# Transfer pricing documentation and CbC reporting

## BEPS Action 13

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2016

# Transfer pricing documentation and Country-by-Country (CbC) reporting

# Proposed Transfer Pricing Compliance Documentation

**New guidelines adopt 3-tiered approach**

The G20/OECD have agreed on very significant changes to the compliance and reporting of global information for risk assessment and transfer pricing purposes. The OECD has adopted a three-tiered approach to documentation, that includes: a) Local File b) Master File and c) Country-by-Country (CbC) report to provide a global financial snapshot of an Multinational Enterprise (MNE). This approach will require MNE to implement new procedures.

**Country-by-Country report**

Key financial information on all group members on an aggregate country basis with an activity code for each member

**Master file**

Key information about the group's global operations including a high-level overview of a company's business operations along with important information on a company's global TP policies with respect to intangibles and financing

**Local file**

Information and support of the intercompany transactions that the local company engages in with related parties

The three-tiered documentation will result in substantially more information disclosure on MNEs. MNEs will be required to disclose their global operations and TP policies. MNES should be aware that the information in the CbC report will be shared amongst all the jurisdictions in which the MNE has its operations. This approach will give tax authorities unprecedented transparency on MNEs' global TP policies. Hence, while preparing their TP policies, MNEs will need to have a global perspective and not an individual country-centric view.

**Indian Government has in-principle adopted the new transfer Pricing documentation.**



Transfer pricing documentation and CbC reporting

# Local and Master File

**Local File**

The local file is required to provide information and support of the intercompany transactions that the local company engages in with related parties. It needs to contain most of the information traditionally included in domestic transfer pricing documentation, though specific additional requirements have been introduced. These include local management structure, organization chart and disclosure of local management reporting lines.

The key elements of local file traditionally included in transfer pricing documentation were details of intercompany transactions, financial information and detailed functional and economic analysis for the intercompany transactions. There is a preference for local comparables and the fresh search for comparable companies could be done once every three years for same functional profile with the financial data updated annualy. The local file should also include details of bilateral and unilateral APAs, and other rulings 'related to' the transactions of the entity. The guidance requires reporting of material transactions, though the materiality threshold has been left to the discretion of the respective country.

The local file is to be filed locally and it is recommended that it be finalised by the filing date for the local tax return.

What needs to be seen is whether local countries impose additional requirements for local file that will require additional costs to prepare locally tailored documentation reports.

**Master File**

The master file is intended to provide a high-level blueprint of the MNE's transfer pricing practices economic, legal, financial, and tax context. The information required in the master file goes significantly beyond what is currently included in transfer pricing documentation for any given country. The master file should provide details of the group organization structure. It must include description of group's business activities, including descriptions of profit drivers and functions that contribute to value creation, as well as descriptions (graphic or written) of the supply chain for the five largest products and services, plus other products or services exceeding 5 percent of an MNE's turnover. It requires the provision of a list of important intangibles and which entities own them. It also requires disclosure of transfer pricing policies for intragroup services, intangibles-related transactions, sources of unrelated-party funding, intragroup financing entities, and intragroup financing policies. Finally, it requires the disclosure of an MNE's consolidated financial statements, unilateral income allocation rulings, and unilateral advance pricing agreements ('APAs').

The master file can be prepared either on an overall company basis or a products group basis. However, the OECD provides that if the master file is prepared on a product group basis, information on all product groups must be submitted to all tax authorities, even if the local subsidiary is part of only one product group.

# CbC Reporting

**Reporting requirement**

The CbC report is required to set out specified financial data (represented below) of the Group by tax jurisdiction in a prescribed template. Additionaly a list of constituent entities by country of residence with indication of their activitiesis are to be reported. 'Constituent Entity' is defined as any separate business unit of the group, including companies together with permanent establishments that prepare a separate financial statement for any purpose (including management control and tax compliance).

MNEs with annual consolidated group revenues of or above EUR 750 million in the previous fiscal year, to file CbC Implemented for fiscal year beginning from January 1, 2016

CbC template is intended to be used for risk assessment purposes only
CbC report is not a conclusive evidence on whether transfer prices are appropriate or not


**First BEPS Action to be implemented – First CBC report expected in December 2017**





**Sources of financial data**

The guidance provides for flexibility of data sources for preparation of the CbC report. Each MNE may choose to use data from its consolidated reporting packages, separate entity statutory financial statements, or internal management accounts. If using statutory financials, amounts should be translated to functional currency of the parent company at average exchange rate for the year. Each MNE is required to provide a short description of the sources of data used in CbC reporting and should use the same data source year on year (any changes in source data need to be reported and explained). Additionally, the data provided in the CbC report is not required to be reconciled with the consolidated financials, nor are any adjustments required for differences in accounting principles applied among tax jurisdictions.

**Some key elements of implementation of CbC reporting**

| | | |
|---|---|---|
| **Exchange** | CbC is to be filed in the tax jurisdiction of the ultimate parent entity (or nominated surrogate parent entity). If the CbC report is not filed with and shared by the tax jurisdiction of the ultimate parent company (or the nominated surrogate), then companies may be required to file the CbC report locally | CbC to be exchanged through Government to Government information exchange program (involving various sharing mechanisms).<br><br>Three model competent authority agreements provided by guidance to tax authorities to facilitate implementation of the exchange of CbC reports. |
| **Use** | As per guidance, jurisdictions should commit to use the CbC report for assessing high-level transfer pricing and other BEPS risks. Information not to be used as substitute for detailed transfer pricing analysis which should be based on full functional and comparability analysis.<br><br>Transfer pricing adjustments should not be made on the basis of the CbC reporting alone. | Participating countries have agreed that they will have in place and be prepared to enforce legal protections for confidentiality of the information in the CbC report, equivalent to those under the Multilateral Convention or a tax treaty. |

**Specific penalty regime introduced in India for failure of filing CbC report**

## Timelines

- CbC report is required to be filed annually by the MNE within 12 months of the end of its financial reporting year (for years beginning on or after 1 January 2015)
- Each constituent entity will need to notify their local tax authority by the last day of the financial reporting year either:(i) that it will be filing the CbC report for the year, or (ii) the name and tax residence of the company that will file the report for that fiscal year
- Tax authorities will be required to share the CbC report with other relevant tax authorities within 18 months of the end of the financial reporting year for the first year (thereafter within 15 months of the financial reporting year of the MNE)
- First CbC report would be required to be filed by 31 December 2017, which then would be shared with other relevant tax authorities by 30 June 2018

### Next Steps

- The G20/OECD are developing an XML Schema and a related User Guide to allow for electronic tagging of data in the CbC reports to facilitate their exchange electronically, which is expected by end 2015
- The G20/ OECD governments have agreed to review the standards to ensure they are working effectively by 2020

Transfer pricing documentation and CbC reporting

# India implementation - Three Tier Transfer Pricing Documentation


As an active member in the BEPS initiative, for implementing the international consensus on Action 13 of the BEPS project, India has introduced the Country by Country (CbC) reporting requirement and the concept of master file in the Indian Income Tax Act, 1961 (through the Finance Act 2016).

**Local File**

The Indian transfer pricing regulations under Section 92D read with Rule 10D of the Income Tax Rules 1962 require every person who has entered into an international transaction to maintain prescribed information /documents for substantiating the arm's length price of its transactions with the related parties, these regulations persist. It is possible that the Local File guidelines in the OECD BEPS Action 13 Report may also be incorporated in the future to the extent it is not already covered by the existing Rule 10D documentation requirements.

**Master File**

The memorandum to the Finance Bill 2016 introduced the concept of Master File, whereby entities being constituent of an international group shall be required to maintain and furnish the Master File. The Memorandum provided that the rules prescribing the information and document as mandated for master file under OECD BEPS Action 13 report shall be prescribed in the rules. The Master File is intended to provide a high-level overview of the MNE groups' business, including the nature of its global business operations, value drivers, supply chain analysis, intangibles employed, financial arrangements, overall transfer pricing policies, and financial and tax positions. The Memorandum also provides for the penalty leviable for non-furnishing of the information and document to the prescribed authority.

**Country-by-Country (CbC) report**

The Finance Act, 2016 introduced the CbC reporting requirement with effect from Assessment Year 2017-18 (financial year 2016-17). Indian headquartered MNEs having consolidated group revenues above the prescribed threshold will be required to file the CbC report in India for Assessment Year 2017-18 (financial year 2016-17) onwards.

MNE's not headquartered in India, having group companies resident in India will be required to notify Indian authorities of the details of their parent entity/alternate reporting entity and its jurisdiction. In certain scenarios, such companies will also be required to file their CbC report in India, such as when India does not have an exchange of information agreement with their parent entity jurisdiction or where there has been a systemic failure in exchange of such reports.





As per existing Indian regulations, the information requirements of the CbC report are similar to those prescribed by the OCED BEPS Action Plan 13. The CbC report is required to set out for each jurisdiction, specified data pertaining to revenue, income, taxes, number of employees, capital and tangible assets.

A snapshot of the CbC regulations is provided below:

| Requirements | Threshold | Timeline | Penalty |
|---|---|---|---|
| • Filing CbC report in India or notification of parent entity<br>• Effective from Assessment Year 2017-18 (Financial Year 2016-17) | • MNE group having consolidated revenue exceeding € 750 million (in line with BEPS)<br>• Threshold in Indian currency – to be computed based on exchange rate as on the last day of previous year. E.g. threshold for FY 2016-17 - INR 5395 crores | • CbC report to be filed in prescribed format on or before due date of filing return of income i.e. 30 November of the relevant Assessment Year | Graded penalty structure from INR 5,000 to INR 50,000 per day for:<br>• Non-furnishing of CbC report<br>• Non- submission of required information<br>Penalty of INR 500,000 for:<br>• Furnishing of inaccurate particulars<br>• Non-furnishing of master file data |

Transfer pricing documentation and CbC reporting

# Impact and way forward

The new guidance will provide tax authorities with substantial information resulting in a high level of transparency. This increase in global transparency is likely to mean that deviations from a company's transfer pricing policy or the implementation of that policy or economic inconsistencies will become more apparent to tax authorities around the world. With the increased level of global transparency, tax authorities may also focus on the broader aspects such as overall structure, beyond the inter-company transactions currently scrutinized.

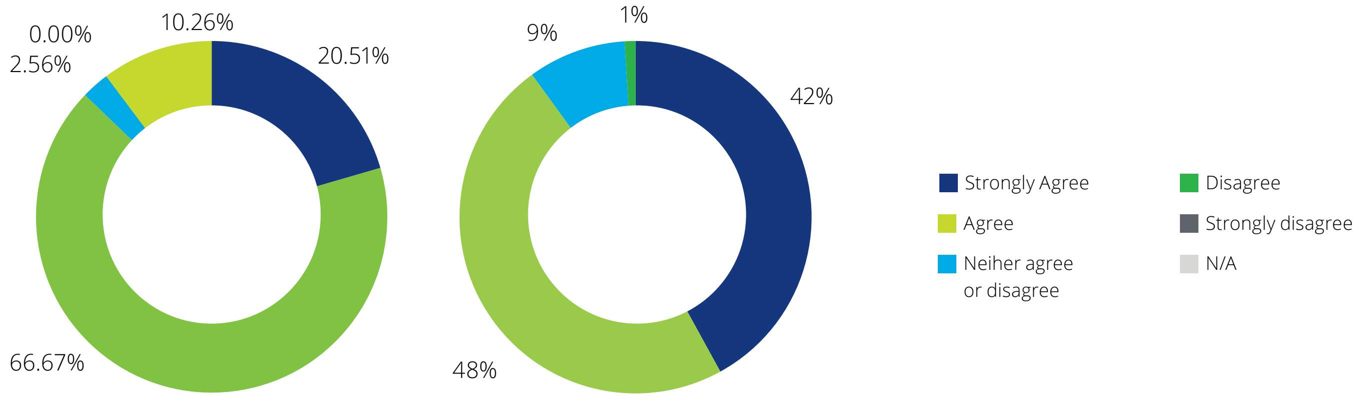
It will be imperative for MNEs to evaluate the existing data, data gaps, economic inconsistencies and non-compliance with transfer pricing policies. MNEs would need to undertake a risk assessment exercise to evaluate how the new documentation guidance will impact their current transfer pricing policies and their process for implementing, monitoring, and defending those policies. MNEs will also need to prepare for greater level of scrutiny by the tax authorities. MNEs that currently do not establish and monitor transfer pricing policies on a global basis may find a need to do so in the near future. This will result in a substantial increase in transfer pricing compliance burden for MNEs.

# Impact

The impact is also evidenced by the following survey results:

**A global and India industry perspective**
The impact of the additional reporting requirements are evidenced by the survey results which highlight that almost half of the global and Indian MNE population perceive that transfer pricing compliance burden will increase as a result from the reporting requirements under BEPS.

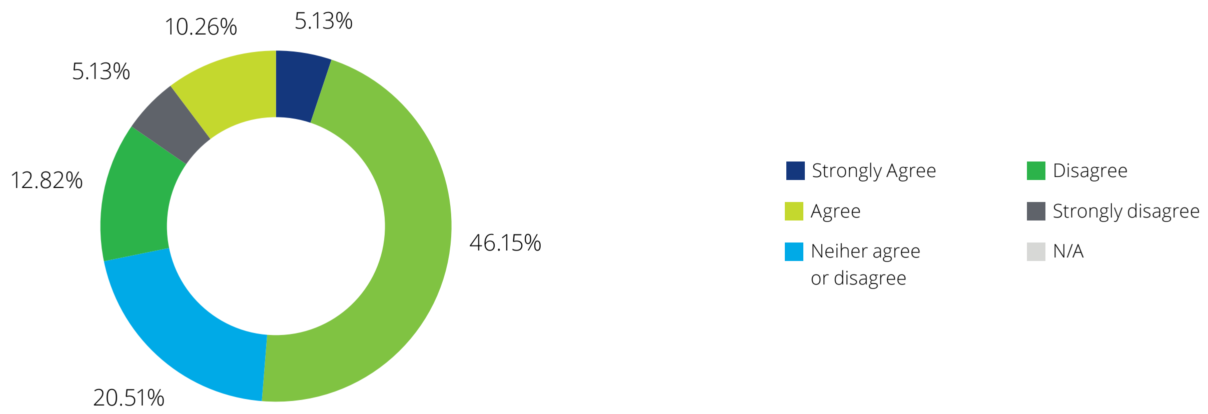
In my view, the corporate tax and transfer pricing compliance burden will substantially increase as a result of additional reporting from the OECD BEPS recommendation




India Global

As a result of the expected BEPS impact, a majority of the organizations operating in India have assessed the potential impact of changes related to Transfer Pricing Documentation and CBC reporting.

My organization has assessed the potential BEPS impact of changes related to implementation of CBC and Transfer Pricing Documentation








# Way forward

The new guidance on documentation will warrant a clear trend towards (global and regional) centralization of transfer pricing risk management. Therefore, centralisation would be the recommended approach wherein the preparation/coordination of documentation is centrally managed.

**Recommended approach**

- Think Global / Act Local
- Central Documentation
  - Common functional and industry analyses
  - Regional economic analyses
  - Common information

**Benefits of Centralized Management**

- Co-ordinated, global or regional approach from HQ
- Eliminates inconsistencies & duplication
- Maximizes 'line of site' on global tax risk & opportunities

For following the centralization approach also, while global involvement is critical, local 'buy-in' and responsibility would also be necessary. It is recommended to identify central and local TP risk management roles and responsibilities.

**Central role**

- Define global operating/tax strategy
- Create global TP policies (aligned to strategy)
- Prepare 'central' documentation
- Support local personnel in TP disputes

**Local role**

- Responsibility for local TP risk management
- Align local TP approach to global strategy
- Leverage from global resources (localise central documentation)
- Local benchmarking if required
- Front line management of local TP disputes

# Way forward

To comply with the new guidance, the documentation process would need to evolve through various stages, keeping in mind the key priorities and considerations.

**Drivers**

- CbC reporting and 3-tier documentation
- More countries with:
  - specific transfer pricing rules
  - documentation and disclosure requirements
- Explosion of penalty provisions
- Pricing and regulatory constraints
- Cooperation among tax administrations

**Current State**

- Incomplete and dispersed information
- Penalty exposure
- Inconsistent analyses
- Multiple and/ or unconnected service providers
- Potential for audit inquiry crisis
- Duplicative cost

**Process**

Prioritize

- Consistent functional analysis
- Risk assessment
- Efficiencies through proprietary tools and consistent methodology
- Quality and cost control

LocalDocumentation

Analyze

Central Documentation

**Shared Commitment**

Client Oversight and active participation

Central TP Team / Consultant Dedicated Core Team and local strength

**Value**

- Enhanced shareholder
- Optimal transfer pricing structure
- Penalty protection
- Rapid audit response
- Identification of planning opportunities
- Flexibility at regional level
- Easy to update





# Benefits

Adoption of the new guidance on global documentation will provide a number of benefits

# Deloitte Approach and Offerings

Transfer pricing documentation and CbC reporting

# Deloitte Approach

Our approach aims to address the significant challenges posed by the Global TP documentation requirements

Significant challenges faced by MNEs in complying with the specific TP requirements of multiple tax jurisdictions - Need to maintain Global Documentation

Our Approach

**Prepare global documentation package by:**

- Coordinated Deloitte service team and approach
- Specialized tools, templates and procedures
- Customized approach to meet country-specific requirements
- Centralized preparation to avoid redundancies
- Undertake detailed value chain analysis

**Prioritizing your company's target locations:**

- Determining transfer pricing needs in various jurisdictions
- Continual risk assessment and identification of transfer pricing optimization opportunities

Streamline global transfer pricing documentation to facilitate overall transfer pricing compliance

- Assembling “core” documentation package and CbC template for use across multiple jurisdictions
- Creating “local” documentation to satisfy individual country requirements

# Deloitte's Offerings

Given the global reporting requirements resulting in high level of transparency, as discussed, centralized management and documentation of a company's transfer pricing policy would be the need of the hour. Taxpayers will need to consider how the new documentation guidance will impact their current transfer pricing policies (including the process for implementing, monitoring, and defending those policies) and will also need to prepare for greater level of scrutiny by the tax authorities.

As BEPS implementation is underway in many countries, companies should begin to consider the process to compile the requisite information. For some large companies, the implementation processes may require substantial lead time including commitment and investment in systems and resources. A risk assessment analysis of how BEPS may impact existing structures and operations will also be imperative.

Moreover, there can be requests from the Tax Authorities to submit some of the information highlighted in master file / CbC template during the current TP Audits and therefore, it is vital for the taxpayers to set the ball rolling.

Deloitte provides a number of tools to assist clients in producing the new transfer pricing documentation requirements or assessing risk arising from global documentation compliance.



Transfer pricing documentation and CbC reporting

# CbC Reporting Offerings – CDX

Deloitte CbC Digital Exchange (CDX) is an online solution designed to help multinational organizations assess readiness for the CbC reporting requirements. This new, web-based tool allows you to run simulations using your own data. It automates the process of data collection from dispersed data providers (split by geography, business unit or other segments) into a central repository, by providing a flexible data upload process. It facilitates the consolidation of the collected data in OECD's CbC reporting template format. CDX provides the flexibility to sort and filter results and allows you to run analytical reports based on the data, providing a high level risk assessment (on similar lines as the tax authorities are expected to undertake). CDX is designed to help visualize the potential impact of CbC reporting requirements.

**CDX helps businesses to visualize and evaluate impact of the OECD's CbC Reporting requirements. CDX can assist businesses in:**

- Gauging organizational readiness to collect and aggregate the data needed under new CbC requirements
- Previewing how data might look through a variety of lens to stakeholders including tax authorities and the public
- Identifying challenges in data collection
- Assessing priorities and consider proactive steps needed before CbC requirements come into effect

**CDX provides standard visualizations and ratios including:**

- Effective Tax Rate (ETR) and Cash ETR
- Percent of related party revenues to total revenue
- Number of employees versus:
  – Unrelated party revenues
  – Profit before tax
  – Stated capital
  – Tangible assets

# Risk Assessment Offerings: Impact Assessors

The BEPS Impact Assessors are questionnaire based tools that facilitate identification of clients key risk areas and evaluate the potential impact the OECD Action Plans may have on client's business. The questions are organized by category and the answers to these generate a 'heatmap' indicating the areas potentially at risk. It is important to understand that this is just the first step and intended to provide directional guidance only, to be followed by a deep dive into the high risk areas. The two tools are:

**General BEPS Assessor:**
A 28 question Assessor, focusing on the OECD Action Points that will impact businesses, that generates a heat map which indicates the potential impact across 12 different areas. We have developed specific tools for deep diving into risk areas such as Permanent Establishment, DEMPE and POEM for both inbound and outbound businesses.

**Global Docs – CbC Reporting Assessor:**
A 23 question Assessor, focusing on Transfer Pricing issues raised by the BEPS Action Plan, that generates a heat map which indicates the potential impact across 5 different areas.

Deloitte.