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United Kingdom

BEPS Action 13: Transfer Pricing Documentation and Country-by-Country Reporting

On 16 September 2014, ahead of the G20 Finance Ministers' meeting on 20-21 September, the OECD published seven papers as a first tranche of deliverables under the Base Erosion and Profit Shifting ('BEPS') Project. The OECD will be continuing its work on the remainder of the 15 Actions on BEPS throughout 2015. It is clear that the G20 and OECD governments intend that recommendations under each of the BEPS Actions will form a comprehensive and cohesive approach to the international tax framework, including domestic law recommendations and international principles under the model tax treaty and transfer pricing guidelines. As a result, the proposed solutions in the first seven papers, while agreed, are not yet finalised and may be affected by decisions and future work on BEPS in 2015.

Under Action 13, the OECD has released a new Chapter V of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.* This sets out a new three tier global standard for transfer pricing documentation requirements, including a common template for country-by-country reporting and blueprints for a global master file and local files for transfer pricing documentation. The new guidelines set out the content of the new requirements, but, as previously announced, the OECD are continuing to work on important questions of implementation, including how the country-by country report and master file should be filed and how transition to the new model will occur. This work will be concluded by the OECD in January 2015.

New three-tier approach

The guidance sets out in detail the compliance requirements that businesses will have to adopt once the new regime is implemented. The guidance is broadly in line with the information given by the OECD in their webcast in April 2014, but confirms the content for the three tiers and in particular clarifies definitions and gives guidance on interpretation.

Country-by-country report

The country-by-country report will require the ultimate parent entity of a multinational group to set out global data by country for its fiscal year in a prescribed template, together with a list of entities by country of residence and indication of their activities. The OECD made clear that this will be for tax administrations only, and will not be made public.

The country-by-country report will include information, aggregated by country, from all 'constituent entities' that make up the consolidated group for financial reporting purposes. In addition, any entity or business unit that is not consolidated solely on the grounds of materiality will need to be included. The OECD has listened to business' concerns about sources of data, and there is considerable flexibility for businesses to use the best available sources – consolidation reporting packages, separate entity statutory financial statements, regulatory financial statements, or internal management accounts. The OECD stresses, throughout the guidance, that what does matter is consistency of treatment across each multinational entity and from year to year.

The financial data to be included by country is:

- Turnover, showing separately related party and third party sales but excluding dividends received (as determined by the law of the paying country).
- Profit before tax.
- Cash tax paid (including withholding taxes suffered in other jurisdictions).
- Current year tax accrual (excluding deferred tax and provisions for uncertain tax liabilities).
- Stated capital.
- Accumulated earnings, as of the end of the reporting year.
- Number of full-time equivalent employees of the entity resident in the jurisdiction. The OECD is allowing some flexibility here - numbers may be at the year end, average for the year or on any other basis consistently applied. Rounding is permitted provided it does not materially distort the relative distribution across countries – emphasising that this is 'big picture' information. Independent contractors undertaking 'ordinary operating activities' may be included as employees, which will be particularly important to some industries.
- Net book value of tangible assets excluding cash and cash equivalents.

Permanent establishments will, as expected, need to be included in a country's data by reference to where the permanent establishment is situated and excluded from the data for the country of residence. The exceptions to this are in respect of stated capital (excluding regulatory capital) and accumulated earnings, which should be reported with the legal entity.

The OECD have confirmed that the information to be provided is to be aggregated by country in the form of simple adding up, and not consolidated by country with full elimination of intra-group items. The majority of businesses that do not consolidate for statutory accounting purposes at the local country level will welcome this clarification. Intra-group dividends are excluded from revenue as a simplification, and to reduce double counting for items that may not be charged to tax.

Master file(s)

In addition to the country-by-country report, the new guidance sets out requirements for businesses to prepare a transfer pricing master file setting out an overview of the group's transfer pricing policies and activities. The master file should be prepared on a global basis but a product line basis is permitted where the facts lend themselves to such an approach. Where a product line basis is used the entire master file of all product lines must include all centralised, non-product line specific items as well. The master file approach represents a significant change to the way most multinationals address their transfer pricing documentation, and will require considerable effort to implement.

The OECD has set out the information that should be included in the master file. This includes:

- Legal ownership structure chart, including geographies.
- Description of the business, including drivers of profit, supply chain for large products/services, important service arrangements including locations, capabilities, cost allocations and pricing; market descriptions, a brief functional analysis showing principal contributions to value creation; and details of important business

restructurings, acquisitions and divestitures during the year.

- A section on intangibles, including a description of strategy, location of principal R&D facilities and R&D management, a list of intangibles (perhaps grouped) showing legal ownership, a list of intangibles-related intra-group agreements such as cost contribution agreements, licences research service agreements, transfer pricing policies and details of intra-group transfers of intangibles during the year.
- A similar section on financial activities, including financing arrangements with third parties, group financing companies and their location and transfer pricing policies.
- Financial and tax information including annual consolidated financial statements and a list and brief description of unilateral advance pricing agreements (APAs) and other tax rulings relating to allocation of income among countries.

There are two changes of note from the master file requirements proposed in January 2014 following consultation with businesses – there is no requirement to disclose bilateral advance pricing agreements or settlements under Mutual Agreement Procedures and the controversial requirement to set out the job title and description of the 25 most highly paid employees has been removed.

Local file

The local file will contain detailed entity and transactional level information. Some of this information (e.g. functional and economic analyses and selection of the most appropriate method) will be required under local documentation requirements currently, but the list of information to be included goes further than many countries' requirements. Notably, the local file should include:

- Local management information and an organisation chart, and a description of the individuals to whom local management reports.
- The amount of intra-group payments and receipts for products, services, royalties, interest etc. by tax jurisdiction of the payer/recipient.
- Information on the financial data used to calculate the arm's length amounts in the tax return.
- Details of bilateral and unilateral APAs, and other rulings, that are 'related to' the transactions of the entity.

Materiality

There remain some difficult practical areas. The OECD is clear that materiality is not a reason to exclude information from the country-by-country information. This is to ensure that it is useful for smaller developing countries as well as large markets, and businesses will have to ensure that they can adequately gather and assess this information where it may not be needed for consolidated financial statements. The list of entities in the country-by-country template will include dormant companies too. The master file is intended to provide a 'high-level overview' to place the group's transfer pricing practices in context, and will include 'important' information. Information is considered important if its omission would affect the reliability of the transfer pricing outcomes. For the local file, individual countries are encouraged to include specific materiality thresholds in their domestic law that take into account the size and nature of the local economy, the importance of the multinational group in that economy, and the size and nature of local operating entities.

Small and Medium Sized Enterprises (SMEs)

Interestingly, the OECD is considering (as part of its work to be finalised in January 2015) whether the country-by-country information will be a requirement only for large businesses. This is potentially a change from the original proposals in January 2014, where the OECD suggested all companies regardless of size would need to comply.

The OECD also recommends that the level of transfer pricing documentation required (i.e. the master file and local file) should be reduced for SMEs. SMEs should be obliged to provide transfer pricing information **only** when specifically requested by the tax authority (the approach already adopted by HMRC). It remains to be seen whether this is widely adopted by other countries, and how countries define an SME, but would be a pragmatic approach to reduce the burden on small and newly international businesses.

Risk assessment and audits

The OECD has made clear that the country-by-country template is for risk assessment purposes only. The master file and local file are to be used for risk assessment and to provide information where the tax authority considers that an audit is necessary. It may be the case that further information is required under the audit, but there is recognition of the need to balance the cost to businesses of preparing documentation up front, with the need for tax authorities to obtain necessary information.

Penalties

The new guidance suggests that local documentation-related penalties should not be levied if the information is not in the possession of the multinational company, but expressly sets out that the assertion that other group members are responsible for transfer pricing documentation is not sufficient reason to preclude the local subsidiary from being charged documentation-related penalties.

Timetable and Implementation

The OECD is still considering how the country-by-country report and the master file will be filed - whether they will be filed with the tax authority in the parent company jurisdiction and provided to other tax authorities under information sharing in double tax treaties or other information exchange agreements, or whether local filing in all jurisdictions will be needed. Important factors that the OECD will need to consider here include (i) the need to ensure that business' information remains confidential, and (ii) that the global country-by-country and master file information may be only within the possession and control of a parent company. In the event that a parent company does not provide global country-by-country and master file information to its subsidiaries, a local tax authority may be limited in its power to compel the local subsidiary to provide the information.

The OECD has not provided a start date for the new rules, and will consider 'transition' in January 2015 in order to ensure consistency. Businesses will need time to undertake the additional work required and the earliest year for the new requirements to apply is likely to be 2016 - although this will depend upon implementation in local law. Given the political pressure in relation to the country-by-country information in particular, a start date much beyond 2016 seems unlikely.

The OECD will review the transfer pricing documentation and country-by-country reporting standards by 2020 to ensure they are working effectively. Active consideration will be given in this review to whether additional transactional reporting of country-by-country or entity-by-entity payments of interest, royalties and especially service fees is needed – areas where some countries (Argentina, Brazil, China, Columbia, India, Mexico, South Africa and

Turkey) are keen to see the information on a global basis over and above the local file requirements.

Deloitte Comments and Business Next Steps

The OECD proposes very significant changes to the compliance and reporting of global information for risk assessment and transfer pricing purposes. Whilst some key issues on the filing and sharing of information remain to be decided, the requirements are taking shape and businesses will need to prepare for them.

As a practical matter, it is likely that only the parent company will be able to obtain the information necessary to prepare the country-by-country information and the master file. For businesses that do not prepare their transfer pricing documentation on a global basis, the new approach will require a substantial change. Even if businesses do prepare their documentation on a global basis, the new guidance is likely to require the compilation and explanation of substantially more information than currently.

Businesses are also likely to find that it is necessary to prepare or coordinate their documentation centrally to ensure that the country-by-country template, master file and local files provide consistent information about global and local operations and transfer pricing policies. There will be a need to implement new procedures to locate, collect, store, validate and assemble the information. The increase in transparency and the greater need for global consistency may require some businesses to increase the resources devoted to transfer pricing compliance, and the collection of data for the country-by-country template.

Deloitte EMEA Dbriefs Webcast

Deloitte's Dbriefs webcast programme for Europe, the Middle East and Africa will include a discussion of the new transfer pricing documentation requirements including country-by-country information on 24 September 2014 at 13.00pm (BST). For further details and to register for the webcast click **here** or go to **www.emeadbriefs.com** for full details of the EMEA Dbriefs programme.

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