 years.[69] The role of data, how it is managed and how it is analysed are expected to significantly change the way in which regulators and tax professionals engage with each other.[70]

62. A.S. Borges & C.A. Takano, *The Improper Use of Country-by-Country Reports: Some Concerns on the Brazilian Approach to BEPS Action 13*, 45 Intertax 12, p. 841 (2016). It is reasonable to assume that potential instruments for proving the improper use of information could be, among others, taxpayer information, exchange of experience between tax authorities, court decisions and the OECD peer review.
63. One of the questions (i.e Question 2) for public consultation is – in fact – whether the introduction of CbCR has had an impact on the number and nature of requests for additional information. OECD, *Public consultation document: Review of Country-by-Country Reporting (BEPS Action 13)*, p. 11 (OECD 2020).
64. *Compare* Hanlon, *supra* n. 32. It is likely that some jurisdictions will use a CbCR as a means to levy tax, or at least to ask for further information. Since such actions will be overall expensive and time-consuming for companies to deal with, some adjustment risks will be considered "too small" to fight. An MNE would rather be subject to a transfer pricing adjustment (if the amount is not particularly significant) and suffer double taxation than devote time and human resources to defending its position.
65. HETRA, p. 3.
66. Id., at p. 24.
67. Id., at pp. 110-111.
68. Id.
69. A. Barnay et al., *Four innovations reshaping tax administration*, McKinsey and Company (2018), available at https://www.mckinsey.com/industries/public-sector/our-insights/four-innovations-reshaping-tax-administration (accessed 13 Aug. 2019).
70. M. Geiger & M. Whipp, *CBC reporting and transfer pricing documentation: what to expect in 2018?*, Tax Journal, p. 20 (22

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In fact, tax authorities are adapting to the digital disruption, for example, by digitizing interactions with taxpayers by using advanced analytics and process automation, as well as talent management.[71]

However, one of the key challenges is managing the sheer volume of data that is received from taxpayers that comes from traditional and digital sources (e.g. digital payments, electronic invoicing, the Internet of Things, social media and Bitcoin).[72] This ever-growing tsunami of data needs to be converted into useful insights by developing Big Data capabilities.[73]

With reference to the CbCR, the volume of information will be challenging not only for tax authorities that rely on manual processes, but even for those that currently use automated processes.[74] The information contained in a CbCR is standardized (with the exception of Table 3; *see* section 3.3.)): it contains numerical data, tick boxes and country codes, which should facilitate the use of automated risk assessment tools.[75]

Risk assessment frameworks should be based on objective parameters in order to operate effectively. Algorithms should be designed to detect potential risks based on an objective assessment of available data.[76] Some tax administrations use automated methods for tax risk assessment to a greater extent.[77] In fact, many jurisdictions have already realized that investments in data analytics will increase efficiency and allow for more effective use of public resources. Several "data-intelligent tax administrations"[78] (e.g. China, India, Malaysia and Mexico) have made significant investments in these systems.[79]

Generally, advanced tax administrations are aware of the necessity to use advanced tools, though most automated risk assessment systems still require manual interaction.[80] Certain tax authorities are already using algorithms for process automation (e.g. text mining) to convert free text into consistent data.[81] With reference to the CbCR, text mining can be particularly useful for assessing the data in Table 3 and the "Other" column for business activities in Table 2. As mentioned in section 3.3., Table 3 can be a powerful instrument for a taxpayer to be proactive and justify why potential anomalies may be misleading and do not require further scrutiny. On the other hand, tax authorities may exploit text mining to search for specific words or phrases that may incite concern for an increased level of tax risk.[82] It is necessary to develop processes to incorporate this into standardized and automated risk assessment tools.[83] Furthermore, in order to gather additional insight, tax authorities should take the next step with more investment in software and tools to analyse a wide range of unstructured documents.[84]

In order to analyse CbCRs, tax administrations should rely on machine-learning algorithms and Big Data analytics[85] that enable the identification of patterns based on historical data analysis that could represent causes for concern. Data analytic techniques will enable tax authorities to make sound and rapid decisions by introducing predictive modelling for investigating root causes for risk assessment purposes.[86]

4.3. Multilateral risk assessments and the ICAP

MNEs are potentially exposed to a significant amount of uncertainty and the potential risk of adjustments due to the lack of uniformity in the way in which CbCR information may be used and incorporated in a jurisdiction's tax assessment framework.

The tax authority and the taxpayer may analyse the same factual situation and reach different conclusions, both having strong arguments in support of their own interpretations. Different opinions on whether a situation is at arm's length may lead to uncertain outcomes during a tax audit.[87]

The ICAP was launched in order to offer taxpayers an opportunity to explain the content of their CbCRs and, at the same time, allow tax administrations to initiate a multilateral conversation on tax risk assessment.[88] The ICAP is a voluntary programme that

Mar. 2018), available at https://www.taxjournal.com/articles/cbc-reporting-and-transfer-pricing-documentation-what-expect-2018-22032018 (accessed 13 Feb. 2020).

71. *Compare* Barnay et al., *supra* n. 69.
72. PwC, *The Data Intelligent Tax Administration: Meeting the challenges of Big Tax Data and Analytics* (2018), available at https://www.pwc.nl/nl/assets/documents/the-data-intelligent-tax-administration-whitepaper.pdf (accessed 18 Nov. 2019).
73. *Compare* id.
74. HETRA, p. 85.
75. Id., at p. 26.
76. Id., at p. 14.
77. Id., at p. 12.
78. *Compare* PwC, *supra* n. 72.
79. *Compare* Geiger & Whipp, *supra* n. 70.
80. S.B. Huibregtse, P. Ottoni & S.C. Muñoz Rodríguez, *How Technology Is Changing Taxation in Latin America*, 73 Bull. Intl. Taxn. 3 (2019), Journal Articles & Papers IBFD.
81. *Compare* Barnay et al., *supra* n. 69.
82. HETRA, p. 38.
83. Id.
84. *Compare* Barnay et al., *supra* n. 69.
85. G. Mazzoni, *(Re)defining the Balance between Tax Transparency and Tax Privacy in Big Data Analytics*, 72 Bull. Intl. Taxn. 11, p. 656 (2018), Journal Articles & Papers IBFD. The author suggests that the use of Big Data analytics may lead to a twofold outcome: (i) it provides insights from the data already gathered and facilitates the delineation of a more accurate and complete representation; and (ii) given its predictive nature, it provides foresight and detects patterns based on historic information.
86. *Compare* PwC, *supra* n. 72.
87. B. Heidecke & L. Slagter, *The International Compliance Assurance Programme and Joint Audits: A New Epoch of Transfer Pricing Tax Audits?*, 25 Intl. Transfer Pricing J. 3, p. 81 (2018), Journal Articles & Papers IBFD.
88. The International Compliance Assurance Programme (ICAP) pilot was launched by the OECD on 23 January 2018 and saw the participation of eight member tax administrations of the Forum on Tax Administration. The eight participating tax administrations in the pilot were Australia, Canada, Italy,

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aims to establish a "collaborative working relationship between the MNE group and covered tax administrations, built on transparency, cooperation and trust".[89] It uses information that is available to tax administrations (e.g. CbCRs) to enhance the current risk assessment processes and will provide all parties with the following benefits: (i) fully informed and targeted use of CbCR information and other information held for risk assessment; (ii) more efficient use of resources and a coordinated approach to engagement; (iii) a faster, clearer route towards multilateral tax certainty; (iv) cooperative relationships between MNEs and tax administrations; and (v) fewer disputes entering into a mutual agreement procedure (MAP).[90]

Leveraging the gained experience and feedback of these tax administrations and MNEs during the pilot phase, ICAP 2.0 was announced on 29 March 2019 at the Forum on Tax Administration.[91] A new joint audit handbook (Handbook 2.0) was released, and additional planned improvements relating to transfer pricing were announced. The participating tax administrations will conduct multilateral risk assessments of MNE groups with headquarters in one of their jurisdictions.[92] The programme is designed to provide MNE groups that are willing to engage proactively and transparently with early tax certainty, when possible, while identifying areas that require further scrutiny.[93]

Below are some of the key features of the programme as updated after the release of Handbook 2.0:

- Covered risks:[94]
  - transfer pricing risk;
  - permanent establishment risk; and
  - other categories of international tax risk, as agreed (e.g. hybrid mismatch arrangements, withholding taxes and treaty benefits).
- Covered periods[95] (for MNE groups with a calendar year end): fiscal years commencing on 1 January 2016, with the possibility to extend the conclusion of the assessment to the following two tax-filing periods ("roll-forward" periods).
- Stage I – Pre-entry:[96] The pre-entry stage begins with a conversation between an MNE and its UPE's tax administration[97] to explore the possibility of participating in the ICAP. In this stage, high-level information needs to be provided, using templates provided by the UPE's tax administration.
- Stage II – Scoping:[98] The scoping stage begins when the MNE submits a complete scoping documentation package to the lead tax administration and all covered tax administrations. The scoping documentation[99] includes:
  - a scoping covered risk overview;
  - a copy of the MNE's latest CbCR;
  - the MNE's MF;
  - a summary of the MNE's current global group structure (unless provided in the MF);
  - a list of all unilateral, bilateral and multilateral APAs in place or in progress; and
  - other tax rulings relevant to the proposed covered risks.
- Stage III – risk assessment and issue resolution:[100] The lead tax administration, at the end of the scoping stage, will communicate the required content of the main documentation package[101] for the ICAP risk assessment to the MNE.[102] The documentation requested at this stage must be provided for all covered periods. Each covered tax administration must draw its own conclusions

Japan, the Netherlands, Spain, the United Kingdom and the United States. *See* J. Martin, *Tax officials crafting plan to jointly identify large multinationals with low risk of tax avoidance*, MNE Tax (7 June 2017), available at https://mnetax.com/tax-officials-crafting-plan-jointly-identify-large-multinationals-low-risk-tax-avoidance-21592 (accessed 18 Nov. 2019).

89. OECD/G20, *International Compliance Assurance Programme Pilot Handbook* p. 8 (OECD 2018).
90. *See* OECD, *What is ICAP and ICAP 2.0?* (OECD 2019), available at http://www.oecd.org/tax/forum-on-tax-administration/international-compliance-assurance-programme.htm (accessed 18 Nov. 2019).
91. The tax administrations that will participate in ICAP 2.0, besides the eight tax administrations already in the pilot, are from the following jurisdictions: Austria, Belgium, Denmark, Finland, Germany, Ireland, Luxembourg, Norway and Poland. For more details, *see* id.
92. OECD/G20, *supra* n. 89, at p. 7.
93. Id.
94. OECD/G20, *International Compliance Assurance Programme Pilot Handbook 2.0* p. 34 (OECD 2019).
95. Id., at p. 37.
96. Id., at pp. 42-51.
97. Typically, the tax administration of the jurisdiction of the UPE of an MNE will be the lead tax administration. If the UPE jurisdiction's tax administration is not willing to act as the lead tax administration or if it is not a covered tax administration, the MNE may contact a tax administration in another jurisdiction where it has significant activities. In such a case, the other tax administration will act as a surrogate lead tax administration. For more details, *see* OECD/G20, *supra* n. 94, at pp. 23-27.
98. Id., at pp. 52-59.
99. Id., at p. 92.
100. Id., at pp. 60-75.
101. The documentation package will include the items necessary to run an in-depth risk assessment. The information that is likely to be requested includes, among others, a completed CbCR self-assessment with respect to the CbCR provided, Local Files (if required to be prepared in the jurisdictions of covered tax administrations), PE documentation, audited consolidated financial statements, additional information relevant to any agreed covered risks beyond transfer pricing risk and PE risk.
102. An ICAP risk assessment will consider the usual policies and practices adopted by the covered tax administrations for assessing the covered risks (e.g. transfer pricing and PE risk assessment). In the event of a reported PE, the assessment will also include the usual transfer pricing policies and practices for attributing profit to a PE. The risk assessment will also take into account relevant published guidance, such as the HETRA.

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based on its ICAP risk assessment, but, despite all efforts, the results may differ.[103]

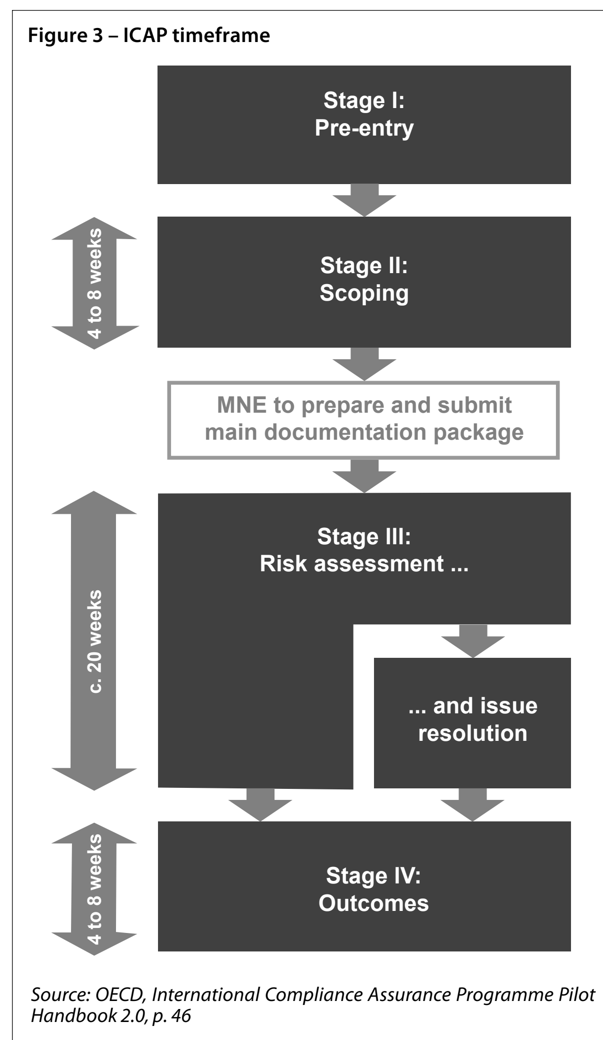
– Outcome letters:[104] This phase includes the issuance of a completion letter by the lead tax administration, confirming the finalization of the ICAP risk assessment on behalf of all other covered tax administrations, and each covered tax administration will provide an outcome letter to the MNE, stating that the group will not likely be subject to an audit in that jurisdiction based on the tax risk that has been assessed. Furthermore, it describes any outstanding issues.[105]

The timeframe for an ICAP risk assessment as described is summarized in figure 3.

The ICAP marks a milestone for risk assessments: the involvement of several tax administrations from the very beginning and the active participation of the MNE group in the discussion allow for assurance and tax certainty. Furthermore, it assists taxpayers in distinguishing (i) transactions that represent low-risk items in areas likely to be subject to further scrutiny by the tax authorities; and (ii) transactions that require adjustments. In addition, it can help reduce double taxation in the event of a tax audit or reduce the length of a MAP.[106]

As mentioned in section 3., the benefit of a CbCR to tax authorities is questionable, considering the numerous issues related to its implementation and use.[107] Tax administrations need to have an understanding of some relevant elements, e.g. the business model, the value chain and the economic cycle of the specific industry, in order to properly interpret CbCR data and derive sound conclusions.[108]

Figure 3 – ICAP timeframe



Source: OECD, International Compliance Assurance Programme Pilot Handbook 2.0, p. 46

Even though taxpayers can (and should) use Table 3 to provide supporting information and clarifications that could facilitate the interpretation of the other two tables, the intrinsic limitations of the CbCR make it likely that tax administrations could misinterpret the data disclosed therein. Nonetheless, due to the ICAP, a taxpayer can approach several tax administrations at once in order to resolve any potential issues at an early stage.

In fact, the ICAP is a potential solution that could limit the uncertainty surrounding the CbCR because it gives MNEs the opportunity to provide business and technical justifications for potential false positives or causes for concern that arise from the application of the HETRA's tax risk indicators before a formal tax audit.[109] Furthermore, such a multilateral cooperative compliance programme could represent an occasion for tax administrations to share their experiences, approaches used and best practices adopted in respect

103. Whenever a covered tax administration is unable to obtain comfort with respect to one or more of the covered risks, it may cease its risk assessment. It will wait for the risk assessment stage to be completed by other covered tax administrations so that all of the tax administrations may enter the outcome stages at the same time.
104. OECD/G20, *supra* n. 94, at pp. 76-82.
105. If a covered tax administration is not able to state that a covered risk is low risk or is not able to reach a conclusion in respect of a certain matter, this will be reflected in the outcome letter. However, the information gathered during the ICAP should facilitate any future domestic or multilateral action (bilateral/multilateral APAs (advance pricing agreements) or simultaneous/joint audits) for the benefit of the MNE and the covered tax administration.
106. *Compare* Heidecke & Slagter, *supra* n. 87.
107. During Seminar G of the IFA 73rd Congress in London, some issues were discussed in relation to the CbCR. In particular, it is worth mentioning the concerns raised in relation to the difficulties that many tax authorities are experiencing in interpreting the data contained in the CbCR. *See IFA 73rd Congress in London - Seminar G: Tax transparency/enhanced cooperation/CbCR experience* (11 Sept. 2019), News IBFD (accessed 18 Nov. 2019).
108. A. Majdanska & J. Leigh-Pemberton, *The OECD's International Compliance Assurance Programme (Part II): A Response to the Need for Multilateral Risk Assessment*, 4 Transfer Pricing International, p. 181 (2018).
109. J.M. Calderón, *The OECD International Compliance Assurance Programme: Just a New Multilateral and Cooperative Model of Tax Control for Multinational Enterprises?*, 72 Bull. Intl. Taxn. 12, p. 690 (2018), Journal Articles & Papers IBFD.

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of CbCR risk assessments, especially in these first years of the CbCR's adoption.

The ICAP has the potential to improve the level of legal certainty in tax matters and reduce the number of tax disputes by developing a multilateral and cooperative model of analysis and assurance regarding international tax risks.[110] This may be particularly relevant in the area of transfer pricing, because new BEPS-driven rules were introduced in the 2017 OECD Transfer Pricing Guidelines as clarification of the previous rules. Therefore, they can be used to address open tax issues given their retroactive effect.[111]

Furthermore, the ICAP has the potential to replace the current paradigm of filing tax returns at the year end and preparing contemporaneous transfer pricing documentation with (almost) real-time and multilateral assessments.[112] The reliance on current assessment models (e.g. APAs and the MAP) is likely to be reduced, since (potential) controversies could now be resolved in real-time.[113]

Therefore, it is advisable in the future to establish appropriate functioning[114] of the ICAP with the participation of an even greater number of tax administrations, since taxpayers and tax administrations should jointly work on enhancing dispute prevention instead of primarily focusing on dispute resolution mechanisms.

4.4. *CbCR and MNE value chains*

As mentioned in section 4.3., the CbCR appears to take a step back by using FTEs to compute risk assessment indicators. Furthermore, the data contained in the CbCR reflect what was already reported in the financial accounts and are unlikely to accurately delineate an MNE's value chain: from the mere analysis of the three tables, it is difficult to ascertain where the value is actually created and where the significant people functions are located.

To mitigate the risk of reaching misleading conclusions, it is advisable for MNEs to conduct an accurate value chain analysis (VCA)[115] as a thorough study of the value chain, which will allow the CbCR stakeholders to gain a better understanding of the outcome of an MNE's CbCR.[116]

In its 2018 Interim Report on Digital Taxation, the OECD provided a detailed overview of the manner in which an MNE creates value.[117] In fact, the VCA is a powerful instrument for identifying how value is created and delivered to the market through a set of activities performed by the entities in the MNE group.[118]

The BEPS Project has placed significant emphasis on value creation. Though the term "value creation" is not explicitly defined in the Actions 8-10 Final Report,[119] the Report reveals the importance of a VCA in its own title, "Aligning Transfer Pricing Outcomes with Value Creation".[120] Furthermore, such an approach accords with what is already voiced in Action 13: VCA is essential for meeting documentation requirements and represents a useful tool – especially when paired with a complete functions, assets and risk analysis – to determine whether the income allocation is made in a BEPS-proof manner.[121]

In particular, a qualitative VCA is already understood to be useful, as it must be included in a BEPS-compliant MF. Furthermore, some countries' documentation requirements (e.g. those of Germany, South Africa and the United Kingdom) provide that it should be reported in the LF as well.[122]

110. *Compare* id.
111. *Compare* Majdanska & Leigh-Pemberton, *supra* n. 108, at p. 182.
112. Huibregtse, Ottoni & Muñoz Rodríguez, *supra* n. 80.
113. Id.
114. Although the ICAP experience has already shown positive results in the pilot phase, one area of potential improvement is related to the establishment of better coordination within tax administrations, e.g. between APA teams and ICAP teams. In fact, Barilla, an Italian MNE group in the food industry that participated in the pilot, received a transfer pricing audit for FY 2016 (the same year covered by the ICAP risk assessment) when the group was already close to receiving the outcome letters. However, the group was able to avoid the audit thanks to the contact made during the ICAP process. *See* J. Stanley-Smith, *The negative aspects of ICAP*, International Tax Review (10 July 2019), available at https://www.internationaltaxreview.com/article/b1fydgpxsrlphm/the-negative-aspects-of-icap (accessed 18 Nov. 2019).
115. Value chain analysis provides a holistic perspective on how all of the business activities interact with each other, how value is created and how profit is allocated among group entities in the global value chain. *See* S.B. Huibregtse & S.C. Muñoz Rodríguez, *Slicing the Pie in Latin America – A Pragmatic Approach to a Value Chain Analysis*, 72 Bull. Intl. Taxn. 12, p. 718 (2018), Journal Articles & Papers IBFD. For an overview of the value chain analysis for transfer pricing purposes, *see OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (10 July 2017), Primary Sources IBFD.
116. I. Verlinden & B. Markey, *From Compliance to the C-Suite: Value Creation Analysed Through the Transfer Pricing Lens*, 44 Intertax 10, p. 774 (2016).
117. OECD/G20, *Tax Challenges Arising from Digitalisation – Interim Report 2018* (OECD 2018).
118. M. Porter, Industry Structure and Competitive Strategy: Key to Profitability, 36 Fin. Analysis J. 4, p. 30 (1980).
119. OECD/G20, *Aligning Transfer Pricing Outcomes with Value Creation - Actions 8-10: 2015 Final Report* (OECD 2015), Primary Sources IBFD.
120. S.B. Huibregtse et al., *Multinational Enterprises, Transfer Pricing and Value Chain Analysis in Latin America following the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72 Bull. Intl. Taxn. 11, p. 636 (2018), Journal Articles & Papers IBFD.
121. *Compare* id.
122. R. Gerardu, S. Huibregste & A. Suud, *Value Chain Analysis after BEPS – The Roadmap from "Staying out of Trouble" to "Being in Control"* (AmCham 2017), available at https://www.amcham.ch/publications/downloads/2017/yb/value-chain-analysis-after-beps-by-raymund-gerar-du-steef-huibregtse-avisha-sood.pdf (accessed 18 Nov. 2019).

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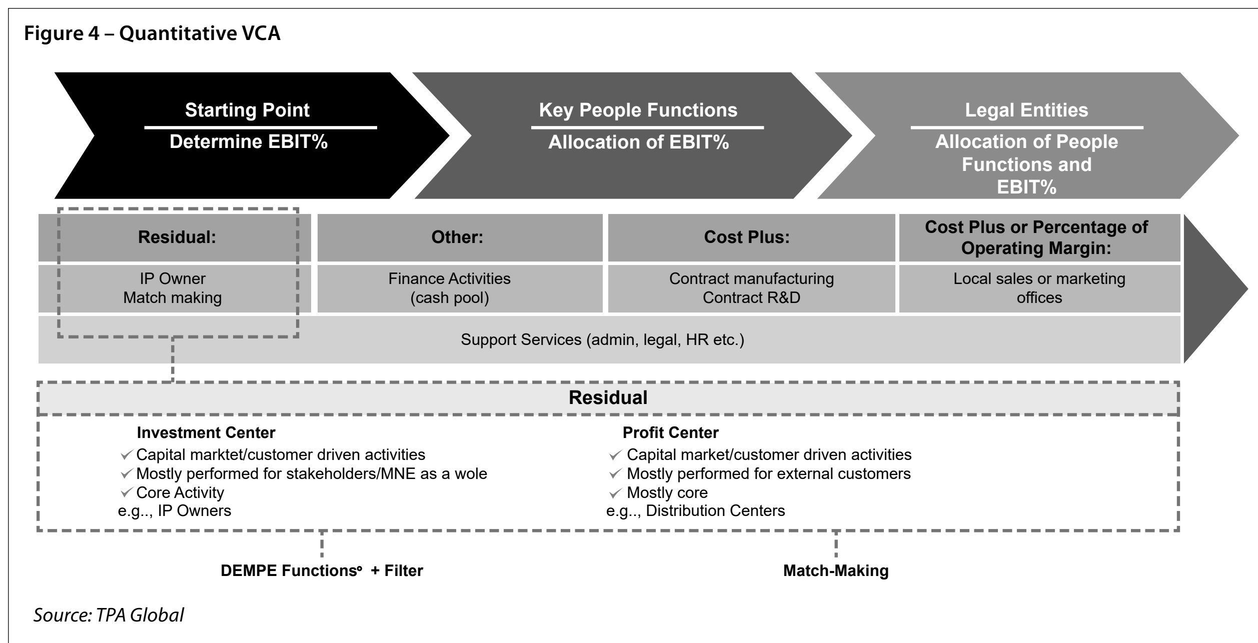
Figure 4 – Quantitative VCA



Source: TPA Global

Even though MNEs can decide to include a thorough VCA, it is advisable to add a quantitative VCA[123] to the qualitative one that is conducted for MF purposes.[124]

A quantitative VCA allows for the determination of the value added by each entity within the MNE group through each process in the value chain and, subsequently, provides a better understanding of how to allocate EBIT to each legal entity.[125]

This analysis may – and very likely will – result in different percentages from those of the CbCR. Detected anomalies and risk flags based on the ratio analysis of the CbCR data may be justified or addressed with the VCA.[126]

Considering the above, it will be crucial for MNEs to be proactive and conduct an in-depth VCA to demonstrate, upon request, that the profit allocation is aligned with value creation.[127] MNE groups that have established the VCA have invested in building up a robust defence to sustain their positions in the event of a potential audit or are able to identify areas in which it is necessary to put remedies into action before the tax authority's assessment.[128] It is advisable to limit the improper use of CbCRs to determine profit allocation based on accounting data that does not capture where the substance is located. A VCA would be far more appropriate in understanding how value is created with the MNE functions.[129]

4.5. CbCR and blockchain

The CbCR is filed, in principle, in the jurisdiction where the UPE[130] is resident for tax purposes and is automatically shared between the tax administrations of the jurisdictions in which the group operates through several exchange mechanisms, e.g. the CbCR Multilateral Competent Authority Agreement (MCAA), the EU Directive on Automatic Exchange of Information or bilateral qualifying competent agreements in effect.[131]

123. *Compare* Huibregtse et al., *supra* n. 120. The cited article illustrates the application of different value chain analysis techniques, e.g. the alignment of financial ratios versus FTE ratios, Porter's value chain analysis model and the process contribution analysis. The authors state that the approach adopted by "the alignment of financial ratios versus FTE ratios" technique is similar to the HETRA recommendations.
124. *Compare* TPA Global, *supra* n. 44.
125. *Compare* id.
126. *Compare* id.
127. Profit allocation and value creation must be aligned in order to avoid cases in which the tax authorities identify tax and/or transfer pricing leakages from many different angles. *See* Huibregtse et al., *supra* n. 120.
128. *Compare* Verlinden & Markey, *supra* n. 116.
129. R.J.S. Tavares & J.P. Owens, *Human Capital in Value Creation and Post-BEPS Tax Policy: An Outlook*, 69 Bull. Intl. Taxn. 10, p. 590 (2015), Journal Articles & Papers IBFD.
130. Under certain circumstances, i.e. (i) no CbCR requirement has been introduced in the jurisdiction of the UPE; (ii) no competent authority agreement has been agreed in a timely manner for the exchange of CbCRs; or (iii) it has been established that there is a failure to exchange the information in practice. A secondary mechanism would be accepted as appropriate through local filing or by designating a constituent entity to act as a sole substitute for the UPE to file the CbCR in its jurisdiction of tax residence on behalf of such MNE group. For more details, *see Action 13 Final Report*, *supra* n. 5. Furthermore, when jurisdictions were not able to domestically implement CbCR obligations for periods commencing from 1 January 2016, a transitional issue arose. In OECD/G20, *supra* n. 31, in order to avoid local filing for the transitional period, the OECD recommended that jurisdictions should adopt a "parent surrogate filing" to allow the UPE to file the CbCR on a voluntary basis..
131. The OECD published an update regarding the status of the CbCR implementation as of February 2019. For more details, *see* OECD, *Country-by-Country Reporting: Update on exchange relationships and implementation* (OECD 2019), available at http://www.oecd.org/tax/beps/country-by-country-reporting-update-on-exchange-relationships-and-implementation.htm (accessed 18 Nov. 2019).

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The automatic exchange mechanism is an expression of the current international standards to promote tax transparency by removing any impediment to the sharing of relevant information among different jurisdictions.

In an attempt to foster transparency, the European Union went even further. The EU proposal[132] for public CbCR for MNE groups that operate in Europe and have a turnover exceeding the EUR 750 million will result in additional pressure on MNEs to pay their fair share of taxes in order to avoid reputational damages. The proposal reads: "[P]ublic scrutiny can help to ensure that profits are effectively taxed where they are generated. Public scrutiny can reinforce public trust and strengthen companies' corporate social responsibility by contributing to the welfare through paying taxes in the country where they are active."

Across Europe, the approach adopted by European countries with reference to public CbCR has not been homogeneous. For example, the UK government advocates regulations to enable making CbCR public in the United Kingdom.[133] On the other hand, in France, it is contended that it is unconstitutional to make CbCR publicly available.[134]

It is worth mentioning that companies operating in certain industries are already subject to public CbCR. In fact, the European Union requires companies in the extractive and logging industries to publish information for each country they operate in rather than providing a single set of information at a global level in order to comply with specific rules in the accounting[135] and the transparency directives.[136,137]

Reputational pressure, especially in light of the public CbCR proposal, may represent strong leverage in the hands of tax administrations or other stakeholders to avoid MNEs' "misconduct".[138] However, addressing tax planning and tax avoidance through "naming and shaming" corporations may be too extreme and lead to a significant infringement of taxpayer rights,[139] especially when confidential data are made public.[140] Furthermore, concern related to transparency has been expressed in respect of the manner in which the disclosed information could potentially be manipulated in order to argue that there is tax avoidance.[141]

As mentioned in section 3.4., a pillar for the exchange of a CbCR is the confidentiality of the information: "Tax administrations should take all reasonable steps to ensure that there is no public disclosure of confidential information and other commercially sensitive information contained in the documentation package."[142] Given the international trends in favour of transparency initiatives such as public CbCR, the OECD seems to take a divergent position in limiting access to CbCR only to tax administrations.[143]

132. European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches, COM 2016/198 final (12 Apr. 2016), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016PC0198 (accessed 18 Nov. 2019).
133. A.J. Sawyer & K. Sadiq, Country-by-Country Tax Reporting: A Critical Analysis of Enhanced Regulatory Requirements for Multinational Corporations, 36 C&SLJ 1 (2019).
134. In December 2016, the French Council of State ruled that public CbCR is unconstitutional, as it undermines the freedom of an enterprise by giving access to confidential information.
135. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements, and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182 (2013), Primary Sources IBFD.
136. Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390 (2004).
137. European Commission, *Public country-by-country reporting* (2019), available at https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/public-country-country-reporting_en (accessed 18 Nov. 2019). All payments to governments shall be reported, broken down by country (and by project, if the payments were attributed to a specific project). The types of payments to be disclosed are the following: (i) production entitlements; (ii) taxes on income, production or profits; (iii) royalties; (iv) dividends; (v) signature, discovery and production bonuses; (vi) licence fees, rental fees, entry fees and other considerations for licences and/or concessions; and (vii) payments for infrastructure improvements. For a more comprehensive analysis, *see* A. Turina, *"Visible, Though Not Visible in Itself": Transparency at the Crossroads of International Financial Regulation and International Taxation*, 8 World Tax J. 3, p. 378 (2016), Journal Articles & Papers IBFD.
138. M. Lagarden, *Behavioural Transfer Pricing – Towards Enhanced Transparency and Compliance?*, 26 Intl. Transfer Pricing J. 3 (2019), Journal Articles and Papers IBFD.
139. X. Huang, *Ensuring Taxpayer Rights in the Era of Automatic Exchange of Information: EU Data Protection Rules and Cases*, 46 Intertax 3, p. 225 (2018). For a more comprehensive assessment on the level of compliance with the minimum standards and best practices on the practical protection of taxpayers' rights, *see* P. Baker, P. Pistone & C.E. Weffe, *Observatory on the Protection of Taxpayers' Rights: 2018 General Report on the Protection of Taxpayers' Rights* (IBFD 2019), available at https://www.ibfd.org/Academic/National-Reports-Observatory-Protection-Taxpayers-Rights (accessed 7 J. 2020).
140. A.P. Dourado, *Fake Tax Transparency? Leaks and Taxpayer Rights*, 46 Intertax 2, p. 100 (2018).
141. Furthermore, the reputational impact of a CbCR could include issues regarding sharing the data contained in the report (e.g. how the template would compare with others). In fact, some tax administrations (e.g. the Australian Tax Office) have clearly stated that the CbCR will not be made publicly available and that, should the tax authority be aware that the report would be made available in other jurisdictions, they would suspend exchanges with that country. For more details, *compare* Sawyer & Sadiq, *supra* n. 133.
142. *Action 13 Final Report*, *supra* n. 5, at p. 44.
143. A.W. Oguttu, *Curtailing BEPS through Enforcing Corporate Transparency: The Challenges of Implementing Country-by-Country Reporting in Developing Countries and the Case for Making Public Country-by-Country Reporting Mandatory*, 12 World Tax J. 1, pp. 23-24 (2020), Journal Articles & Papers IBFD. In the cited article, the author advocates for mandato-

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However, it should be noted that Action 13, being a minimum standard, could potentially be subject to significant changes in 2020.[144] One of the potential modifications could be the public disclosure of CbCR information.

Recently, the work towards public CbCR has again been on the agenda of the EU legislator: in March 2019, the European Parliament adopted a proposal for a directive on public CBCR, suggesting a number of amendments to the text that was proposed by the Commission.[145] The proposal recently received a new impulse when the newly elected European Parliament adopted a resolution on 24 October 2019 to "break the deadlock within the Council … to finalise the legislative process as soon as possible".[146] This renewed interest in public CbCR should also be read in light of the recent proliferation of EU legislation (e.g. the Sixth EU Directive on Cross-Border Tax Arrangements)[147] to enhance disclosure requirements and transparency.

Therefore, it may be advisable for multinationals to be fully aware of the information disclosed therein, seeing as what is depicted in the three tables could be exposed to the public domain.[148] On the other side of the spectrum, there are MNE groups that consider public disclosure an opportunity to demonstrate their long-standing commitment to transparency. For example, Vodafone voluntarily published the group's CbCR for the year that ended in March 2017 by stating, "The OECD does not require this information to be published and recommends that tax authorities limit their use of it to high-level risk assessments only. However, given the comprehensive nature of our public disclosures and the wider context of our Taxation and Total Economic Contribution Report, we have no hesitation in sharing this information publicly."[149]

However, groups may fear that the lack of context will make it difficult for other stakeholders (beside the tax authority) to fully interpret the information without further explanations and additional sources of information. Furthermore, the disclosure of CbCR data (through either the adoption of public CbCR or leaks of information due to misuse by a tax authority) could make commercially sensitive information – which, by definition, is confidential – available in the public domain, which could have repercussions for a business.

There are less invasive solutions to make CbCR more effective and make automatic exchange of information more safe and secure, at least from data leakage. A potential solution may be to use blockchain technology for the exchange of CbCRs between jurisdictions.[150] Blockchain is a type of database that operates as a peer-to-peer network, which independent participants are allowed to use in a safe and secure environment.[151]

All of the jurisdictions that have relationships established for the exchange of CbCRs may be interested in being participants or network members of a CbCR

ry public CbCR based on the 1970s UN proposals for public CbCR as a way to ensure corporate transparency.

144. As already mentioned in sec. 1., CbCR forms one of the four BEPS minimum standards. Each of these standards is subject to peer review in order to ensure timely and accurate implementation and, thus, safeguard the level playing field. Furthermore, reviews of specific BEPS measures are expected to occur by the end of 2020. The 2020 review will evaluate whether modifications to CbCR should be made.
145. European Parliament legislative resolution of 27 March 2019 on the proposal for a directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches, COM(2016) 198 (2019), available at http://www.europarl.europa.eu/doceo/document/TA-8-2019-0309_EN.pdf?redirect (accessed 18 Nov. 2019).
146. European Parliament resolution of 24 October 2019 on the state of play on the proposal for a directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (2016/0107(COD)), known as public country-by-country reporting (2019/2882(RSP)) (2019), available at http://www.europarl.europa.eu/doceo/document/TA-9-2019-0048_EN.pdf (accessed 18 Nov. 2019). Notwithstanding its failure to pass at the EU Competitiveness Council meeting on 28 November 2019 and at the ECOFIN meeting on 5 December 2019, the vote on public CbCR is a hot topic in the agenda of European Parliament and Commission. Despite the political deadlock, the European Commission confirmed, during a press conference, that it has no intention of withdrawing the proposal. Following Brexit, the voting dynamics might change in Europe, leading to a revamping of the proposal. For more details, *see* Tax Journal, *ECOFIN stalls on public CbCR*, Tax Journal (11 Dec. 2019), available at https://www.taxjournal.com/articles/ecofin-stalls-on-public-cbcr (accessed 9 Feb. 2020).
147. Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139 (2018), Primary Sources IBFD.
148. For more details, *see* the modified version of a keynote speech presented by Professor Jeffrey Owens at the Tax Administration Research Centre Workshop, held at the University of Exeter, 21-22 April 2015, *Tax Transparency and BEPS*, available at http://epub.wu.ac.at/5096/1/36-162-1-PB.pdf (accessed 18 Nov. 2019).
149. Vodafone, *Taxation and our total economic contribution to public finances 2018* (2019), available at https://www.vodafone.com/content/dam/sustainability/pdfs/vodafone_2018_tax.pdf (accessed 18 Nov. 2019).
150. S.K. Bilaney, *From Value Chain to Blockchain – Transfer Pricing 2.0*, 25 Intl. Transfer Pricing J. 4, p. 294 (2018), Journal Articles & Papers IBFD. As previously mentioned in sec. 2., the CbCR should be filed in the jurisdiction of the tax residence of the UPE and shared with the tax administrations of various jurisdictions where the group is present by way of automatic exchange of information. However, the process of data-gathering and automatic exchange of information may be expensive in the event that it is conducted manually or if it requires the integration of different information technology systems. The adoption of the blockchain technology may be a solution for more efficient integration of all participants of the CbCR blockchain (i.e. constituent entities and all relevant tax jurisdictions) on a real-time basis. For more details, *see* Huibregtse, Ottoni & Muñoz Rodríguez, *supra* n. 80.
151. G. Hileman & M. Rauchs, *Global Blockchain Benchmarking Study* (Cambridge Centre for Alternative Finance 2017), available at https://www.ey.com/Publication/vwLUAssets/ey-global-blockchain-benchmarking-study-2017/$File/ey-global-blockchain-benchmarking-study-2017.pdf (accessed 13 Aug. 2019).

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blockchain, seeing as it allows CbCRs to be available to them on a real-time basis.[152] Furthermore, the use of distributed ledgers could represent a potential tool to pre-populate the first two tables of the CbCR by using transactional data collected in real-time. This could have several positive implications, including increased explanatory power, given the more accurate reconciliation of the data gathered for the filing of the CbCR with other reports (e.g. audited financial statements and tax returns).[153]

Given its huge potential, blockchain technology may result in many advantages if implemented for tax and transfer pricing purposes. In particular, the use of a blockchain solution for CbCR provides,[154] for example:

- the possibility for MNEs to access aggregated information from a single distributed ledger source that is available for review and approval by all participants;
- tax authorities' certainty that the information received was gathered consistently, since the blockchain technology allows sharing and validating secure data between participants;
- the easy identification of trends in CbCR results by both tax authorities and taxpayers;
- tax authorities' better understanding of CbCR results;
- reporting consistency; and
- MNEs' ability to constantly monitor CbCR outcomes.

It is worth mentioning that this hypothesis is not free of potential pitfalls. For example, the creation of a blockchain network may be considered an additional burden for MNEs and tax authorities, especially in the implementation phase. Furthermore, even though the technology is considered more secure than other systems due to the use of cryptography for authentication, permission enforcement, integrity verification and other elements, it is not 100% infallible.[155] Therefore, tax administrations that would like to adopt blockchain may have to work on how breaches of stored information may be averted in order to be compliant with traditional secrecy in tax matters.[156]

However, blockchain has the potential to revolutionize the transfer pricing world by making many processes automatic[157]. Policymakers should further scrutinize the implications of adopting this technology, since the benefits of embracing it will likely outweigh the overall costs in the long run.

5. Conclusion

After the second government-to-government exchanges of CbCRs, MNEs are still wondering what impact CbCR information will have on risk assessments and transfer pricing adjustments. Even though the CbCR is not designed to be used as a blueprint for transfer pricing audits, it represents a veritable goldmine of information for tax authorities.[158] They may be tempted to use it to the fullest extent possible – regardless of the "appropriate use" condition – by making adjustments relying on the sole elements of the CbCR. This, in the end, would be a form of one-sided formulary apportionment, which is unacceptable under the arm's length principle. Even in the event that tax authorities would adopt a less aggressive approach, it is likely that the report will be exploited, at least as a starting point, to select a file and orientate the investigations. The way in which CbCR will be used and analysed is likely to change as tax authorities gain more experience, which will lead to the more accurate and sophisticated identification and assessment of tax risk.[159]

Considering the role that CbCR will play in future tax assessments, adopting a "wait and see" strategy is not a feasible solution for MNE groups. Taxpayers should be aware when filing the CbCR that it could be read by a wide variety of stakeholders, and they should remember such audiences while drafting it.[160] At a very minimum, they should try to mitigate the potential risk of drawing false conclusions during the CbCR risk assessment by using dry-run tests and preparing robust explanations for anomalies supported by other sources and tools. This is particularly crucial due to the intrinsic flaws of the CbCR that undermine its use for risk assessment purposes.

The 2020 review of CbCR will be a crucial step towards protecting the standard from potential inappropriate use, improving its scope and evaluating whether modifications to the content of the CbCR should be made, given the current discussion on the use of its elements

152. *Compare* Bilaney, *supra* n. 150.
153. Vienna University of Economics and Business (WU), First Meeting in the Multi-stakeholder Series, *Blockchain: Taxation and Regulatory Challenges and Opportunities* (WU 2017), available at https://www.wu.ac.at/fileadmin/wu/d/i/taxlaw/institute/WU_Global_Tax_Policy_Center/Tax___Technology/Backgrd_note_Blockchain_Technology_and_Taxation_03032017.pdf (accessed 17 Nov. 2019).
154. PwC, *How blockchain can help reduce transfer pricing complexity: Managing intercompany transactions more effectively is critical under US tax reform* (PwC 2018), available at https://www.pwc.com/us/en/services/tax/transfer-pricing/blockchain.html (accessed 18 Nov. 2019).
155. *Compare* Hileman & Rauchs, *supra* n. 151.
156. EY, *Blockchain relevant for tax and transfer pricing* (EY 2018), available at https://taxinsights.ey.com/archive/archive-articles/blockchain-relevant-for-tax-and-transfer-pricing.aspx (accessed 18 Nov. 2019).
157. L.F. Neto, *The Blockchain Revolution for Transfer Pricing Documentation: If Not in 2020, Then When?*, in *Taxing the Digital Economy* (P. Pistone & D. Weber eds., IBFD 2019), Books IBFD.
158. *Compare* Verlinden & Markey, *supra* n. 116.
159. B.J. Mantegani, *Country-by-Country Reports: New OECD Handbook Guides Countries and Taxpayers in Risk Assessment Best Practices*, 47 (23) BNA TM International Journal 1 (2018).
160. *Compare* id.

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to support the global implementation of Pillar I[161] and maybe Pillar II.

Even though the first CbCRs were lodged by the end of 2017, it will take a few years to be able to measure the impact of such reports, especially in terms of the prevention of BEPS phenomena. Only time will tell how successful this all will be.

161. The OECD Secretariat has published a proposal for a Unified Approach under Pillar One, advocating a new approach for allocating profits among jurisdictions. In order to implement the new approach, it is necessary to gather some information (e.g. on sales, profits or losses split on the MNE business line) to be exchanged among tax administrations. Given the interplay of such data with those gathered for CbCR purposes and in order to reduce the compliance burden on taxpayers, a possibility would be to modify the current version of CBCR documentation in such a way that would facilitate the implementation of the proposed approach. This would then also result in an amendment of the automatic information exchange framework. *See* R. Danon & V. Chand, *Comments to Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One* p. 37 (OECD 2019), available at https://www.oecd.org/tax/beps/public-comments-received-on-the-secretariat-proposal-for-a-unified-approach-under-pillar-one.htm (accessed 7 Jan. 2020); V. Chand, *Allocation of taxing rights in the digitalized economy: assessment of potential policy solutions and recommendation for a simplified residual profit split method*, 47 Intertax 12, p. 1023 (2019); and OECD, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy* (OECD 2020).

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