COUNTRY – BY – COUNTRY REPORTING: A NEW DIMENSION IN TAXPAYER COMPLIANCE OBLIGATIONS IN AUSTRALIA

LES NETHERCOTT, LIVIA GONZAGA AND ESIN OZDIL*

ABSTRACT

The G20/Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting Action Plan (BEPS Action Plan) aims to combat tax evasion through an effort to improve tax transparency and enhance the exchange of information and co-operation between tax authorities, governments and global entities. As part of the BEPS Action Plan's recommendations on transfer pricing documentation, country-by-country reporting (CbCR) requirements have been introduced in many countries, including Australia. This paper analyses the Australian CbCR legislation and the impact of compliance requirements on large multinational consolidated groups in Australia. The paper reflects on CbCR issues that include and transcend the taxation sphere, such as general business reporting and corporate governance, as well as the consequences of failing to comply with CbCR obligations. The discussion underlines the need for a cohesive global cooperative effort involving tax authorities and taxpayers. It also raises the need for reporting entities to make the necessary governance adjustments in order to comply with the CbCR obligations, which will support the objectives outlined in the BEPS Action Plan.

Keywords: BEPS, Country-by-Country Reporting, Compliance, Accounting, Taxation, Australia

* Department of Accounting & Data Analytics, La Trobe Business School, College of Arts, Social Sciences and Commerce, La Trobe University.

I INTRODUCTION

In the search for greater tax transparency and accuracy in reporting, the efforts of the G20/Organisation for Economic Co-operation and Development (OECD) and European Union (EU) have led to shifts in the global tax landscape, with the introduction of base erosion and profit shifting (BEPS)[1] and the 'Action Plan on Base Erosion and Profit Shifting'.[2] The Action Plan contains a number of actions designed to address the issue of BEPS. In particular, Action Plan 13 focuses on the issue of transfer pricing documentation and country-by-country reporting (CbCR).[3] Under the CbCR requirements outlined in the BEPS Action Plan 13, multinational enterprises (MNEs) are required to provide and report financial and tax information detailing their global allocation of income and taxes. Since the introduction of CbCR, approximately 76 jurisdictions[4], including Australia, have agreed to incorporate the OECD's CbCR recommendations into their domestic legislation to varying degrees and/or have signed the OECD's Multilateral Competent Authority Agreement on CbCR[5], which will facilitate the automatic exchange of CbCR information among signatories. CbCR compliance requirements may have varying effects on MNEs, and in particular, impose certain challenges and obstacles. The strategic responses of MNEs will be central to preparing them for compliance and helping CbCR become established as authoritative guidelines for tax behaviour.

This analytical paper considers the implications of CbCR requirements in Australia and how MNEs can respond as organisations. In particular, this paper considers how corporate entities in Australia may change their systems, structures and procedures in response to this legislation in order to support their compliance with national and international tax authorities. This paper contributes to the limited academic literature on CbCR by examining the global context of CbCR and its introduction in Australia. It also alludes to the various strategic and accounting considerations reporting entities will need to consider in preparing themselves for CbCR compliance. The key matters and issues of CbCR and the possible responses outlined in this paper will provide fruitful guidance for reporting entities in preparing them for CbCR as well as alerting them to various organisational challenges and opportunities.

---

[1] OECD, 'About BEPS and the Inclusive Framework' (2016) http://www.oecd.org/ctp/beps-about.htm. Also: OECD, 'Country-by-Country Reporting: Update on exchange relationships and implementation' (2016) http://www.oecd.org/ctp/exchange-of-tax-information/country-by-country-reporting-update-on-exchange-relationships-and-implementation.htm

[2] OECD, 'Action Plan on Base Erosion and Profit Shifting' (2013) https://www.oecd.org/ctp/BEPSActionPlan.pdf

[3] OECD, 'Transfer Pricing Documentation and Country-by-Country reporting, Action 13—2015 Final Report' (2015) http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm

[4] OECD, 'Country-by-Country Reporting: Update on exchange relationships and implementation' (2018) http://www.oecd.org/tax/beps/country-by-country-reporting-update-on-exchange-relationships-and-implementation.htm

[5] Australian Taxation Office, 'Country by Country Reporting – Automatic Exchange of CbC Reports' (2018) https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/Country-by-Country-reporting/

II BACKGROUND – GLOBAL CONTEXT

The erosion of the tax base by artificial shifting of profits to low tax or no tax jurisdictions is a serious issue that affects most developed and developing countries. Profit shifting and base erosion practices are possible where there is low tax transparency associated with inadequate or outdated tax legislation and poor international coordination between tax authorities. The OECD estimates an annual revenue loss of between US$ 100 billion and US$ 240 billion as a result of BEPS.[6] Among other factors, lack of tax transparency in reporting practices of multinational entities, lack of coordination between tax administrations, and poor interaction with domestic tax rules have been mentioned as some of the main causes for these losses.[7]

According to the Financial Transparency Coalition's report 'Why Public Country-by-Country Reporting for Large Multinationals is a Must'[8], the functions of CbCR go way beyond increasing tax transparency. In particular, the high-level information provided by CbCR will allow governments to assess the effectiveness of their tax policies and make adjustments over time. These will lead to a better-informed civil society, effective policymaking and an increase in governments' accountability. This is an especially desirable outcome for developing countries battling corruption in governmental institutions. CbCR is relevant not only for tax purposes, it is also important for general transparency affecting global corporate social responsibility, corporate governance, accountability, and, on a macro-economic scenario, prevention and combating of corruption, political stability, economic development and fair trade.[9]

The consequences of BEPS are always harmful and have widespread impact. D'Ascenzo[10] explains that BEPS reduces the corporate tax revenue available to governments, distorting the allocation of resources and ultimately affecting the government's capacity to provide adequate levels of public services and infrastructure. This effect is particularly harmful in developing countries, whose economies are heavily reliant on the revenue from corporate taxes. BEPS minimisation strategies also undermine the notion of tax justice, where the wealthiest entities pay little or no tax, while individuals and smaller entities bear the bulk of the tax burden.

---

[6] OECD, 'Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project' (2015) https://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf

[7] Monique Longhorn, 'Country-by-Country Reporting: A Critical Analysis' (2015). Brisbane: Queensland University of Technology.

[8] Financial Transparency Coalition, 'Why Public Country-by-Country Reporting for Large Multinationals is a Must—Questions and Answers' (2016) Financial Transparency Coalition (eds) https://financialtransparency.org/wp-content/uploads/2016/02/Joint_Civil_Society_QA_pCBCR.pdf

[9] Richard Murphy, 'Country-by-Country Reporting: Accounting for Globalisation Locally' (2012). Norfolk: Tax Justice Network; Longhorn, above n 7; Francesco Cortellese, 'Country-by-Country reporting: Comparison and Analysis, 23rd Public Economics Meeting' (2016) Ourense, Galicia (Spain): Universidad Autonoma de Madrid; Monique Longhorn, Mia Rahim and Kerrie Sadiq 'Country-by-Country Reporting: An Assessment of its Objective and Scope' (2016) 14 e-Journal of Tax Research 4–33.

[10] Michael D'Ascenzo, 'The Spotlight on BEPS: Business Erosion and Profit Shifting' (2013) Melbourne Law School Conference – Tax Avoidance in the 21st Century, Melbourne: Melbourne Law School https://law.unimelb.edu.au/__data/assets/pdf_file/0007/1550653/Michael-DAscenzo-Spotlight-BEPS-Tax-Avoidance12.pdf.

In order to address this issue, tax and policy specialists from the OECD and G20 countries analysed the tax planning strategies utilised by multinational companies to identify the loopholes that allowed opportunities for BEPS. The findings were published in the 2013 report entitled 'Addressing Base Erosion and Profit Shifting' (the BEPS Report).[11] The Explanatory Statement that accompanied the 'OECD Guidance on the Implementation of Country-by-Country Reporting' highlighted that 'standardised country-by-country reporting and other documentation requirements will give tax administrations a global picture of where MNE profits, tax and economic activities are reported, and the ability to use this information to assess transfer pricing and other BEPS risks, so they can focus audit resources where they will be most effective'.[12] Knobel and Cobham[13] further elaborate the OECD findings, stating that 'CBCR is a transparency measure that genuinely shifts power and drives greater accountability in multiple channels. Those accountability channels can address a range of unequal power relations: from the principal–agent issues that may face investors in opaque, tax-avoiding multinationals, to the gross inequality that faces lower-income countries in the distribution of taxing rights on multinationals'.

Following the BEPS Report, the OECD/G20 group issued the 'Action Plan on Base Erosion and Profit Shifting' (the BEPS Action Plan), which comprises 15 action points with recommendations to address the issues of each particular area. The BEPS Action Plan final reports were published in 2015 and contain a number of recommendations for legislative changes in the relevant areas of concern. CbCR was introduced in Action 13 as part of the transfer pricing documentation recommended actions designed to increase tax transparency.[14] Action 13 is specifically aimed at MNEs with annual consolidated group revenue equal to or exceeding EUR 750 million (or equivalent in domestic currency), requiring that they provide annual statements detailing their business activities and allocation of profits to the tax authorities of the countries where they carry out business.[15]

Action 13 was further developed into two subsequent reports: the 2015 'Action 13: Guidance on Transfer Pricing Documentation and Country-by-Country Reporting',[16] which outlines the three-level reporting system; and the 2015 'Action 13: Country-by-Country Reporting Implementation Package',[17] which presents a legislative template to be used by countries in the

[11] OECD, 'Addressing Base Erosion and Profit Shifting' (2013) http://www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm

[12] OECD, above n 6.

[13] Andres Knobel and Alex Cobham, 'Country-by-Country Reporting: How Restricted Access Exacerbates Global Inequalities in Taxing Rights' (2016) *Tax Justice Network* https://financialtransparency.org/wp-content/uploads/2016/12/TNJ_AccesstoCBCRreport.pdf.

[14] OECD, above n 3.

[15] OECD, above n 6.

[16] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project. Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting' (2015) https://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf

[17] OECD, 'Guidance on the Implementation of Country-by-Country Reporting—BEPS Action 13, OECD/G20 Base Erosion and Profit Shifting Project' (2015) https://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf

process of introducing CbCR into their domestic legislations. The findings and recommendations of the three initial reports were consolidated in the 2015 'Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report',[18] according to which:

- The revised standards for transfer pricing documentation and CbCR incorporated a master file, local file, and a country-by-country report that would outline revenues, profits, taxes paid and certain measures of economic activity.
- The standardised approach meant that (i) taxpayers would need to review and articulate their transfer pricing positions and (ii) the information will be provided to the tax authority in a standardised format, thus facilitating the risk assessment and audits processes.
- Some CbC reports will be automatically exchanged (or exchanged at request) between tax authorities.

Under the recommendations of Action 13, the statements to be provided by relevant MNEs under the CbCR requirements are:

- The master file: The master file will contain high-level information regarding the MNE's global business operations and transfer pricing policies and will be made available to all relevant tax administrations
- The local file: The local file will be lodged with the local tax authority and will include detailed transactional transfer pricing documentation, identifying material related party transactions and their respective amounts, as well as the MNE's analysis of the transfer pricing determinations made in relation to those transactions.
- The CbC report: The CbC report will typically be prepared by the MNE's parent entity and will provide, on an annual basis, details on revenue, before-tax profits, income tax paid and accrued, number of employees, stated capital, retained earnings and tangible assets for each country in which the MNE does business. It also requires that the MNE identifies and explains the business activities undertaken by each entity within the group in each jurisdiction[19].

As the legislative template refers to automatic exchange of reports between tax authorities, the implementation of CbCR is also related to the application of the Multilateral Convention on Administrative Assistance in Tax Matters,[20] as well as to the double taxation agreements and information exchange agreements in force between the countries involved. Therefore, the process of implementing CbCR legislation may require further amendments to existing double taxation agreements and information exchange agreements to accommodate the new reporting requirements. Since the 2015 Final CbC Report was published, many countries have made considerable progress in introducing CbCR into their domestic transfer pricing regulations.

[18] OECD, above n 3.

[19] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project. 2015 Final Reports. Executive Summaries' (2015) https://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf

[20] OECD and Council of Europe, 'Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol' (2011) *Paris: OECD Publishing* https://www.oecd.org/ctp/exchange-of-tax-information/ENG-Amended-Convention.pdf

Alongside other OECD countries, Australia applied the CbCR legislation on 1 January 2016, and submitted the first round of CbC reports on 30 June 2018.

In this paper, we used secondary sources of information to provide facts, and support and inform our discussions. We searched for all secondary sources relating to CbCR in Australia and globally. We retrieved information and documentations from the OECD, Australian Taxation Office, American Institute of Certified Public Accountants and Financial Transparency Coalition websites, tax journal articles, and communications from KPMG, Deloitte and PricewaterhouseCoopers. We examined all secondary sources of data collected, and collated and reported information relating to the main points of discussion of this paper in relation to CbCR in Australia, namely compliance challenges, penalty protection, tax auditing risk policy, and the strategic, governance, reporting, data management and risk management considerations, which are presented in the following sections and subsections.

III COUNTRY – BY – COUNTRY REPORTING IN AUSTRALIA

Following the OECD recommendations of BEPS Action 13, in December 2015 the Australian Government enacted amending legislation introducing CbCR obligations to certain categories of large multinational consolidated groups, effectively implementing the recommendations of Action 13 of the OECD/G20 BEPS Action Plan (Action 13).[21] The new legislation, introduced into the Australian Income Tax Assessment Act 1997 (ITAA97) as Subdivision 815-E (Subdivision 815-E ITAA97), applies to years starting 1 January 2016. This demonstrates the Australian Government's commitment to global tax transparency and Australia's engagement with other tax jurisdictions in fighting international tax avoidance by profit shifting.[22]

The Australian CbCR requirements reflect most of the recommendations of Action 13, with the exception of the particular format adopted for the local file.[23] They target a group of entities legally referred to as 'significant global entities' (SGEs), comprising Australian resident corporate entities that are either 'global parent entities' (GPEs) or members of consolidated multinational groups with an annual global income exceeding A$1 billion.[24] The concept of SGE also includes cases where the global group's annual income exceeds the A$1 billion threshold due to an extraordinary transaction in one year only, unless the group is granted an exemption upon written application to the Commissioner.[25]

---

[21] OECD, above n 3; OECD, above n 17.

[22] Commonwealth of Australia, 'Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015 No. 170' (2015) *Canberra: Commonwealth of Australia*. Commonwealth of Australia, 'Explanatory Memorandum to the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015' (2015) *Canberra: Commonwealth of Australia.*

[23] Adrian Sawyer and Kerrie Sadiq, 'Country by Country Tax Reporting: A critical analysis of enhanced regulatory requirements for multinational corporations' (2019) 36(7) *Companies and Securities Law Journal* 570-586. Sawyer and Sadiq highlight the much-reduced requirements for New Zealand-headquartered entities.

[24] Commonwealth of Australia, above n 22.

[25] Australian Taxation Office, 'Country-by-Country Reporting: Questions and Answers' (2017) https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/Country-by-Country-reporting/; Commonwealth of Australia, 'Income Tax Assessment Act' (1997).

The main reason why only SGEs are required to comply with CbCR obligations is related to the belief that large MNEs have more opportunities to engage with aggressive international tax avoidance schemes[26] involving related party international dealings.[27] Addressing the reasons why CbCR is necessary for large multinational entities, the Financial Transparency Coalition explained that:

> '… despite publishing their accounts as if they are unified entities, transnational enterprises are not taxed in this way. Each business entity within the transnational enterprise is taxed individually, making it difficult to establish an overview of what is happening within a group of companies for tax purposes. This would be different if reporting was done on a "country-by-country basis'.[28]

Large multinational entities are generally able to avoid (or evade) taxes through artificial shifting of profits to lower tax or even to no tax jurisdictions, effectively eroding the tax base through exploitation of gaps and mismatches in the tax legislation, ultimately undermining the principle of tax justice and the fairness of tax systems.[29] For example, multinational groups often have subsidiaries in several countries, meaning that they do not necessarily have to engage third parties to finance their transactions. By utilising intra-group loans, multinational entities can easily claim excessive interest deductions on intra-group debts. Analysing the introduction of the new Australian Multinational Anti-Avoidance Law (MAAL) and the introduction of CbCR, Ting[30] explains that the creation of intra-group debt is a tax avoidance tool, which is both relevant and relatively simple to implement. The simplicity is because it does not require the involvement of third parties or movement of personnel or assets. This type of arrangement only requires a legal agreement between the Australian subsidiary and the overseas subsidiary whereby the interest on the loan repayments is claimed by the Australian subsidiary, while the overseas subsidiary who receives the interest is subject to low (even zero) tax on this income. Furthermore, as intra-group loans are not subject to the constraints that would generally apply to amounts, interest rates and credit securities in an unrelated party transaction, such intra-group loans, open an avenue for manipulation and flexibility. SGEs are also much more likely to be regarded as being at high risk of obtaining a transfer pricing benefit,

---

[26] Commonwealth of Australia, 'paras 2.4–2.5 Explanatory Memorandum to the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015' (2015) *Canberra: Commonwealth of Australia*.

[27] OECD, above n 6.

[28] Financial Transparency Coalition, 'Why Public Country-by-Country Reporting for Large Multinationals is a Must—Questions and Answers' (2016) *Financial Transparency Coalition (eds)* https://financialtransparency.org/wp content/uploads/2016/02/Joint_Civil_Society_QA_pCBCR.pdf.

[29] Cortellese, above n 9; Leslie Nethercott and Livia Gonzaga, 'Australia—Country-by-Country Reporting: Another Step in Global Tax Transparency' (2016) 22(5) *Asia-Pacific Tax Bulletin 1–6.*

[30] Anthony Ting, 'Multinational Tax Avoidance is Still an Issue for the Government, The Conversation' (2016) https://theconversation.com/multinational-tax-avoidance-is-still-a-revenue-issue-for-government-61674. See also: Max Bruce, 'Multinational Anti-Avoidance Law (MAAL) and Pt IVA — a critical analysis of the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 (Cth) and Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 (Cth) and comparison with general anti-avoidance provisions' (2017) 4(4) *Australian Tax Law Bulletin*63-69.

and as such, producing the CbCR statements would allow such entities to properly justify their intra-group international dealings.[31]

From a different perspective, restricting the scope of CbCR legislation only to SGEs (defined by their international status associated with the elevated consolidated income, as explained above) is not without problems. As suggested by the Financial Transparency Coalition[32], this may generate fair competition issues whereby medium-sized multinational entities or even those just below the annual income threshold[33] might not be subject to the same compliance requirements and therefore could benefit from an unfair competitive advantage.

Other potential reporting issues may result from corporate restructures (including mergers, demergers, takeovers, etc.) undertaken during a year while an entity is an SGE with CbCR obligations in place. These issues are addressed in the ATO's Country-by-Country Reporting Guidance, which clarifies that 'a restructure during an income year of a group consolidated for accounting purposes does not change whether you are an SGE in the preceding year' because 'the CbC reporting obligation follows from being an SGE in the preceding year or for part of that year'. [34] The Australian CbCR requirements require that SGEs lodge three separate statements, being (i) the CbC report, (ii) the master file and (iii) the local file[35] (with the Australian Taxation Office (ATO) within 12 months after the end of their income tax year. While the Australian CbC report and the master file closely follow the OECD template in terms of both content and structure, the Australian local file departs from the OECD model in relation to both content and structure.

For the structure and format, the Australian local file is closely related to the International Dealings Schedule (IDS), which forms part of the Australian transfer pricing documentation requirements.[36] Having said that, the Australian local file follows a two-tier structure, which aims to facilitate compliance by entities with less complex transfer pricing affairs. The first tier is the 'short form local file', which must disclose data on the reporting entity's organisational structure, including business strategies and restructures affecting the entity in the current or previous income year; the entity's management reporting hierarchy, indicating the countries to

---

[31] Cortellese, above n 9.

[32] Financial Transparency Coalition, above n 28.

[33] The issue is illustrated at the Exemptions section of the ATO's Country-by-Country Reporting Guidance: 'Example 4: Different currency thresholds: L Co is an Australian resident that is a subsidiary of a foreign global parent entity. The foreign global parent entity is resident in a jurisdiction that is implementing CbC reporting with a specified threshold amount in another currency. L Co and its parent do not have related entities or operations in any other jurisdictions with CbC reporting obligations. The annual income of the global group exceeds Australia's threshold of A$1 billion, however the currency exchange rates are such that the foreign global parent entity falls slightly below its local CbC reporting threshold. An exemption from lodging the CbC report and master file will be considered.' Australian Taxation Office, 'Country by Country Reporting Exemptions' (2018) https://www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/?anchor=BK_2Exemptions#BK_2Exemptions.

[34] Australian Taxation Office, 'CbC Reporting Obligations' (2018) https://www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/?page=2#CbC_reporting_obligations.

[35] See Appendix 1 of this paper for detailed explanations of each statement.

[36] See Appendix 1 of this paper for details on transfer pricing documentation.

which local managers report, as well as a description of any transfers of intangibles in the current or previous year; and finally, a list of key competitors. However, as the eligibility requirements are extremely limited and the materiality thresholds are very low,[37] in practice very few entities will benefit from this simplified reporting option.

The 'full local file' is the standard report for any entity not eligible to lodge the short form local file, and it must include all the data required in the short form local file plus two additional parts. In the local file 'Part A', the entity will disclose information regarding all controlled transactions for the relevant income year, including the names of the Australian and foreign counterparties (and their countries of residence), category of transaction and the income and expenses associated with such transactions (including transactions of capital nature), the transfer pricing method (or capital asset pricing method) relied upon, and finally, the transfer pricing documentation code. The local file 'Part B' will further extend the information from Part A and will require that the reporting entity provides copies of all intercompany agreements underpinning all material international intra-group transactions, as well as any advance pricing agreements in relation to the Australian transactions and general purpose financial statements.

The local file Part A is substantially similar (although with a much deeper level of detail) to the IDS Part A. Due to this relative overlap, the ATO authorises entities who voluntarily lodge the local file Part A together with their income tax return to skip the majority of the questions of the IDS Part A. Where this is the case, the local file Part B must still be lodged by the relevant deadline. Most importantly, SGE global management teams wishing to prepare their global CbCR statements based on the OECD templates will need to keep in mind the peculiarities of the Australian local file and make sure it is prepared in accordance with the Australian model, or otherwise they could be at risk of failing to comply with the Australian CbCR requirements and therefore be subject to heavy penalties.[38]

With the clear interface between the transfer pricing documentation and the CbCR statements, it is important to clarify that the CbCR statements and the transfer pricing documentation (which includes the transfer pricing report [TPR]), as well as the IDS, constitute independent compliance requirements based on separate legislative bases. For this reason, even though there are similarities between the two sets of statements, they are not substitutes for one another, and reporting SGEs must be aware that each of the CbCR statements is regarded as a separate statement for the purposes of late lodgement penalties.[39] The transfer pricing documentation, although technically not mandatory, is required for the purposes of establishing a reasonably arguable position and for penalty protection. However, all SGEs operating in Australia must lodge CbCR statements regardless of their volume of operations or the materiality of

[37]Australian Taxation Office, 'Local File Instructions 2017' (2017) https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/Country-by-Country-reporting/Local-file-instructions--2017/.

[38] PwC, 'Australian Country-by-Country Reporting Implementation—Unique Local File Design Finalised' (2016) https://www.pwc.com.au/tax/taxtalk/assets/monthly/pdf/cbc-reporting-implementation-jul16.pdf

[39]Australian Taxation Office, 'Country by Country Reporting Administrative Matters' (2018) https://www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/?anchor=Administrativematters#Penaltiesforlatelodgment.

international related party (IRP) dealings.[40] Failing to comply, including late lodgement, will lead to the application of potentially extremely high penalties to the SGE.

A. *Compliance Challenges*

Even though CbCR obligations represent a major effort to increase tax transparency and to improve the risk assessment of SGEs, complying with such legislation may pose significant challenges to Australian SGEs and may represent an exposure to possible penalties for non-compliance.

For example, CbCR requirements apply to income years beginning on or after 1 January 2016. Considering that in Australia the income year runs from 1 July until 30 June, and given that SGEs may lodge their documentation up to 12 months after the end of the income year, the first CbCR deadline was 30 June 2018. However, the operations developed during this period might not necessarily have begun exactly on or after 1 January 2016. On many occasions, the reports may contain several entries of intra-group loans taken before January 2016, which might not have been documented in accordance with the CbCR obligations because there were no such obligations at the time the underlying legal agreements were entered into.

Therefore, it is possible that under the CbCR requirements entities may face the challenge of having to report on structures and operations that may not be readily available. This may be due to the fact the information has not been recorded or because there was no legal obligation to do so. This represents a challenge insofar as failing to produce adequate evidence, especially for the purposes of elaboration of the local file, may place the entity at risk of heavy penalties.

On other occasions, an SGE may find itself in a position of not being able to comply with the Australian CbCR obligations either because its GPE is located in a jurisdiction that does not impose CbCR obligations; or because one or more of its subsidiaries is/are located in countries that do not have CbCR requirements in place,[41] or maybe because the relevant information might never have been available or documented in the foreign jurisdiction. While some degree of administrative relief may be available (including exemptions, in certain cases), such relief would only be considered on a case-by-case basis, and there is no guarantee that entities in

[40] PwC, 'Update on Australian Country-by-Country Reporting Local Files' (2017) https://www.pwc.com/gx/en/tax/newsletters/pricing-knowledge-network/assets/pwc-tp-australia-cbcr-update.pdf

[41] These issues are likely to be particularly problematic for SGEs located in Middle Eastern countries, where CbCR requirements are either not implemented or their development is still at an early stage. This is the case in Egypt, Qatar and Saudi Arabia, which are expected to release CbCR guidelines by the end of 2018. Furthermore, while the United Arab Emirates and Bahrain are the most recent signatories to the OECD BEPS Inclusive Framework, any developments in CbCR legislation are only expected in 2019. KPMG, 'BEPS Action 13: Country Implementation Summary' (2018) https://home.kpmg.com/content/dam/kpmg/xx/pdf/2018/07/tnf-beps-action-13-july31-2018.pdf; PwC. 2018, Significant Transfer Pricing and Tax Transparency Developments Expected in the Middle East in 2018, at https://www.pwc.com/m1/en/tax/documents/2018/significant-transfer-pricing-and-tax-transparency-developments-expected-in-2018.pdf.

circumstances as described above would effectively be granted such relief measures or that such an application for relief would prevent the application of late lodgement penalties.[42]

As further highlighted by Nethercott and Gonzaga,[43] another relevant challenge concerns the interpretation of the materiality thresholds for the purposes of the local file. The problem in this case is that there is no consensus as to what parameters are to be used in defining materiality, such as qualitative outcomes or quantitative data. These authors further explain that 'while some information relating to a reportable transaction may be immaterial when it is considered in isolation, this may not be the case when considered in relation to other transactions undertaken, which, in aggregation, may be material. In this respect, a quantitative guideline viewed in isolation may not reflect what is truly material'.[44] The risk here is due to the fact that even though there is no consensus regarding materiality thresholds, penalty provisions will still apply if the information provided by the entity is considered inaccurate.

Some of these issues have already been addressed by the ATO in several guidance documents, such as the 'Country-by-Country Reporting Guidance',[45] as well as the 'Law Companion Guideline (LCG) 2015/3,'[46] where the ATO outlines how the CbCR legislation will be applied. Relevant practical guidance is also provided in other documents, such as the 'Country-by-Country Reporting: Questions and Answers',[47] which addresses common issues and frequent questions regarding difficulties in complying with CbCR obligations. For example, the ATO CbCR Q&A explains that the Australian entity may apply for aligning its reporting period with that of the SGE's GPE where it produces the CbC report and the master file. In a different scenario, the Australian entity may apply for a one-year exemption in relation to lodging the CbC report where the SGE's GPE country of residence does not have CbCR legislation in force.

Finally, it is important to note that in some exceptional and very limited circumstances, an SGE may apply for a temporary exemption from CbCR obligations and, in any case, any exemption will depend on a formal, written and well-substantiated application. The one-year temporary exemption regarding the master file.[48] is one example. From a different perspective, SGEs headquartered in Australia with no IRP dealings that would need to be disclosed in the CbC

[42] Australian Taxation Office, 'Country-by-Country reporting Exemptions' (2018) https://www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/?page=3#Exemptions.

[43] Nethercott and Gonzaga, above n29.

[44] Ibid.

[45] This guidance is referred to in several paragraphs earlier on in this paper.

[46] Australian Taxation Office, 'Law Companion Guideline 2015/2' (2015) https://www.ato.gov.au/law/view/pdf/psr/lcg2015-002.pdf.

[47] Australian Taxation Office, above n 25.

[48] See Appendix 1 of this paper.

report could potentially have good grounds for applying for an exemption.[49] However, where the SGE has an Australian GPE but has IRP dealings, it would not qualify for an exemption.

Considering a purposive interpretation of the Australian CbCR legislation, it could also be argued that tax-exempt multinational entities operating in Australia could potentially be good candidates for an exemption from CbCR requirements. This is because such entities, being tax exempt, would not be expected to engage in tax avoidance or profit shifting schemes, and as such, would be outside the scope of the CbCR legislation. This could arguably be the case, for example, for some multinational civil society groups, multinational charitable entities, and foreign universities operating in Australia. In any case, no SGE would ever be automatically exempt, meaning that even tax-exempt SGEs would in principle have an obligation to comply with CbCR requirements and would potentially be subject to penalties in case of non-compliance or late lodgement.

B. *Penalty Protection—Establishing a Reasonably Arguable Position*

Lodging the CbCR statements as well as the transfer pricing documentation on time will offer protection against the increased administrative penalties announced in the 2017 Budget, which came into effect on 1 July 2017.[50] The recently enacted amendment will substantially increase the non-compliance and late lodgement penalties applicable to SGEs by a factor of 100. These penalties were further increased because of the adjustment of penalty units from A$180 to A$210,[51] effectively pushing the highest possible penalty that can be applied to an SGE to $525,000.[52]

The failure to lodge on time (FTL) penalties were substantially increased to compel SGEs to comply with their CbCR obligations on time. Where the entity is an SGE the base penalty for late lodgement will be multiplied by 500. As a result, the minimum FTL penalty will start at $105,000 where the documentation is up to four weeks late, potentially reaching $525,000 where the entity is more than 16 weeks late. Importantly, the FTL penalties apply to all statements required from SGEs, including income tax and fringe benefits tax returns, business activity statements, CbCR and general purpose financial statements. However, administrative safe harbour provisions may protect SGEs where there is evidence that the SGE provided all relevant information to their tax agents and that due to their lack of reasonable care, there was

---

[49] KPMG, 'ATO Releases Country-by-Country Reporting Exemption Guidance' (2016) https://home.kpmg.com/au/en/home/insights/2016/09/ato-releases-country-by-country-reporting-exemption-guidance-27-september-2016.html.

[50] Commonwealth of Australia, 'Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017' (2017) *No. 27, Canberra: Commonwealth of Australia.*

[51] Commonwealth of Australia, 'Tax Integrity Package—Increasing Administrative Penalties for Significant Global Entities Measure' (2016) *Canberra: Commonwealth of Australia.*

[52] See Appendix 2 of this paper.

a false or misleading statement or a late lodgement penalty.[53] However, safe harbour provisions may not be argued where it is a case or reckless behaviour or intentional disregard of the law.

C. *Tax Auditing Risk Policy and Compliance Burden*

CbCR statements represent an important tool both for entities and for the ATO for the purposes of tax auditing risk policy. In its 'Guidance on Transfer Pricing Documentation and Country-by-Country Reporting' the OECD has advised that 'the specific content of the various documents reflects an effort to balance tax administration information needs, concerns about inappropriate use of the information, and the compliance costs and burdens imposed on businesses'.[54] As the three statements will contain a substantial amount of detailed information about the entire group's IRP dealings and allocation of income, the Australian entity will be able to identify and review those arrangements that may be regarded by the ATO as at 'high risk' of raising a transfer pricing benefit.

Much of the information to be utilised in assessing CbCR and transfer pricing risks will come from the data and documents provided in the local file, especially in the documents lodged in the local file Part B, due to the substantive overlap with the information required for the IDS Part A. Therefore, it is extremely important that SGEs keep their intercompany agreements up to date in order to correctly reflect the transactions that they formalise. Even though the ATO has indicated that it will not require SGEs to produce intercompany agreements solely for the purpose of substantiating IRP transactions in the local file, where such agreements did not previously exist the reporting entity must be able to provide enough documentation to substantiate the transaction as well as to evidence the observance of the arm's length principle. In view of this, it is of utmost importance that Australian reporting entities keep proper tax and accounting records, as well as proper records of their practices, processes, standards and evidence of any reviews thereof.

IV ACCOUNTING FOR COUNTRY – BY – COUNTRY REPORTING

As authoritative guidelines for reporting entities, the rules and requirements of CbCR can have certain implications for reporting entities' extant organisational arrangements. It is suggested that the issue of CbCR represents an important extension of corporate governance and corporate social reporting (CSR) by interfacing such requirements into a global tax forum.[55] In this context, corporate governance may be seen as limited to the disclosure of information to the shareholders of the company concerned and compliance with the requirements of regulatory bodies. CSR takes on a broader perspective by extending disclosure of information concerning

[53] Robin Woellner, Stephen Barkoczy and Shirley Murphy, 'Australian Taxation Law' (2016) *Sydney: Oxford University Press.*

[54] OECD, above n 16.

[55] Murphy, above n 9.

the company activities to the broader community.[56] However, CbCR extends the reporting domain to include global taxation obligations.

According to Johnston and Sadiq[57] 'tax reporting obligations are likely to become a crucial means of holding MNEs accountable to society, marking an important break with the previous movement for voluntary CSR'. As a result, mandatory tax transparency rules, such as the CbCR requirements, have developed a third pillar of corporate accountability extending on from corporate governance and CSR requirements. In response to the introduction and implementation of CbCR, SGEs will need to consider, generate and apply a range of effective and timely tax and accounting measures and processes to help support compliance with national and international tax authorities, and manage associated risks.

As there is no universal approach established to guide and prepare SGEs for CbCR, SGEs will need to plan for CbCR with respect to entity-specific needs and circumstances. Undoubtedly, this will require SGEs to take a proactive approach to various tax, accounting and accountability considerations and practices to prepare themselves for CbCR compliance with tax authorities. To prepare and safeguard themselves against these challenges, SGEs may need to review and adjust their interpretive schemes (strategies) and design archetypes (data management, risk management, governance and reporting structures) and all other CbCR compliance-related practices. The following sections discusses the significance of these considerations in preparing and adapting SGEs for CbCR.

A. *Global and Local Strategies for Country-by-Country Reporting*

The introduction of CbCR presents SGEs with both challenges and opportunities. SGEs can prepare themselves for CbCR compliance and any (un)anticipated challenges by developing flexible CbCR approaches and strategies.[58] A coordinated and consistent response strategy reflecting the interests of the reporting entities and the tax authorities is likely to generate greater benefits for SGEs.[59] Strategic frameworks developed at the SGE level with the input of the GPE and its subsidiaries can help determine appropriate reporting governance structures, provide greater reporting synergies among SGE groups, promote voluntary disclosure and dissemination of information across corporate reporting systems, and achieve a degree of standardisation in preparing and submitting CbC reports.[60] SGE level CbCR strategies can also facilitate revisions and adjustments to tax strategies and policies across the SGEs, leading to the (re)development of authentic and transparent tax structures and policies across entities, which may be effective in strengthening SGEs' corporate tax communication internally and

---

[56] Kenneth Arrow, 'Social Responsibility and Economic Efficiency' (1973) *Public Policy, 21 (3): 303–17.*

[57] Andrew Johnston and Kerrie Sadiq, 'Beyond Country-by-Country Reporting: A Modest Proposal to Enhance Corporate Accountability' (2017) 27(3) *New Zealand Universities Law Review 569–600.*

[58] KPMG, 'Country-by-Country Reporting. An EU Perspective' (2016) https://home.kpmg.com/content/dam/kpmg/pdf/2016/08/eu-tax-centre-cbcr-an-eu-perspective.pdf.

[59] KPMG, 'Country-by-Country Reporting: What's Your Strategy?' (2015) http://www.businessmirror.com.ph/country-by-country-reporting-whats-your-strategy/.

[60] KPMG, above n 59.

externally. SGEs' strategic responses to the introduction and implementation of CbCR may vary. For example, some SGEs have begun articulating the magnitude and complexity of CbCR requirements and in response are taking immediate action (i.e., diagnostic reviews and strategic planning) to evaluate their tax business policies and reporting structures in line with CbCR expectations[61]. However, preliminary results from a recent study by Sawyer and Sadiq[62] reveal that CbCR is not yet well understood by SGE clients of major accounting firms, with little comprehension of the magnitude of the influence that CbCR will have in their international dealings and in their businesses as a whole.

If SGE level CbCR strategies and approaches are not able to be established, then it is essential that local GPE and subsidiary level strategies are developed at local entity levels to help govern reporting entities. As mentioned earlier in this paper, an inability to comply with all reporting requirements may not only result in penalties, it can also have adverse effects on companies' public image and cause compliance burdens. Therefore, whether it is at the SGE or local GPE and subsidiary level, clearly defined strategies and approaches to CbCR will be a stepping-stone in preparing reporting entities for compliance and responding to possible risks and opportunities.

As part of strategic contemplations, SGEs will need to assess and determine how to treat certain items for CbCR, such as branches, minority investments, permanent establishments, joint ventures, and subpart F income.[63] The development of clear philosophies and strategies for CbCR at the SGE and local entity levels, combined with corporate values, will assist reporting entities' compliance with CbCR expectations. CbCR strategies can also support corporate reputation management through the consistency achieved in information disclosures and reporting across all SGE groups.[64] Planning and strategising for CbCR will be pivotal in preparing reporting entities for compliance without significant burdens and difficulties. Non-compliance may also be an obvious strategy for some entities. However, the financial and non-financial cost of non-compliance is likely to redirect SGEs to the correct path of planning and preparing for CbCR compliance.

B. *Governance and Reporting Structures*

The introduction and requirements of CbCR may require SGE boards to not only strategise, but also to reconsider their corporate governance structures and financial reporting arrangements. Incoherent or inappropriate structures and practices may inhibit SGEs from retrieving vital information and generating the reports required by CbCR. Governance structures and reporting systems tailored for CbCR will assist with the identification and assignment of CbCR-related responsibilities and accountabilities among the SGE group. The

[61] Ibid.

[62] Sawyer and Sadiq, above n 23.

[63] Deloitte, 'Tax Data Analytics and Country-by-Country Reporting. Insight to Action' (2016) https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-tax-data-analytics-and-country-by-country-reporting.pdf.

[64] KPMG, above n 59.

establishment of clearly defined reporting structures and systems will help facilitate the generation and gathering of the information required for CbCR in a timely manner. If explicit governance structures and reporting streams are not determined in advance, reporting entities may face certain difficulties or conflicts in retrieving data required to prepare their CbC reports. This may be the case if, for example, GPEs or certain subsidiaries are residing in countries that have not implemented CbCR or are delayed in doing so. In order to address these challenges, some SGEs have begun evaluating their existing information technology systems, data collection and aggregation processes, as well as their financial reporting systems by performing dry-run CbC reporting using data from previous years in preparation for the real reporting period and to determine how the CbC report will be received by tax authorities.[65]

Without the collaboration and support from the GPE and other subsidiaries, the reporting entity may encounter difficulties in gathering all required information and providing complete reports to its tax authorities. For instance, specific CbCR-relevant information may be omitted from the reports if the information resides with the GPE or another subsidiary in different realms and could not be retrieved and reported due to foreign jurisdiction privacy concerns or delays in information transfers. Regardless of whether GPEs or other subsidiaries are exempt from reporting, local reporting entities will still be required to supply the master file and local file to their tax authorities. A key question then arises as to who is accountable for producing and filing these reports.[66] Although the OECD recommends that all SGE groups file CbC related reports, if the GPE or a subsidiary operates in a jurisdiction where CbCR is not mandated then they may not be motivated to fulfil such requirements. In addition to the establishment of inter-subsidiary reporting and governance structures, reporting entities will also need to determine their own entity's reporting and governance structures. For instance, the reporting entity will need to consider who within their own organisation (i.e., senior managers, tax division, board of directors, middle managers) is responsible for generating and managing the information required for CbCR and preparing the CbC report.

In preparation for CbCR, SGEs should clearly assign roles, responsibilities and accountabilities among the GPE group to determine who is responsible for preparing and submitting the reports and files required by CbCR, and who will be liable if requirements are not met. Definition of roles and responsibilities will be effective for determining which group of the SGE will be exempt from submitting the CbC report and master file and ensuring that local files are prepared accurately and are consistent with the CbC report and master file. An inability to assign roles and clarify responsibilities may result in the omission of significant data and submission of incomplete reports to tax authorities.

C. *Managing Data*

The vast amount of information required for CbCR will necessitate the need for appropriate and efficient data collection and management systems and staff expertise for the generation, collection and aggregation of relevant data from multiple sources in a timely manner.

[65] Deloitte, above n 63; PwC, 'Country-by-Country Reporting: Countdown to Compliance' (2015), at https://www.pwc.com/gx/en/services/tax/transfer-pricing/country-by-country.html

[66] Deloitte, above n 63.

Developing and implementing consistent data management systems suitable for CbCR across all SGE groups will require time, effort and expertise. It can take six to nine months for an entity to implement a new centralised data collection process.[67] Therefore, SGEs and their professional advisors should assess their current data management system capabilities and perform data mapping to identify and determine if any changes will be required to enhance existing data collection systems or implement completely new ones. Entities should also assess their tax functions and perform local legal entity and jurisdiction mapping to ensure consistency of tax policies, approaches and reporting across cross-border operations. Inconsistencies in tax policies may result in the collection and reporting of inappropriate data, leading to the misinterpretation of reported data by tax authorities when local reports are exchanged among different jurisdictions and reconciled with the main CbC report.

To help compile the various information required for CbCR, a standardised (i.e., use of SharePoint, Excel or MS Office) and consolidated approach[68] across all entities can ease the burden of combining information from multiple groups and sources, especially if data is available across corporate systems. The development and implementation of joint reporting systems and adoption of the same definitions among SGE groups can help minimise the time involved in gathering and reporting information .[69] A centralised approach can ensure that all entities involved in collecting and reporting data have the same understanding of the parameters around the requested information. Potential misunderstandings or misinformation among entities may hinder the integrity and certainty of information collected and reported. Therefore, reporting entities should move from their current standalone processes to collecting and reporting local tax data and embrace data harmonisation[70] and aggregation at the SGE country level to ensure the consistency and integrity of reported data across all reporting SGE groups. They should also establish simple and routine approaches that can manage voluminous data and gather important information on a regular basis. For instance, Deloitte[71] suggests the integration of tax data analytics into entities' tax compliance systems to gauge CbCR readiness by assisting entities with the collection and interpretation of data and the prevention of data anomalies and unintended consequences. Effective and appropriate data management systems and processes will be vital to help alleviate the problems of preparing CbC reports and achieving greater synergies across all corporate entities reporting.

D. *Managing Risks and Exposures*

CbCR may give rise to certain compliance and reputational risks and exposures for reporting entities. CbCR will provide tax authorities with detailed and transparent financial information about SGE group operations and tax strategies. This information may lead to tax authorities undertaking high-level transfer pricing risk assessments, and assigning tax audit resources

[67] Deloitte, 'Country-by-Country Reporting. The FAQs' (2016) https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-country-by-country-reporting-faqs.pdf.

[68] Deloitte, above n 67.

[69] Nethercott and Gonzaga, above n 29.

[70] Deloitte, above n 63.

[71] Ibid.

accordingly.[72] The detection of any data anomalies, non-arm's length behaviour and high-level transfer pricing risk across entities may lead to tax authorities raising concerns[73] and wanting to interrogate the entity's transfer pricing and tax practices, which may lead to audits or more extensive compliance burdens for entities (i.e., adjusting transfer pricing methods).

A lack of risk management can be costly for SGEs, both financially and non-financially. Aside from incurring penalties and further costs, SGEs may risk damage to their reputation and competitive advantage.[74] Reporting entities can manage and mitigate (un)anticipated risks relating to CbCR by undertaking timely risk assessments and developing well-constructed tax risk management systems and frameworks across all SGE groups. For example, SGEs can identify and assess the impact of possible risks of CbCR by undertaking dry-run simulations using historic data.[75] Diagnostic review tools[76] can also help evaluate readiness for CbCR compliance and ability to respond to likely risks and opportunities. As part of these simulations, SGEs and their groups can determine whether their existing risk management frameworks are sufficient to track and manage CbCR-related risks.

The extensive requirements of CbCR may require the adoption of more advanced and proactive data analytic approaches,[77] and processes that can help detect and manage various risks. Analytical procedures can help determine the data required for the CbC report and provide precaution through the identification of possible tax outcomes and alternative strategies and approaches to CbCR. These deliberations, facilitated by analytical approaches, can help reporting entities detect data errors and anomalies in transfer pricing policies, and address CbCR-related risks prior to reporting.

E. *Compliance Costs*

Evers, Meier and Spengel[78] classify CbCR-related costs as direct and indirect. Direct costs relate to the tax compliance costs, such as outlays incurred for updating or adjusting extant data, financial reporting and IT systems and processes. They also relate to the ongoing preparation and reporting of CbC reports, as well as costs incurred for employing external tax expertise to undertake a diagnostic review of current systems and capabilities for CbCR and provide guidance on preparing CbC reports. On the other hand, indirect costs may emerge from the disclosure of corporate sensitive tax information, which may become public. Sawyer and Sadiq[79] suggest that CbCR may cause information overload for tax authorities, and, in turn, raise confidentiality and consistency issues in relation to the contents of local files across

[72] Ibid.

[73] Ibid.

[74] Maria Evers, Ina Meier and Christoph Spengel, 'Transparency in Financial Reporting: Is Country-by-Country Reporting Suitable to Combat International Profit Shifting?' (2014) 68(6/7) *Centre for European Economic Research 1–22.*

[75] Deloitte, above n 63.

[76] KPMG, above n 59.

[77] Deloitte, above n 63.

[78] Evers, Meier and Spengel, above n 74.

[79] Sawyer and Sadiq, above n 23.

different jurisdictions. If no legal protections are enforced by jurisdictions to ensure the confidentiality of local reporting entities reported information, the availability of commercially sensitive tax data to competitors may affect the competitive advantage of SGEs. The disclosure of tax payments by reporting entities in certain jurisdictions may also violate the principle of tax secrecy governed by tax law and may also give rise to double taxation for a reporting entity if relative tax authorities use the CbC reports to claim additional tax payments from the entity.[80]

Another potential indirect cost may be reputational costs. If reporting entities do not fully meet their CbCR requirements or if their CbC reports unveil information that leaves the entity's tax affairs under further scrutiny, then the entity may face reputational harm from tax authorities as well as the public. Therefore, to minimise direct and indirect compliance costs, it is essential for reporting SGEs to develop and implement proactive strategies, appropriate governance and tax structures, reporting systems and risk management frameworks that facilitate CbCR compliance and reduce (un)anticipated problems and costs.

Overall, SGEs will need to evaluate their organisations in the context of a new global tax environment, and to some extent, adapt their organisational arrangements to help prepare themselves for CbCR expectations and achieve compliance. A lack of consideration of the possible implications of CbCR on organisational interpretive schemes and design archetypes may threaten SGEs' ability to fulfil the demands of CbCR, and potentially lead to financial penalties and impairments to their reputation with various stakeholders, including legal tax authorities. An inability to comply with CbCR expectations and fulfil all reporting requirements may leave certain stakeholders questioning the credibility of SGE tax reporting.

V Overall Critique of Country – By – Country Reporting

From the above analysis, it can be seen that the CbCR issue is not only important from a tax perspective, but is also a reflection of the change in regulatory authorities and social perspectives at a local and global level arising from fiscal leakage. Furthermore, it should be seen as only part of the BEPS Action Plans designed to address the issue of BEPS.[81] While the implementation of such a policy can be viewed through a local prism, such as that in Australia, effective implementation is dependent upon global co-operation with the appropriate policies, as evidenced by the BEPS Action Plans, but also on an administrative process that is able to implement and monitor compliance. In this sense, and from an Australian perspective, the amendments to the ITAA97 contained in Subdivision 815-E may be seen as a welcome addition to the ATO's armoury in reducing fiscal leakage arising from international transactions that lack commercial substance. However, the practical outcome will be dependent on local compliance by the affected SGEs as well as the ability of the ATO to access information offshore by related parties where necessary. While at first instance this will rely on voluntary disclosure of information by Australian SGEs, in a global sense there may also be a need for the effective exchange of information through the multilateral exchange of information

[80] Evers, Meier, and Spengel, above n 74.

[81] OECD, above n 20.

between relevant overseas jurisdictions.[82] Without such an agreement, there is a concern that the appropriate information required under the CbCR provisions may not be obtained.

Australia has been actively involved in the BEPS project for some time and has been supportive of the recommendations contained in the BEPS Action Plans. The legislation contained in Subdivision 815-E ITAA97 very much mirrors Action Plan 13 outlined in the BEPS Action Plan. However, with the introduction of Subdivision 815-E there may be some concern as to whether various countries may introduce their own legislation, which may not be consistent with the BEPS Action Plan recommendations. A lack of consistency by way of information, disclosure requirements or operative and penalty provisions may undermine the effective operation of Action Plan 13 at a global level and reduce the effectiveness of any information exchange of information between countries. As a reflection of the above, some of the following issues arise with the Australian legislation relating to CbCR.

First, it is not clear whether there is a need for overseas financial statements to comply with Australian accounting standards. If overseas countries are compliant with International Financial Reporting Standards (IFRS) as released by the International Accounting Standards Board (IASB) there may not be a significant issue. However, in the case of entities affected by the CbCR rules (such as a corporate limited partnership, or where the taxpayer is a foreign resident operating a permanent establishment and did not lodge a general purpose financial statement [GPFS] with the Australian Securities and Investment Commission [ASIC], etc.), there may be a need to formalise information that is compliant.

Additionally, in the case of large multinational corporations the question arises as to whether the consolidated statements of the parent entity would be compliant. Given the earlier comments, it may be possible that such consolidated statements are not compliant. It is understood that that the ATO is seeking feedback on the issue. A main example of where such a difficulty would arise is in the situation where the parent entity is a company based in the US. As such, for reporting purposes in the US the entity would be required to adopt US Generally Accepted Accounting Principles (GAAP). As the US GAAP is not compliant with IFRS, such disclosures would not meet the requirements of the CbCR provisions in Subdivision 815-E ITAA97. If such an issue arises, there would be a significant cost in making such reports Australian compliant and this would raise the issue of penalties being imposed. While an immediate solution would be for the legislation to require disclosure-based non-IFRS compliant reports, the issue of US GAAP is a major issue. It is understood the ATO has indicated that as part of a transitional process for the first year SGEs may comply with their respective countries' accounting standards. However, this is not enshrined in any legislative process. In particular, a reason for the divergence between IFRS and US GAAP accounting standards is attributable to the fact that IFRS is largely principle based, whereas US GAAP is largely rule based. According to the American Institute of Certified Public Accountants,[83] some examples of where IFRS and US GAAP divergence occurs are in the following areas:

---

[82] OECD, 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS' (2017) http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm

[83] American Institute of Certified Public Accountants (AICPA), 'IFRS Resources' (2018) https://www.ifrs.com/overview/General/differences.html

1. Under US GAAP acquired intangible assets, such as goodwill, are recognised at fair value. However, under IFRS acquired intangible assets can only be recognised at fair value where the asset has future economic benefits that can be measured reliably.
2. Inventory: may be valued using Last In, First Out (LIFO) or First In, First Out (FIFO) for US GAAP purposes. However, under IFRS only FIFO may be used.
3. Where inventory is written down under IFRS, in certain situations the write-down can be reversed under IFRS in later periods. This is not possible under US GAAP.
4. Development costs: may be capitalised under IFRS where future economic benefits are assured, whereas under US GAAP they are expensed when they occur.
5. Fixed assets must be valued at cost under US GAAP, whereas IFRS allows entities to use cost or apply the revaluation model and adopt their fair value.

In relation to CbCR requirements, the ATO has indicated that the financial statements lodged with the ATO will not be required be to be audited. This is quite an anomaly. While it is a requirement that the CbCR financial statements must be compliant with Australian standards, there is no process to verify the veracity or integrity of the data other than through the penalty provisions relating to false and misleading statements. In an attempt to address some of these issues, the ATO has released the 'Law Companion Guideline 2015/3'[84] and the 'Country-by-Country Reporting Guidance'.[85] However, the guidelines contained in these documents do not fully address the matters raised above. Furthermore, it is a questionable outcome that uncertainty in legislation is addressed by the release of a law companion guideline, only part of which is designated as a public ruling (see Law Companion Guideline 2015/3, paragraphs 1–39). It can be seen from the discussion above that accounting for CbCR has become an issue of utmost importance (in spite of the relative unawareness of some SGEs) requiring a proactive approach and implementation of adequate CbCR compliance policies as a matter of prudent risk management[86].

The task of compliance with the provisions in Subdivision 815-E ITAA97 is onerous and time-consuming, especially where there are a number of overseas entities that may come within the scope of the provisions. In this respect, given the urgency of compliance with such statements, there is a degree of urgency to ensure affected companies are compliant and avoid any related penalties. Although it is the SGE's responsibility to ensure compliance, the question arises as to whether the entity will undertake this task, delegate it or outsource it to their professional advisor. Where such a task is delegated, it will be critical that the appropriate advisors and the

[84] Australian Taxation Office, 'Law Companion Ruling 2015/3' (2015) https://www.ato.gov.au/law/view/document?DocID=COG/LCG20153/NAT/ATO/00001&PiT=99991231235958

[85] Australian Taxation Office, 'Country by Country Reporting Guidance' (2018) https://www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/.

[86] Les Nethercott, 'Country-by-Country Reporting: A Paradigm Shift in Tax Compliance' (2017), *In The Black* https://www.intheblack.com/articles/2017/09/08/country-by-country-reporting-tax-compliance.

entity concerned have an engagement letter or formal process established to ensure the relevant financial information is documented in a timely and accurate manner.

On a broader and macro level, it may be argued that a failure by MNEs to implement an appropriate level of disclosure as required by CbCR may result in a substantial backlash from consumers and governments at both a local and global level. More recently, as the issue of BEPS and fiscal leakage has become more public there is increased scrutiny of large corporations concerning their cross-border transactions and the legitimacy of their operations. An example of this occurred in 2016 when Apple was ordered to pay €13 billion concerning cross-border transactions. Consequently, it is suggested that CbCR reporting is a necessary step in identifying and disclosing such transactions and that MNEs need to be aware of such changes and implement appropriate strategies and reporting functions to deal with their reporting requirements.

VI CONCLUSION

This paper has examined CbCR requirements according to the recent amendments to the Australian Income Tax Assessment Act 1997 and the tax and accounting implications arising from these for large multinational consolidated groups. The paper provides an analysis and discussion of the anticipated issues, challenges and opportunities of CbCR for Australian SGEs. With the release of the OECD Action Plan 13 concerning CbCR disclosure and the formalisation of the Australian requirements in Subdivision 815-E ITAA97, the local Australian and global environment has become much more aware of, and concerned by, fiscal leakage through BEPS, and there is a call for a cohesive and global effort to address the implementation of CbCR obligations. While an individual country may attempt to address the matter by implementing domestic legislation, caution is needed to ensure there is no fragmentation of the appropriate global policies as outlined in all of the BEPS Action Plans, and particularly in Action Plan 13. The reduction or elimination of global tax avoidance by BEPS can be supported through a global effort where taxpayers, tax authorities and government institutions work together for the ultimate purpose of increasing tax transparency and ensuring that the tax burden is fairly distributed among taxpayers. Without effective operation of the multilateral treaties on the exchange of CbCR information, reporting entities may place at risk the timely submission of reliable and accurate information to address the issue of BEPS. While CbCR obligations represent an opportunity to increase tax transparency and improve the risk assessment of SGEs, obeying such legislation may pose significant challenges to Australian SGEs and may represent an exposure to possible penalties for non-compliance.

In order to mitigate the potential challenges and penalties, Australian SGEs will need to consider their governance structures to ensure CbCR becomes established as an authoritative guideline for organisational and tax behaviour. This will require entities to reconsider their global and local entity-level strategies, systems, structures and procedures in response to this legislation to better equip themselves for compliance.

This paper has considered the anticipated issues that may affect the capacity of Australian SGEs to comply with their CbCR obligations and outlined the key tax and accounting considerations for SGEs to ensure and support compliance. As the first CbCR statements were due on 30 June 2018, future research can provide empirical evidence as to the extent to which

SGEs have responded to and managed the anticipated challenges during their CbCR compliance efforts.

VII APPENDICES

A. *Appendix 1: Outline of Transfer Pricing Documentation and Country-by-Country Reporting Statements*

Source: www.ato.gov.au

Transfer Pricing Documentation
Transfer Pricing Report (TPR): The TPR comprises a detailed analysis of the entity's international related party transactions, with clear identification of the arm's length conditions applicable to each relevant transaction and the comparable circumstances relevant to identifying the arm's length conditions, supported by a functional analysis and benchmarking study in accordance with the applicable transfer pricing methods.[87] Even though it is not mandatory to lodge a TPR, lodging it before lodgement of corporate tax returns[88] allows the reporting entity to establish a reasonably arguable position[89] and provides penalty protection. Having adequate transfer pricing documentation has become especially important in view of the recent substantial increase in the penalties for non-compliance with reporting obligations, in force from 1 July 2017.
International Dealings Schedule 'Part A' (IDS Part A): The IDS Part A is a mandatory part of Australian corporate entities' tax return where the taxpayer is engaged in international related party dealings above the threshold of A$ 2 million. It follows a questionnaire structure and provides information about the nature and size of a company's international related party dealings for the purposes of risk and materiality assessment; however, it does not require an analysis of the arm's length principle or the transfer pricing methods used by the taxpayer.
Country-by-Country Reporting Statements
Country-by-Country Report (CbC Report): The CbC Report follows the OECD recommended model. It is a statement relating to the SGE's global operations and activities, including its transfer pricing policies. This statement is to be prepared and lodged by the global parent entity in their own jurisdiction and must include data relating to all other members in the global group. In other words, the CbC Report is filed by the parent entity, but relies on information provided by its subsidiaries. Where there is an information exchange agreement between Australia and the global parent entity's country of jurisdiction, the CbC Report will be automatically be exchanged between tax authorities. However, if the global parent entity is based in a country that does not automatically exchange information with Australia, or if the global parent entity's country of residence does not have CbCR legal requirements, the Australian entity becomes responsible for lodging the CbC Report with the

87 Australian Taxation Office, 'Tax Ruling 98/11' (1998) https://www.ato.gov.au/law/view/document?DocID=TXR/TR9811/NAT/ATO/00001&PiT=99991231235958

88 Commonwealth of Australia, 'Tax Administration Act 1953' (1953).

89 Australian Taxation Office, 'Tax Ruling 2014/8' (2014) https://www.ato.gov.au/law/view/document?DocID=TXR/TR20148/NAT/ATO/00001

ATO. In this case, the Australian entity will electronically lodge the CbC Report using the OECD XML schema, separately from the local file and master file, which must be lodged using the XML schema designed by the ATO. Finally, if there are discrepancies in the reporting periods, the Australian entity is required to request a replacement of the reporting period.

Local File: The Australian local file is substantially different from the OECD recommended model both in relation to its format and in its content. As such, it will require careful preparation and attentive management by reporting entities.

The Australian local file follows a two-tier structure, which aims to facilitate compliance by entities with less complex transfer pricing affairs. The first tier comprises the 'short form local file', which is a simplified version of the 'full local file' and is available to reporting entities with few international intra-group transactions, provided they meet certain eligibility conditions. The short form local file must contain information on the reporting entity's organisational structure, including business strategies and restructures affecting the entity in the current or previous income year; the entity's management reporting hierarchy, indicating the countries to which local managers report; as well as a description of any transfers of intangibles in the current or previous year, and finally, a list of key competitors. However, because the eligibility conditions reflect very low materiality thresholds, in practice it is expected that very few reporting entities will be able to lodge the short form local file.

Reporting entities not eligible to lodge the short form local file will need to lodge a full local file. This will include all the information required in the short form local file plus two additional parts. In the local file 'Part A' the entity will disclose information regarding all controlled transactions for the relevant income year, including the names of the Australian and foreign counterparties (and their countries of residence), categories of transactions and the income and expenses associated with such transactions (including transactions of capital nature), the transfer pricing method (or capital asset pricing method) relied upon, and finally, the transfer pricing documentation code. The local file 'Part B' will further extend the information from Part A and will require that the reporting entity provides copies of all intercompany agreements underpinning all material international intra-group transactions, as well as any advance pricing agreements in relation to the Australian transactions and the general purpose financial statements.

The information required in the local file Part A is substantially similar (although with a much greater level of detail) to that required in the IDS Part A. Due to this relative overlap, the ATO authorises entities who voluntarily lodge the local file Part A together with their income tax returns to skip the majority of the questions of the IDS Part A. Where this is the case, the local file Part B must still be lodged by the relevant deadline.

Most importantly, SGE global management teams wishing to prepare their global CbCR statements based on the OECD templates will need to keep in mind the peculiarities of the Australian local file and make sure it is prepared in accordance with the Australian model, otherwise they could be at risk of failing to comply with the Australian CbCR requirements and therefore subject to heavy penalties.[90]

Master File: The master file will follow the OECD template and will provide information on the allocation of income between countries where the group operates, the activities of, and taxes paid by, the SGE parent entity and by the other members of the global group.

[90] PwC, above n 38.

Generally, the master file will be prepared by the foreign parent entity and the Australian entity will lodge a copy of it with the ATO, together with the local file. However, if the GPE is not mandated to prepare the master file, then the local reporting entity will be required to prepare and submit the master file and the local file.

In some cases, a temporary one-year exemption (concessional treatment) may apply to reporting entities meeting the following criteria:

The taxpayer has a foreign global parent entity; and

Neither the global parent entity nor any other entity in the group is required to prepare a master file prior to the due date in Australia; and

The reporting entity commits to providing the master file for the second reporting period.[91]

However, these cases are expected to be very limited, given that a significant number of OECD countries already have legislated CbCR obligations and in most cases, the deadlines recommended by the OECD are followed, just as they are in Australia.

[91] PwC, above n 40.

B. *Appendix 2: Outline of Recently Enacted Increased Penalties*

Source: www.ato.gov.au

Administrative Penalties (False or misleading statements resulting in tax shortfall)	Culpable behaviour		Former base penalty (% of shortfall/penalty units)		Current base penalty (% of shortfall/penalty units)	
	Making a false or misleading statement		25%, 50%, 75%		50%, 100%, 150%	
	Making a statement that treats a law as applying in a way that was not reasonably arguable		25%		50%	
	Failing to provide a document as required		75%		150%	
Administrative Penalties (False or misleading statements not resulting in shortfall)	Intentional disregard of the law		60 penalty units ($10,800)		120 penalty units ($25,200)	
	Reckless behaviour		40 penalty units ($7,200)		80 penalty units ($16,800)	
	No reasonable care		20 penalty units ($3,600)		40 penalty units ($8,400)	
Failure to Lodge on Time (FTL)	Days late	<28	29>56	57>84	85>112	112+
	Current large entity penalties	$900	$1,800	$2,700	$3,600	$4,500
	Large entity penalties (increased penalties)	$1,050	$2,100	$3,150	$4,200	$5,250
	SGE penalties (increased penalties)	$105,000	$210,000	$315,000	$420,000	$525,000