



Nº03/17

POSTPONEMENT OF COUNTRY-BY-COUNTRY REPORTING AND (POTENTIAL) UNCONSTITUTIONALITY

BACKGROUND AND FRAMEWORK

This note concerns Country-by-Country Reporting ("CbCR"), particularly the Portuguese regime, the postponement of reporting duties, potential legal changes due to the EU Directive regarding CbCR and, lastly, the recent decision by the French Conseil Constitutionnel that decided for the unconstitutionality of the public part of the French CbCR regime. Such public nature of CbCR is also being pursued by the European Union.

This regime is one of many pieces being put in place in favour of tax transparency but its public format has now encountered a substantial obstacle regarding its proportionality.

The Portuguese National Budget for 2016 introduced CbCR in Portugal. This regime entered into force in fiscal year 2016 and, although the deadline for the first reporting obligation was set on 31 December 2016, the Portuguese Government has decided to prolong the deadline until 31 May 2017 (Despacho n.º 254/2016-XXI). As explained below, this deadline practically coincides with the entry into force of the EU Directive regarding CbCR.



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The CbCR regime was originally developed in the G20/OCDE Base Erosion and Profit Shifting (“BEPS”) project, namely Action 13, regarding transfer pricing documentation and country-by-country reporting. The Portuguese regime is essentially based on the guidelines set therein. In parallel, the European Commission has been putting energy into the Action Plan on Corporate Taxation (June 2015) and Anti Tax Avoidance Package (January 2016), which also address CbCR and, in general, tax transparency.

Indeed, work within the European Union led to the introduction of EU Directive 2016/881 from the Council, from 25 May 2016, which changes Directive 2011/16/UE regarding automatic exchange of information in tax matters. This Directive deals, only, with non-public CbCR and it is meant to enable the automatic exchange of Country-by-Country Reports.

Yet another Directive has been proposed and is currently under discussion (COM(2016) 198 final 2016/0107(COD)). This other Directive seeks to introduce a public CbCR regime and, with that in mind, proposes to change Directive 2013/34/UE with respect to the publication of information regarding income taxation for certain enterprises and their subsidiaries.

With respect to the already approved Directive (EU) 2016/881, Member States have until 4 June 2017 to implement or adapt their domestic legislation accordingly. The Directive's provisions are enter in force and are applicable after 5 June 2017. The need to adapt the domestic legislation is one of the reasons for the postponement of the obligation to deliver all the required documentation.

THE COUNTRY-BY-COUNTRY REPORTING (CbCR) REGIME

The Portuguese CbCR regime determines that a set of entities must communicate financial and fiscal information to the Portuguese tax authorities.

In general terms, this obligation applies to Multinational Enterprises that fulfil certain requirements:

COVERED ENTITIES (CUMULATIVE REQUIREMENTS)

- Have direct or indirect control over corporations located in other jurisdictions or having permanent establishments therein;
- Required to prepare consolidated financial statements;
- Consolidated income \geq € 750.000.000 in the last fiscal period; and
- Not controlled by another Portuguese entity that falls in the scope of CbCR or by a foreign entity that falls in the scope of a CbCR regime in a country with which exchange of information mechanisms are available.

ADDITIONAL COVERED ENTITIES (CUMULATIVE REQUIREMENTS)

- Is directly or indirectly controlled by a non-resident group entity that is not required to submit CbCR reports in that country or exchange of information mechanisms are not available;
- The controlling entity would be encompassed by the CbCR regime if they were Portuguese tax residents; and
- Do not prove that another group entity, resident in Portugal or in a country where exchange of information mechanisms are



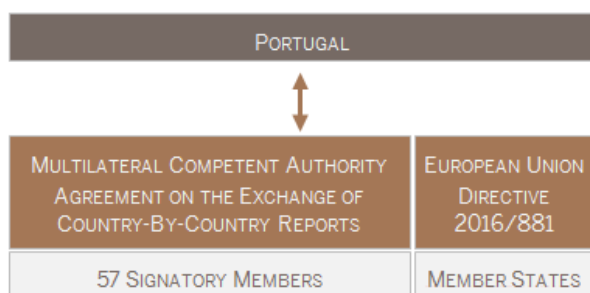
available, was designated as the reporting entity.

The CbCR regime requires the reporting of information regarding the multiple tax jurisdictions where the group entities are active. That information displays details about the economic activity and role assumed by each entity, their profits and losses, tangible assets, income tax paid and number of employees.

It is relevant to note that CbCR is merely one of the clockwork pieces relating to transfer pricing documentation. BEPS Action 13 adopted a self-designated three level approach, which requires three kinds of documentation outputs: a Master File, a Local File and Country-by-Country Reports. The OECD clarifies that Country-by-Country Reports will allow, in particular, to a better risk assessment related to transfer pricing.

Failure to submit Country-by-Country reports before their due date is subject to penalties up to € 10.000.

AUTOMATIC EXCHANGE OF COUNTRY-BY-COUNTRY REPORTS



Seeking an effective implementation of these reports, the OECD promoted the conclusion of a Multilateral Competent Authority Agreement on the Exchange of Country-By-Country Reports (57 Signatory Members as of 26

January 2017). Portugal is a signatory member and these type of agreements is covered by the Convention on Mutual Administrative Assistance in Tax Matters, which itself has 107 signatory members.

The European Union Directive 2016/881 harmonizes CbCR across its Member States and introduces the obligation of exchanging financial and fiscal information between tax authorities of EU Member States (all of which are also signatory members of the above-mentioned multilateral agreement). This means that not only will the Portuguese tax authorities automatically send, but also automatically receive financial and fiscal information about the covered entities.

PUBLIC CbCR AND THE FRENCH *CONSEIL CONSTITUTIONNEL*'S UNCONSTITUTIONALITY RULING

Early on, during the discussion phase of Action 13's BEPS Report, CbCR stakeholders expressed concerns regarding its public nature the potential non-confidentiality or confidentiality breaches, as well as the need to secure and protect sensitive business information from their competitor's eyes. An example of these concerns was reproduced in the *Factual Summary of the responses to the public consultation on assessing the potential for further transparency on corporate income taxes* (Q10 and Q17) – a preparatory document published on 20 January 2016 regarding the EU Directive on Public CbCR.

Public CbCR, if implemented, would lead to the collection and communication of financial and fiscal information (as described above), but, now, with broader (and public) publishing. Paraphrasing the European Commissions' Explanatory Memorandum in the proposed Directive: *"The consolidated report on income*



tax information will be published in a business register with the objective of ensuring certainty and availability over time. Moreover, as the objective of this initiative is to enable public scrutiny, those reports will also be made accessible to the public on company websites. To allow for comparisons over time, reports will remain accessible for at least five consecutive years on the websites”.

Despite the seemingly obvious relation to taxation, the European Commission is reportedly seeking to relate the Directive to company and internal market matters, as that would allow the Directive’s approval to not require unanimity among the EU Member States, which is required in tax matters.

The *Conseil Constitutionnel*, in its decision from 8 December 2016, declared that, in general, the law proposal regarding “*transparency, fight against corruption, and a modernization of economic activity*” does not conflict with the French Constitution. Its goal is to reinforce procedural transparency in public decisions, as well as to more severely and swiftly repress corruption. However, the *Conseil* objected certain provisions regarding Country-by-Country Reporting (among other provisions).

Extending previous jurisprudence, the *Conseil* considered that the obligation imposed on some corporations of making public (freely accessible by all on the internet) of country-by-country economic and fiscal indicators may allow all the economic operators active in the concerned markets, particularly those corporations’ competitors, to identify essential elements regarding industrial and commercial strategy. Against this background, the *Conseil* ruled that the public CbCR regime amounted to a disproportionate restriction to

entrepreneurial freedom and, thus, unconstitutional. The “*liberté d’entreprendre*” is based on the “*Déclaration des droits de l’Homme et du citoyen*” from 1789 – a text that bears constitutional value in the French jurisdiction.

The Portuguese Constitution also addresses the entrepreneurial freedom (“*liberdade de iniciativa económica e privada*”), classifying it as a fundamental right. As it has been recognized by scholars and the Constitutional Court, this freedom has two dimensions: one related to the freedom to start a economic activity, and another related to the freedom of structuring, managing and to pursue a certain activity by that corporation.

In abstract, this argument may also carry weight in Portugal if a public CbCR is ever introduced, either spontaneously by the Portuguese legislator or due to a European Union Directive. The latter is currently being considered.

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