

Dbriefs Bytes Transcript

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For comments on general information, see [the highlighted text below](#).

BEPS

(i) TP Documentation and “Country By Country” Reporting

Several BEPS developments this week.

The first concerns Action 13 on transfer pricing documentation.

On 30 January, the OECD released a discussion draft on TP documentation and “country by country” reporting. From a practical perspective, a very important initiative.

The OECD has asked for public comments to be given by 23 February.

The OECD emphasizes that the discussion draft is a work-in-progress and it does not necessarily reflect the consensus views of Working Party 6.

So with that health warning in place, what does the draft say?

Well, the discussion draft introduces three types of document:

- The first type is the so-called common template for “country-by-country” reporting.

This will be a transfer pricing risk assessment tool.

The discussion draft contains an example of the template – more about that in a moment.

- The second and third types of documents are the transfer pricing master file (which would contain standardized information relevant for all members of the group) and a local file (which would be specific to each entity in the group).
- The master file and local files are designed for companies to prove their compliance, and for tax authorities to thoroughly audit that asserted compliance, with the arm’s length principle.

In annexures to the discussion draft, the OECD sets out the information that should be included in the master file and in the local file.

So, for example, in the master file, there will be information on the group’s: (i) organizational structure; (ii) its business lines; (iii) intangibles; (iv) intercompany financing; and (v) finally, its financial and tax positions, including a copy of the group’s “country-by-country” reporting.

And in the local file, which would be prepared for each relevant legal entity in the group, there will be a detailed transfer pricing analysis of that entity’s related party cross-border transactions.

Let’s come back to the example of the “country-by-country” reporting template. The example reflects the following points:

- It would be prepared on an “entity by entity” basis, not on a “country consolidated” basis.
- A permanent establishment would be treated as a separate entity, if it prepares a separate income statement for regulatory, financial management, financial reporting or tax purposes.
- The template covers a period of 12 months.

- Entities are listed according to their country of formation. However, the place of effective management of each entity must also be shown.
- For each entity, its important business activities must be indicated by use of a code. For example, “holding intellectual property” is code B and “manufacturing and production” is code D.
- A so-called “bottom-up” approach is adopted. This means that the relevant financial information for each entity is shown, without any group consolidation adjustments. Thus, at an aggregate level, there could be a lot of double counting.
- Accordingly, total revenues of each entity must be shown, regardless of whether they were generated from related party or third party transactions. The revenues should be shown in the entity’s functional currency (and that currency must be indicated), and the numbers should be taken from that entity’s statutory financial statements, other audited financial statements, or internal management accounts.
- There is no need for the amounts of revenue and other financial information for all entities to be reported using the same accounting standards.
- For each entity, earnings before income tax should be stated.
- In regard to income tax, this should be reported, for each entity, on a “cash paid” basis. This would cover both income tax paid in the country of formation and income tax paid in other countries.
- If tax is paid on a group basis, the tax paid should be allocated amongst the members of the group in proportion to each entity’s earnings before income tax.
- For each entity, there should be shown the total amount of withholding tax paid with respect to payments received from other entities. The template does not seem to distinguish between income tax paid in a foreign country and withholding tax paid in a foreign country – each of these needs to be separately recorded.
- For each entity, the stated capital and accumulated earnings should be shown.
- The total number of employees of each entity, as of the last day of the entity’s fiscal year, should be shown, regardless of the location of the employees. “Seconded-in” employees should be included, but “seconded-out” employees should not.
- For each entity, the total employee expense should be shown, including all non-cash payments or benefits such as employee option schemes.
- The book value of tangible assets should be shown. This excludes cash and other financial assets. The OECD makes a particular point that intangible assets should not be shown.
- And finally, for each entity, various related party payments and receipts should be reported: royalties, interest and service fees.

The OECD has asked for comments on all of these components and aspects of the template, including (in particular) the proposed “bottom-up” approach.

A few final points to note:

- As currently drafted, the “country by country” reporting template is limited to transfer pricing information. At the start of the discussion draft, the OECD says that it will give consideration to whether other information, not relating to transfer pricing, should also be built into the template.
- In regard to language, the discussion draft says that, “as a general matter”, the master file and the “country by country” reporting matrix should be completed in English.
- The discussion draft does not propose that any of the three types of documentation be required to be certified by an external auditor or other third party.

If you like to obtain a copy of the discussion draft, please follow the link in the summary slides at the end of this video.

(ii) BEPS : Unilateral Actions

One of the sensitive issues in regard to BEPS is the taking of unilateral action by individual countries. The OECD has stated that it does not want to see individual countries “jumping the gun” (so to speak) and making domestic law changes, before the OECD has completed its Action Plan. The OECD is naturally concerned about the risk of an uncoordinated and incoherent outcome if many countries were to do this.

But unilateral action can also be seen, not in domestic law changes, but in tax audit activities and assertions, and in MAP discussions. Mike Danilack, the US competent authority, made this point at a conference last week. He said that foreign country tax authorities have taken the BEPS debate as an invitation, and maybe even a direction, to aggressively use BEPS concepts in subjecting multinationals to tax audits and in MAP discussions.

And press reports in the last few weeks give some support to that theory. For example :

- The Mexican tax authorities held a conference on 14 January to outline their new tax audit initiative to fight BEPS activities.
- And in France, in the last two weeks, we’ve seen magazine articles accusing firstly McDonald’s, and then Google, of major tax avoidance based on BEPS-type planning.

(iii) Digital economy

A couple of weeks ago, Pascal Saint-Amans was quoted in newspaper articles as saying that the digital economy task force has concluded that it is not appropriate to formulate tax rules specifically for the digital economy. And the reason for this is that digitization has become so embedded in the so-called traditional economy that there is no logical way of distinguishing so-called “pure play digital companies” from digitized traditional companies. As one commentator put it: Volvo sells cars online.

Of course, we have not yet seen the discussion draft on BEPS Action 1 – that’s not expected until March. In the current vacuum, theories abound as to the significance of Pascal’s statement:

- On the one hand, there is the view that it indicates that the OECD has found the whole topic of the digital economy as “too difficult”, and is effectively throwing in the towel in regard to an income tax response to the business structures employed by Google, Amazon, and so on. Of course, that would still leave the opportunity for a VAT-based response.
- The alternative view is that the OECD has concluded that a comprehensive solution, covering both “pure play digital companies” and digitized traditional companies, is required; and that this comprehensive solution will involve contributions from some other BEPS actions, notably Action 7 on expanding the PE concept and Action 8 on the transfer pricing aspects of intangibles. According to this alternative view, Pascal’s statement is consistent with the BEPS reforms being far more broadbased than just “pure play digital companies”.
- Time will tell.

Hybrid Mismatch Arrangements

The final BEPS development concerns the leaking of a discussion draft on hybrid mismatch arrangements, which is BEPS Action 2.

I’m happy to report that the leaking did not involve the Wikileaks anonymous electronic dropbox, but was instead done by fat fingers at the OECD.

Unfortunately, I don’t have a copy of the leaked document.

But apparently, Lee Sheppard does, because she’s currently writing an article on it, to be published on Monday by Tax Analysts.

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