Executive summary

On 4 May 2017, the Organisation for Economic Co-operation and Development (OECD) provided an update on the exchange relationships to automatically exchange Country-by-Country (CbC) reports. Along with this update, the OECD released a clarifying note regarding local filing in Brazil and China (Local Filing Update).

Detailed discussion

Background

The OECD’s Base Erosion and Profit Shifting (BEPS) Action 13 calls for jurisdictions to implement CbC reporting for fiscal years commencing on or after 1 January 2016. As a general rule, CbC reports should be filed in the jurisdiction of tax residence of the ultimate parent entity (UPE) and shared between jurisdictions pursuant to the automatic exchange of information provisions under a multilateral or bilateral international agreement such as the multilateral Convention on Mutual Administrative Assistance in Tax Matters, a bilateral tax treaty, or a tax information exchange agreement (TIEA). In order to facilitate the implementation of CbC reports, the OECD included an implementation package as part of the final report on Action 13. The implementation package contains CbC reporting
model legislation and three competent authority agreements (CAAs) respectively based on (1) the Convention on Mutual Administrative Assistance in Tax Matters, (2) bilateral tax conventions and (3) TIEAs.

Exchange relationships
As noted above, the OECD implementation package includes model CAAs. In January 2016, the OECD opened for signature by interested parties the CbC MCAA for the automatic exchange of CbC reports.1 To date, this CbC MCAA has been signed by 57 jurisdictions. As part of the CbC MCAA, signatories shall provide a list of the jurisdictions of the competent authorities with respect to which they intend to have this agreement in effect (i.e., a list of their exchange relationships). When two jurisdictions have included themselves mutually in the list of exchange relationships, the relationship is activated. In contrast, some countries, e.g., the United States (US), will undertake bilateral CAAs based on existing double tax treaties or TIEAs.

On 4 May 2017, the OECD released the activated exchange relationships to date. Based on the information released, 30 jurisdictions have submitted their list of exchange relationships.2

Local filing
As a general rule, CbC reports should be filed in the jurisdiction of tax residence of the UPE. In addition, a jurisdiction may require the filing of a CbC report by the resident constituent entity that is not the UPE (referred to as local filing). Local filing may only be applied in three specific circumstances, namely:

1. The UPE of a multinational enterprise (MNE) group is not obligated to file a CbC report in its residence jurisdiction.
2. The residence jurisdiction of the UPE has a current international agreement (multilateral or bilateral tax convention or TIEA for the automatic exchange of tax information) with the residence jurisdiction of a constituent entity, but there is no qualifying CAA in place between the two jurisdictions by the end of 12 months following the end of the fiscal reporting year of the MNE group.
3. There has been a systemic failure to exchange CbC reports by the residence jurisdiction of the UPE, which has been notified to the constituent entity by the tax authority in its residence jurisdiction.

Local filing generally will not apply if the MNE group appoints a surrogate parent entity (SPE) to file on behalf of the group.3 The Local Filing Update also reiterates the core principles from the Action 13 Report that even where one of these conditions is met, local filing is not permitted where the residence jurisdiction of the constituent entity does not meet conditions of the minimum standard concerning consistency, confidentiality and the appropriate use of CbC reports.

In the Local Filing Update, it was noted that the OECD is working with jurisdictions in relation to the implementation of CbC reporting in order to provide certainty to groups which need to prepare for the filing of CbC reports by UPEs or SPEs, and avoid local filing wherever possible. It was further noted that jurisdictions that have the capacity to impose a local filing obligation on resident constituent entities that are not UPEs are keen to ensure that such resident constituent entities, where a UPE or SPE will file a CbC report by 31 December 2017, are not impacted by these local filing obligations.

Brazil
CbC reporting in Brazil applies to fiscal years commencing on or after 1 January 2016. The CbC report (either by a resident UPE, SPE or as a local filing) is required to be filed as part of the entity's corporate tax return (it will be “block W” of the electronic filing of the so-called ECF), meaning the first reports are scheduled to be due by 31 July 2017, though there is a possibility that this deadline will be postponed.

Brazil’s CbC regulations require resident constituent entities that are not UPEs to notify the tax authority in its ECF, of the identity and tax residence of the group’s reporting entity, whether UPE or SPE, and otherwise confirm that the local filing requirement in Brazil does not apply to the Brazilian resident entity. According to the Local Filing Update, a constituent entity resident in Brazil that wishes to avoid local filing must submit a notification by 31 July 2017, informing the Brazilian tax authority of the identity and tax residence of the group’s reporting entity, based on an initial assessment of whether the conditions for local filing are expected to be met by 31 December 2017. Where this notification subsequently proves to be incorrect, a resident constituent entity may submit an amended notification by 31 December 2017, or comply with local filing.

Thus, for example, according to this update, to the extent that the Brazil resident constituent entity is a member of an MNE group with a US UPE, that entity could, based on an
initial assessment that the UPE is expected to file the CbC report with the US tax authorities, and that the US and Brazil CAA is expected to be in place as of 31 December 2017, notify Brazil that the US UPE would be the CbC reporting entity. If this initial assessment proves to be incorrect, an amended notification or compliance with local filing would be accommodated.

As a practical matter though, the Brazilian regulations have not yet been updated to reflect these clarifications made by the OECD. Also, the software needed to submit the 2016 Brazilian ECF has not yet been released. It is expected, however, that further confirmation of the Local Filing Update would be released by the Brazilian tax authorities to acknowledge the changes that must be made to the domestic tax regulations, reporting systems and CbC notification requirements to take stock of the Local Filing Update from the OECD.

China

In China, CbC reporting similarly applies to fiscal years commencing on or after 1 January 2016. Resident UPEs are required to file their CbC report with their annual enterprise income tax return by the applicable deadline (i.e., 31 May following the reporting year).

Importantly, resident constituent entities that are not UPEs or SPEs are not automatically required to file CbC reports. Those entities may only be required by local tax offices to provide the CbC report during the course of a transfer pricing audit in the event that the MNE group meets the CbC reporting requirements in another country, the conditions for local filing as described above have been met and the Chinese tax authorities fail to receive such report through the information exchange process.

In the case of a Chinese constituent entity that is required to submit a CbC report during an audit, and the UPE or SPE has not yet filed a CbC report since the local rules in the UPE or SPE jurisdiction have a later filing deadline, the Chinese constituent entity should prepare written evidence to explain such reason and an extension will be granted to meet the local filing requirement in China.

Implications

The release of the activated exchange relationships provides greater clarity regarding which countries will be automatically exchanging and receiving CbC reports. This should assist MNE groups in determining which countries may require local filing.

The Local Filing Update with respect to Brazil and China is an important policy development and clarifies that these countries are keen to ensure that constituent entities resident in those jurisdictions are not impacted by these local filing obligations where a UPE or SPE will file a CbC report by 31 December 2017 in the jurisdiction where the UPE or SPE is resident.

Although this is an important development, as noted, as a practical matter, changes will be necessary to the domestic filing requirements in Brazil in order to accommodate the notification requirements and the ability to amend those notifications if the initial assessment of CbC reporting obligations by the MNE group proves to be incorrect. It will be important for business to monitor additional comments from the Brazilian and Chinese tax competent authorities with respect to the Local Reporting Update. Moreover, as more countries implement CbC reporting consistent with Action 13, business should also keep abreast of new reporting requirements and how countries implement these new rules.

Endnotes


2. A detailed Alert is forthcoming.

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