



HM Treasury

Capital Requirements Directive 4:

summary of responses on country-
by-country reporting



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1

Introduction and next steps

Background

1.1 Article 89 of the Capital Requirements Directive 4 (CRD4) requires institutions to disclose: their name, the nature of their activities and geographic location, number of employees, and their turnover on a country-by-country basis on 1 July 2014. Global systemically important institutions will also be required to disclose to the European Commission their pre-tax profit or loss, their taxes paid and any public subsidies received. Subject to the Commission's impact assessment, all firms will be required to disclose the latter items from 2015 onwards on an annual basis. Since the country-by-country reporting (CBCR) requirements are provided by an EU Directive, the UK must transpose them into national law.

1.2 On 20 September the Government launched a consultation on its proposed approach to implementing the CBCR requirements into UK law.

1.3 The Government received 25 responses to the consultation, from both individuals and interested organisations. A list of the organisations that responded is provided in Annex A.

1.4 The aim of this document is to summarise the responses received, and to set out the Government's response. The Government is grateful to all those who contributed their views during the consultation process.

Aim of the consultation

1.5 The consultation set out the Government's initial approach for implementing the CBCR rules in CRD4. It aimed to gather views from stakeholders to ensure that the final approach taken will result in domestic legislation that meets the aims of the EU provision in a proportionate way, and is compatible with the Government's obligations to properly transpose the Directive.

1.6 Chapters 2 to 7 summarise the responses received to the questions posed in the consultation document, together with the Government's response.

Next steps

1.7 The Government has carefully considered all of the responses to the consultation and used them to inform the drafting of the legislation and accompanying guidance. These documents have been published alongside this Consultation Response Document and are subject to a one week final consultation. The Government's intention is for the Regulation to be made in December 2013.

2

Institutions in scope

Introduction

2.1 One of the key policy questions to be addressed is which institutions must comply with the CBCR requirement. This chapter addresses the questions posed in the consultation concerning the scope of the requirements.

Question 1: Do respondents believe that it would be proportionate to apply the CBCR rules to all institutions captured by CRD4? If not, please describe what specific difficulties arise for particular categories of firms, and what approach you believe would be more proportionate whilst complying with Article 89.

Question 2: Do respondents agree that the CBCR requirement should apply equally to UK subsidiaries and to UK branches of institutions which are established in third countries?

Summary of responses

2.2 Many respondents argued that applying the CBCR provisions to all the institutions within scope of CRD4 would place a disproportionate burden on smaller institutions, specifically a number of respondents suggested that requiring institutions that did not operate outside of the UK to report would be meaningless and others suggested that smaller investment firms should be exempt from the CBCR provisions.

2.3 A number of other respondents suggested that to be effective all institutions should be covered by the CBCR provisions; specifically one respondent suggested that smaller institutions could still aggressively avoid payment of tax.

2.4 A large majority of respondents agreed that the provisions should apply to UK subsidiaries of institutions established in a third country, however a small majority did not believe that branches of institutions located in a third country should be captured. A range of reasons were given for this including the fact that third country branches are not covered by CRD4 and the operational difficulties in requiring branches to report on a standalone basis. Other respondents asked that it should be clarified that only branches of credit institutions and investment firms would be required to report.

Government's position

2.5 The Government believes that the CBCR requirements have a natural element of proportionality due to the fact that larger multinational institutions will have more data to gather and this would also lead to a relatively larger reporting burden. Smaller institutions that operate purely domestically will already have most of the relevant data in their annual reports. Therefore, the Government does not believe that the burden on smaller institutions will be significant and disproportionate.

2.6 Furthermore, exempting small institutions would be a clear breach of our obligation to properly transpose the Directive. Given that the costs of disclosure are naturally proportional to the size and complexity of the institution, the Government intends to apply the CBCR requirements to all institutions in scope of CRD4.

2.7 Given the disproportionate burden on third country branches and the fact that branches themselves are not considered “institutions” under CRD4, the Government believes they should not be included in the scope of CBCR.

3

Consolidation

Introduction

3.1 Article 89 requires disclosure of the relevant information “on a consolidated basis” by country in which it has an establishment. This chapter addresses the questions posed in the consultation concerning the appropriate approach to consolidation.

Question 3: Which approach to consolidation (prudential or IFRS accounting) do respondents believe is more appropriate?

Question 4: Do respondents believe the above approach for reflecting consolidation adjustments is satisfactory? If not, please describe an approach that you believe would be more suitable.

Summary of responses

3.2 The majority of respondents indicated a preference for an accounting consolidation (either IFRS or UK GAAP) approach. They argued that accounting consolidation systems are able to provide aggregate accounting derived data more easily. They also argued that this will better meet the expectations of external users with some arguing that a prudential consolidation would provide a meaningless disclosure.

3.3 However, many respondents suggested that institutions should be permitted to choose which approach best fits their business structure (with a select few arguing for prudential consolidation outright). They argued that prudential consolidation would be particularly relevant for groups that are not in scope of CRD4 but have one institution that is within the scope and therefore an accounting consolidation of the whole group would capture entities not intended for by the legislation. Hence, allowing a choice of which approach to use would provide institutions with flexibility to choose the approach that best suits their organisational structure.

3.4 In response to question 4, a small number agreed with the proposal, providing institutions have flexibility around the format of the reconciliation to be provided. A number of respondents considered it important that they should be allowed to provide a narrative discussion, including the basis of preparation of the disclosure, to ensure the numbers are not misunderstood and to explain how, if at all, consolidation adjustments give rise to tax liabilities within legal entities’ tax computations. The general tenor of other responses was to avoid prescription and permit flexibility.

3.5 A significant number of respondents drew attention to the distinction between a top parent company’s ‘consolidation approach’ (whether under IFRS or another GAAP framework) and a ‘disaggregation approach’ based upon local GAAP. Most of these commentators focused on the distinct categories of consolidation adjustments that arise under the former approach and therefore some of the practical difficulties and challenges that would be encountered in providing the reconciliation proposed in the consultation. Some of these respondents disagreed with reconciling local GAAP figures to group consolidated accounts under IFRS; and, argued

that this would create considerable difficulty, imposing significant and onerous resource constraints, disproportionate to the benefits.

3.6 There was, in view of these practical issues, a strong consensus that it would be better to provide for reporting by a top parent company to be based on its existing consolidated accounts and systems, and in particular by reference to group GAAP, thus using a consistent basis of reporting throughout the disclosures. On this basis, it would nonetheless be important and necessary to attribute consolidation adjustments on some reasonable basis to different countries; to do otherwise would run the risk of undermining the usefulness of the information. Residual consolidation adjustments (for example, to eliminate inter-company transactions between countries) would appear in the overall 'consolidation adjustments' column in order to reconcile with published consolidated figures. However, the disclosure would be compiled on the basis of group GAAP and there would be no need to reconcile with local GAAP.

3.7 In respect of the proposal to provide the reconciliation, over half the responses pointed to an additional reporting (and hence cost, including additional audit cost) burden compared with existing reporting requirements for a significant number of institutions within the scope of the measure, pointing to 'gold plating' and cost; it was pointed out by some of these commentators that Article 89 requires no such reconciliation (this was acknowledged in the consultation).

Government's position

3.8 A large majority of respondents agreed that the Government should, where possible, attempt to ensure the implementation of Article 89 is consistent with the approach adopted by other countries. The majority of Member States we have liaised with have indicated an initial preference for an accounting consolidation. Given the Government's preference for consistency, and the fact that the majority of respondents to the consultation preferred an accounting consolidation, we have decided to pursue the accounting consolidation approach.

3.9 Whilst the Government is committed to taking an approach which is most proportionate, we believe allowing a choice between a prudential consolidation or accounting consolidation could undermine the consistency and value of the disclosure.

3.10 However, it is not the Government's intention to capture institutions that are not in scope of CRD4. Therefore, the Government intends to require institutions to use an accounting consolidation approach in relation to itself and any subsidiaries/branches it has. This will ensure that groups that only possess a small minority of institutions in scope of CRD4 will not be required to disclose for institutions that are not in scope. Although, given that many groups will consist primarily of institutions in scope of CRD4, institutions will be permitted to consolidate at a parent level (including the holding company level) if in practice this makes compliance easier.

3.11 The Government believes this approach will ensure consistency across Member States and provide a meaningful disclosure in a proportionate manner.

3.12 Furthermore, the Government welcomes the contributions made in pointing out some of the practical difficulties with what was proposed in the consultation and is therefore minded to permit, where relevant, the reconciliation to be compiled on a group 'consolidation approach' (rather than to require it) and not require it to be reconciled with local GAAP. The Government also agrees that reporting entities should have as much flexibility as possible in providing the requisite information and additional narrative disclosure which is consistent with achieving the objectives of the Directive.

4

Establishment

4.1 Article 89 (1) requires disclosures to be made by each institution in respect of each country in which it has “an establishment”. The term “establishment” is not defined within either the CRR or CRD4. This chapter addresses the question posed in the consultation concerning the appropriate definition of the term “establishment”.

Question 5: Do respondents agree that the appropriate definition of the term “establishment” in this context should be both subsidiary and branch?

Summary of responses

4.2 Whilst some respondents suggested that only subsidiaries of institutions should be classed as establishments, a clear majority agreed that the definition of establishment should capture both branches and subsidiaries.

Government’s position

4.3 Both branches and subsidiaries are important locations of business for institutions. In light of this and the responses to the consultation the Government believes defining establishments as subsidiaries and branches or institutions is appropriate.

5

Reporting

Introduction

5.1 This chapter addresses the questions posed in the consultation concerning the format, location and timing of the disclosures, as well as the auditing requirements.

Question 6: Do respondents think there should be a standard template for disclosures?

Question 7: Do respondents agree with the above approach? **If not, please describe an approach that you believe would be more suitable.**

Question 8: Can respondents identify any serious impediments to institutions reporting the relevant information by 1 July 2014?

Question 9: Do these auditing requirements pose any difficulties?

Summary of responses

5.2 The vast majority of respondents disagreed with the need for a standard template with only one respondent supporting a standard template for disclosures. Whilst the majority of respondents agreed that a template may aid comparability, they argued that it may lead to reduced transparency as it leaves institutions with minimal scope to deal with their specific circumstances in the most informative way. Furthermore, many respondents pointed out that a standard template would be unnecessary given that there are only six items to be disclosed and may encourage a checklist approach.

5.3 Question 7 relates to institutions being permitted to disclose on a website where it is not possible to publish the information as an annex to companies' annual financial statements. Nearly all respondents preferred being able to disclose the information on a website explaining that it would be congruent with the streamlining of the information within the annual report and argued that website publication will be more accessible.

5.4 Many respondents stressed that allowing for website publication would relieve some of the timing pressure on institutions (covered in the responses to questions 8 and 9).

5.5 One respondent raised concerns surrounding fees for downloading accounts from Companies House and therefore suggested that the disclosure should be required both on the institution's website as well in its annual report (or provide soft copies free of charge at the public's request).

5.6 Many respondents indicated concerns surrounding the first year of reporting particularly if they had a March or June year-end. They argued that as a result of these year-ends, accounts will not have been audited by 1 July 2014 therefore making compliance impracticable.

5.7 Practically all respondents indicated concerns with the auditing requirements, with many citing the concerns around timing mentioned above. Furthermore, they added that the first reporting period could require a separate audit which could result in disproportionate costs.

5.8 The majority of respondents suggested that it would better serve the purposes of the legislation to have a separate assurance engagement as opposed to including it in a statutory audit. Some pointed out that Article 89 does not suggest that the CBCR disclosure should form part of the statutory financial statements and therefore they should not be within the scope of the auditor's opinion on the statutory financial statements. Furthermore, they argued that financial statements are already criticised by some for including too much disclosure that may not necessarily be relevant for their purpose i.e. to enable investors to make economic decisions. However, some respondents indicated a preference for including the disclosure in the scope of the statutory audit.

5.9 A few respondents suggested that an alternative to a statutory audit, relevant in the context of CBCR, would be a report prepared under the International Standard on Assurance Engagements ('ISAE') 3000 Assurance Engagements Other Than Audits or Reviews of Historical Financial Information which would give the user a similar level of comfort to a statutory audit.

5.10 Many respondents also raised concerns about the materiality measure proposed suggesting that an IFRS level of materiality may not be in proportion to the relatively granular CBCR information. However, a few respondents supported the IFRS approach to materiality.

Government's position

5.11 In light of the responses and the Government's commitment to ensuring a meaningful disclosure, the Government has decided not to produce a standard template. The Government will instead focus on providing common definitions, including those set out in chapter 6, which allows for consistency without encouraging a checklist approach.

5.12 In relation to the latter questions, the Government recognises that CRD4 captures a broad spectrum of institutions and hence the Government believes that type of assurance engagement an institution would apply necessarily depends on its particular circumstances. Therefore, the Government intends to require institutions to use the International Framework for Assurance Engagements in deciding which assurance engagement is appropriate. This Framework defines and describes the elements and objectives of an assurance engagement, and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply.

5.13 This could result in, depending on individual circumstances, the disclosure being included in the statutory audit or requiring an external assurance. The Government would expect materiality to be applied in line with the relevant engagement (e.g. ISAE 3000) and for it to be applied in the context of country-by-country reporting. Where an institution decides that including the CBCR requirements in the statutory audit is not appropriate, the Government would expect the assurance engagement to provide the same level of comfort as a statutory audit.

5.14 This approach would also be consistent with allowing institutions to report the disclosure on a website that is easily accessible. However, where an institution chooses to report the disclosure on a website, we would expect them to provide a link within their annual report.

5.15 Whilst the approach deals with the general concerns over the audit requirements, it does not address the problem in the first reporting period i.e. that the deadline may make compliance impracticable for some institutions. Furthermore, many institutions may have already audited the required information and conducting an additional audit will be disproportionately burdensome.

5.16 After the first reporting period (i.e. reporting in July 2014), institutions will have flexibility as to when they disclose the required information and the Government expects that they will align this with their respective year-ends.

5.17 Given the concerns and potentially significant burdens in the interim period, the Government has decided that the audit requirement does not apply for the disclosure in July 2014.

6

Definitions

Introduction

6.1 The precise scope of the information which has to be disclosed is not defined in the legislation. This chapter addresses the questions posed in the consultation concerning the definitions of key terms. The questions relating to tax are looked at in the latter section of this chapter.

Question 10: Do respondents agree with the above definition of turnover?

Question 14: Do respondents agree with the above definition of public subsidies?

Summary of responses

6.2 The majority of respondents agreed with the Government's definition of turnover. However, many respondents pointed out the definition would only be appropriate for banks/credit institutions.

6.3 Whilst the majority of respondents agreed with the Government's definition of public subsidy, many asked for further clarification. A number of respondents argued tax deductions such as the UK's research and development (R&D) tax credit should not be viewed as public subsidies for the purposes of CBCR as these would be captured through the "tax on profit or loss" and therefore keeping them in scope would result in double-counting. Some respondents asked whether specific central bank schemes such as the Funding for Lending scheme would be included in the definition of public subsidies whilst others asked whether Help to Buy would be included.

6.4 One respondent stated that given practical challenges in capturing the relevant information on a country-by-country basis, public subsidies for the purposes of CBCR should be confined to direct cash payments by Governments and local authorities. Another respondent asked whether the disclosure of public subsidies received should be on a cash-received basis or an accruals basis.

Government's position

6.5 The Government does not intend to apply a definition of turnover that is appropriate for banks/credit institutions but inappropriate for other types of institutions. Therefore, the Government would expect the definition of turnover used by an institution to be consistent with that in an institution's financial statements.

6.6 The Government does not intend to capture general tax deductions (including the R&D tax credit regime available for large companies) that apply across the board within the definition of public subsidy for the purposes of CBCR.

6.7 As the consultation document set out, the Government would not expect any central bank operations that are designed for financial stability purposes or that aim to facilitate the functioning of the monetary policy transmission mechanism. Moreover, schemes in line with the European Commission's guidance on State Aid would not be considered public subsidies in the

context of CBCR; therefore the Government would not consider the Help to Buy scheme a public subsidy in the context of CBCR.

6.8 The Government does not believe that narrowing the definition of public subsidies to direct cash payments is conducive to the transparency objectives of the CBCR requirements in CRD4.

6.9 Lastly, the Government expects the disclosure of public subsidies received on a cash-received basis.

Tax

6.10 The precise scope of the information which has to be disclosed is not defined in the legislation. As such, this section sets out the Government's interpretation of each of the key items that institutions are required to disclose.

Question 11: Do respondents agree to limit the scope of "tax on profit and loss" to corporation tax payments?

Question 12: Do respondents agree that disclosures should be reported on a cash-paid basis?

Question 13: Do respondents agree that using the existing method for corporation tax attribution ensures minimal additional compliance burdens with respect to disclosure by UK branches of third country institutions?

Summary of responses

6.11 Most of the responses to question 11 agreed with the proposal to limit the scope of "tax on profit and loss" to corporation tax payments only. A number of respondents indicated that institutions should be able to voluntarily disclose other taxes paid if they wish to give an indication of the total tax contribution. Some respondents felt it would be appropriate also to include withholding taxes and one respondent indicated a preference for including any CFC charges.

6.12 A small number of respondents proposed that the International Accounting Standards (IAS) 12 definition of taxes on income should be applied as not all jurisdictions apply the same definition of 'corporation tax'; one also noted that that this definition would be significantly wider than UK corporation tax.

6.13 On question 12, most respondents were in favour of using the accounting tax charge, with some suggesting only current tax and a few suggesting that current tax, deferred tax and tax paid should all be reported. Some respondents recognised that cash tax paid appears to be most consistent with the reference in the recitals to CRD4 for 'taxes paid'.

6.14 However, most respondents expressed a strong feeling against reporting tax paid on a cash basis and a preference instead for reporting the accounting tax charge only. Respondents noted that turnover and profit would be reported on an accounting basis and felt that the accounting tax charge would be consistent with this.

6.15 None of the respondents said that they would be unable to provide information on a cash basis but noted that it may involve an additional administrative burden to prepare.

6.16 A number of the respondents mentioned timing issues. Many large companies in the UK make quarterly payments and not all cash tax payments are made in the accounting period. Respondents also noted that other tax adjustments such as group relief and losses brought forward will change the cash tax paid figure so that it may not be a true reflection of an entity's economic contribution.

6.17 Some respondents said that if tax is reported on a cash tax basis then companies should also have the option to voluntarily report current tax and deferred tax alongside this. Some respondents felt that this would help companies reconcile the cash tax figure to the profit and turnover figures reported. However, some respondents felt that for an entity to have to reconcile the cash tax paid figure to the accounting tax charge could be very burdensome.

6.18 All respondents agreed that using the existing method for corporation tax attribution ensures minimal additional compliance burdens with respect to disclosure by UK branches of third country institutions.

Government's position

6.19 For the purpose of reporting 'tax on profit or loss' under CRD4 the Government proposes to limit the scope to corporation tax payments as defined in the Corporation Tax Act 2009 or a similar charge in other jurisdictions.

6.20 The consultation document set out the proposed approach for defining "tax on profit and loss" on the basis of the actual cash figure for corporation tax paid in a financial year. This approach most closely aligns with the transparency objectives of the legislation and will give the most meaningful analysis in terms of "taxes paid" as referred to in recital 52 of CRD4.

6.21 Furthermore, reporting corporation tax paid on a cash basis is also consistent with the approach being discussed at the OECD for the country-by-country reporting tool being developed as part of the transparency work-stream in the Base Erosion and Profit Shifting project.

6.22 The Government proposes that institutions will have the option to separately and voluntarily report additional information such as current tax and deferred tax as well as other taxes paid beyond corporation tax in order to help clarify their tax position.

6.23 Given that all respondents agreed with the Government's approach on corporation tax attribution, the Government has kept the approach as set out in the consultation document.

7

Other issues

Introduction

7.1 The consultation also asked respondents what additional reporting would be required under the CBCR requirements. Some respondents also asked for clarification on other issues.

Question 15: Can respondents outline how the new reporting requirements will differ from what they are currently required to report and what, if any, additional information is required.

Summary of responses

7.2 All respondents, apart from one which has no subsidiaries and wholly operates within the UK, felt that the CBCR requirements in CRD4 would create additional burdens.

7.3 Whilst total numbers for turnover, profit etc may be available at group level these are not currently produced on an individual country basis and it will require significant additional financial and personnel resource to do this.

7.4 Some respondents thought that as the new requirements go significantly further than any existing disclosures a group is currently required to make at the consolidated level new or additional systems may be required.

7.5 One other issue that respondents requested clarification on was whether all global systemically importing institutions (G-SIIs) would be captured by the UK legislation.

Government's position

7.6 Taking into account the comments received on this question, the Government has revisited the table of impacts and the revised version is published in the Tax Information and Impacts Note which has been published alongside this Consultation Response Document.

7.7 In response to the G-SII issue, only UK-headquartered G-SIIs will be in scope of the legislation.



List of respondents

Only organisations that responded are listed here; there were additionally 3 responses from private individuals.

Association for Financial Markets in Europe

Association of British Insurers

Association of Foreign Banks

Baillie Gifford & Co

BlackRock

British Bankers' Association

Confederation of British Industry

Deloitte

EY

HSBC

ICAP

Institute of Chartered Accountants in England and Wales

Investment Management Association

J.P. Morgan

KPMG

Mizuho Bank

PricewaterhouseCoopers

Standard Chartered Bank

Tax Research LLP

TD Bank Group

Wealth Management Association

Wholesale Market Brokers Association

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