Tax Risk Assessment
Using CbC Report

Third Annual Developing Country Forum
South South Cooperation in International Tax Matters
9-10 Dec,2019

Directorate of Risk Assessment, CBDT, New Delhi

CbC Report as a tool for Risk Assessment

- Developing countries generally have higher tax rates and are prone to BEPS.

- Large MNEs need to file CbCRs which include detailed financial and tax information relating to the global allocation of their income and taxes, among other indicators of location of economic activity within the group.

- It helps to identify, on a larger scale, the jurisdictions where profits are generated, value is added, and risk is taken.

- The reporting reveal important indictors of where tax risk may exit.

Indian Experience with CbCR Reporting

- India's CbCR provisions have been applicable with effect from 1st April 2016

- So far India has received CbC Reports for FY2016-17 & 2017-18

- The Outbound CbCRs are nearly 200 whereas the Inbound are about 1200

- Reports have been received from around 50 countries and encompass more than 100 jurisdictions

- There have not been much data quality issues with the outbound CbCRs

Issues with Inbound CbC Data

- Repetition of same jurisdiction in one table
- Use of multiple currencies
- Essential data element like RE names missing
- Language not English
- Truncated values used
- Abnormal values in some fields
- Mismatch of jurisdictions between table 1 and table 2

Data Processing Steps

- Data Extraction pertaining to one FY for comparison
- Applying correction and deletion in Account Reports
- Conversion of currency to INR
- Impute CE PAN where PAN is not reported
- Removal of detected defects and anomalies before risk assessment
- Standardization of values

Risk Assessment prior to CbC Reporting

- Local File – 3CEB – Reporting of International transactions with associated enterprises

- ITR and 3CEB report give perspective of transactions from India and lack global perspective

- Risk assessment rules are applied on the various transactions undertaken by the taxpayer with associated enterprises

- Rules do note take BEPS angle into consideration – focuses only on Arm's length pricing of the transactions

Major Risk Indicators

- Revenue per unit of economic activity(employees or assets) is large
- Jurisdiction with significant profit but little substantial activity
- Jurisdiction with significant profit but low levels of tax accrued i.e., Low effective tax rate
- Significant profit derived mostly from related party transactions
- High proportion of Related Party Revenues in a particular jurisdiction
- Profitability lower than as a group as a whole
- The group discloses Stateless Revenues
- The jurisdiction has adversely low cost base
- Return on equity is high
- The jurisdiction having IP separated from related activities
- Business re-organisation

Key Ratios for Macro Risk Assessment

- High Net Profit rate (NPR) – PBIT/Total revenues
- Low Effective Tax Rate (ETR) – Income tax accrued/PBIT
- Large revenue per unit economic activity–
  - Total revenue/number of employees is high
  - Total Revenue/ Tangible assets is high
- High proportion of Related Party Revenue to Total Revenue in a jurisdiction or across jurisdictions
- High return on equity- PBIT-Tax Accrued/Stated Capital
- Low Cost Base – Net Profit Rate is high; low expenses

New Risk Assessment Approach

- Identification of foreign MNE groups with large revenue footprint in India based on inbound CbCR data

- Compound rules (using key ratios) are formulated to identify
  - **High Risk Jurisdictions** of each MNE Group
  - **High Risk MNEs**

- Identify Indian CE of the same MNE Group which may pose BEPS risk by using other data sets
  - Income Tax Return
  - 3CEB (Report from CA to be furnished u/s 92E of the IT Act)
  - 15CC (Quarterly Statement to be furnished by an Authorised Dealer)
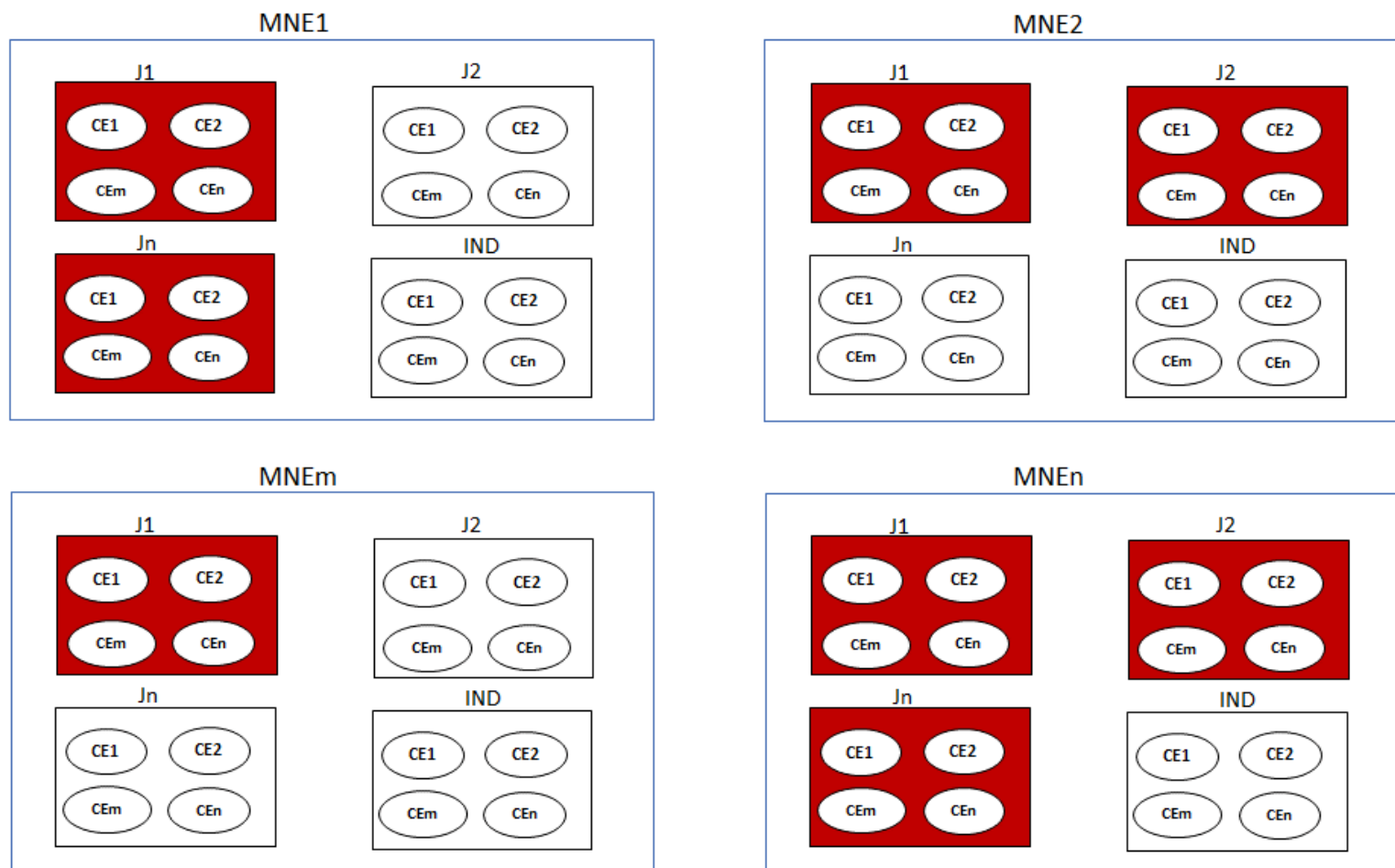 - 15CA/CB(Information to be furnished for payment to Non-resident)

Risk Assessment Framework (1)
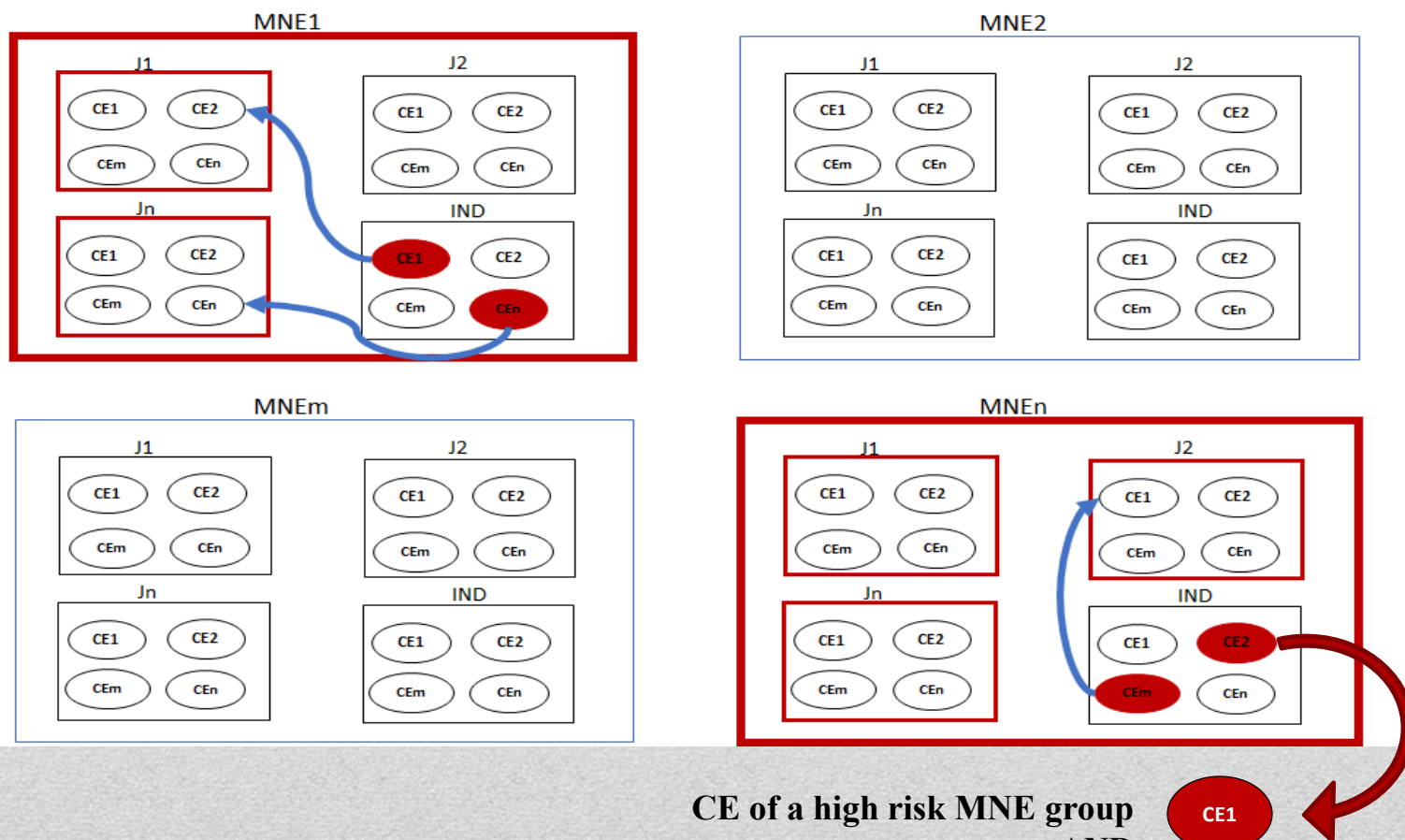

Reported CbCR Data
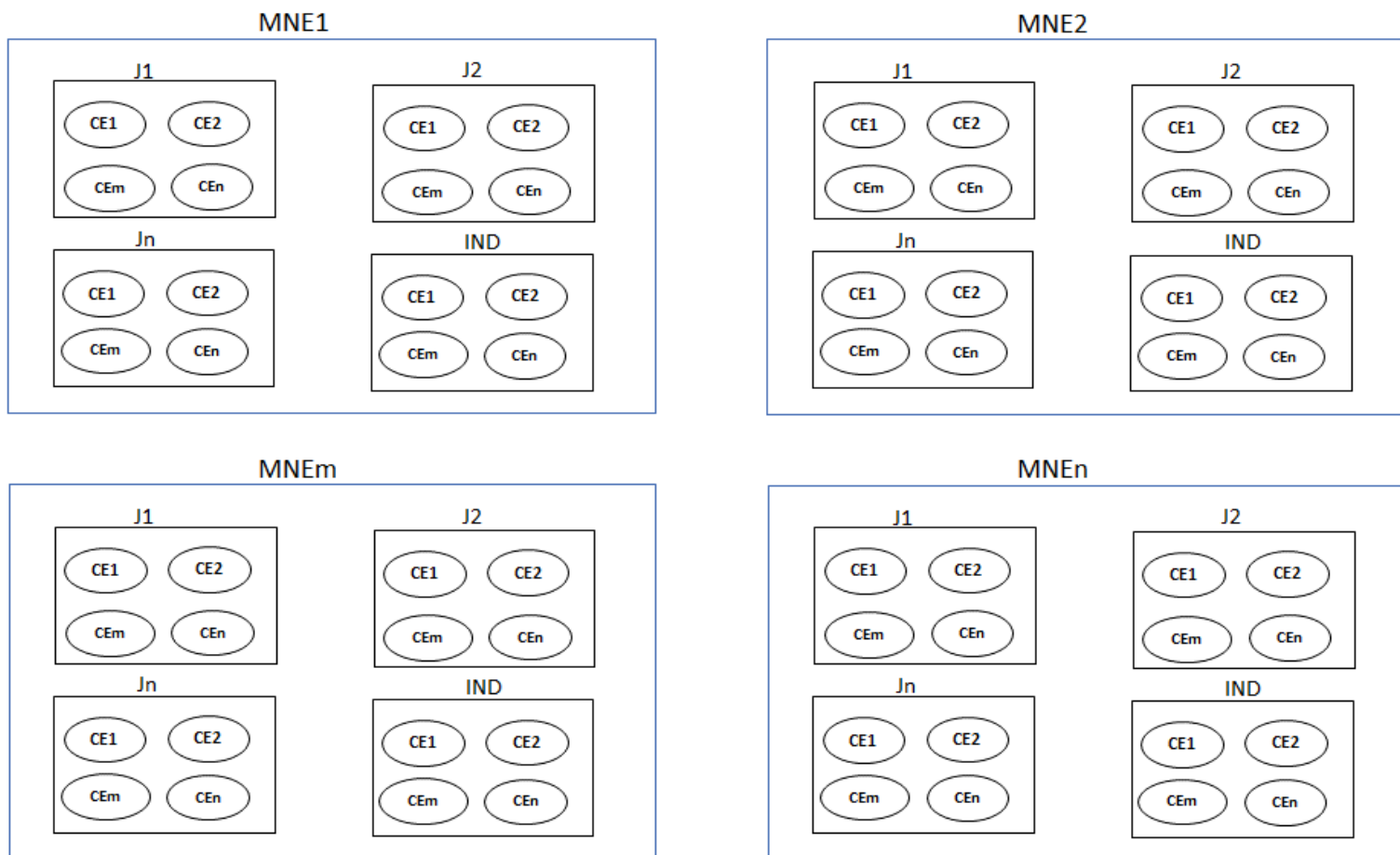
Risk Assessment Framework (2)

Identification of High Risk Jurisdiction w.r.t. each MNE

Risk Assessment Framework (3)
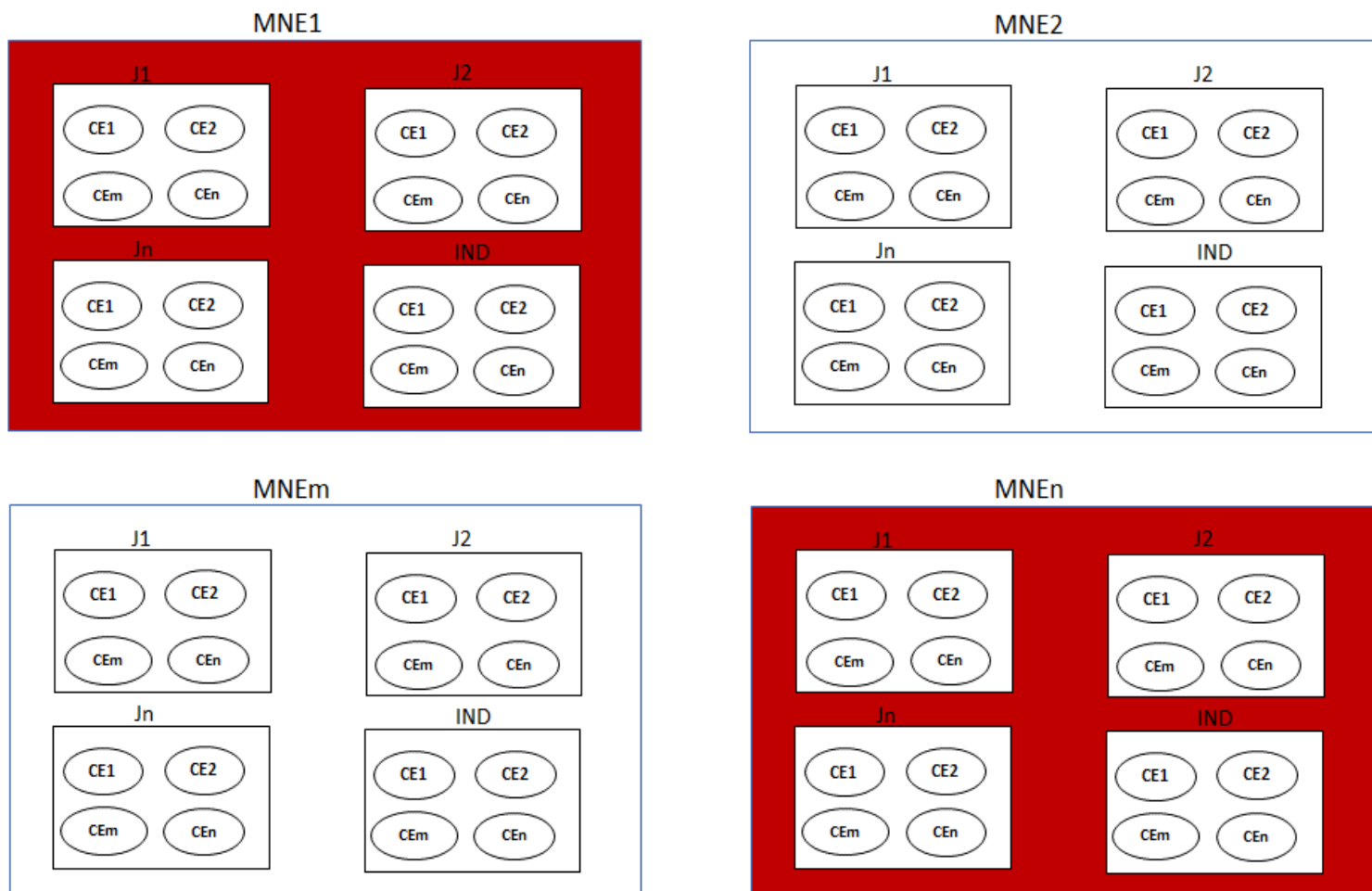

Identification of High Risk Indian CEs

CE of a high risk MNE group
AND
Transaction with high risk jurisdiction (15CC/3CEB) > X amount

Risk Assessment Framework (3)

Identification of High Risk MNE

Effectiveness of Selection Process

- 2019 was the first year in which selection of cases for TP Audit has been made using CbCRs.

- It is premature to comment on effectiveness of the selection process at this stage.

- The new approach using CbCR is expected to yield qualitatively better selection of cases for TP audit than using local file to flag cases.

Thanks !

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