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# Tax Data Analytics and Country-by-Country Reporting

## Insight to Action

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Sweeping changes to tax laws worldwide are creating a new paradigm that affects nearly every aspect of global business

Over the last two years, the Organization for Economic Co-operation and Development (OECD) has been working on its Base Erosion and Profit Shifting (BEPS) project, "the first substantial renovation of the international tax rules in almost a century."[1]

Final reports on the project's focus areas were issued in October 2015 and the leaders of the G20 committed to the implementation of BEPS at their summit the following month. The OECD will subsequently finalize guidance that fundamentally changes the global tax landscape.

Further new legislation and reporting requirements aim to create a degree of public transparency and global tax fairness that has never before existed. On the same theme, additional reporting obligations are also being implemented in the banking and extractive industries.

The confluence of the BEPS project, high levels of sovereign debt, increased media attention, and information sharing between tax authorities is culminating in sweeping changes to tax laws and treaties and triggering a complete Global Tax Reset.

[1] *http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm*

The countdown has
already started

CbCR will give tax authorities access to detailed financial information about group operations worldwide

### Country-by-Country Reporting

One of the key BEPS changes is the introduction of Country-by-Country Reporting (CbCR) requirements for multinational corporations (MNCs) with turnover in excess of €750 million. CbCR will give tax authorities access to detailed financial information about group operations worldwide.

CbCR provides tax authorities with information to help them assess Transfer Pricing risks and allocate their tax audit resources. A draft template has been issued by the OECD which requires MNCs to report on revenues, pre-tax profits, corporate income taxes paid and accrued, headcount, assets, capital, business activity codes for each operating entity, and several other items of information. Countries are expected to implement local legislation to give effect to the BEPS outputs so that MNCs file their first CbC report 12 months after the end of the fiscal year beginning on or after 1 January 2016.

CbCR reports will be filed with the tax authorities in the country where the MNC is headquartered. Where that country is delayed in implementing the legislation, the MNC can select one of its subsidiaries operating in a country where CbCR is already required and where their most significant activities occur to act as a surrogate filer.

In other words, as long as an MNC operates in at least one country where CbCR is required, it will have to comply and the countdown has already started.

## How do I get it, how do I check it, and how do I analyze it?

### How are affected companies responding to CbCR?

Currently, MNCs tend to fall into one of two groups. The first group has recognized the size and complexity of the requirement and started to develop their overall CbCR approach strategy and data discovery, or have at least put in place the new annual processes required to gather the data. They have appreciated that compliance with CbCR is more than a data gathering exercise and must involve a strategic first step to determine impacts of their organization and tax structure. This involves assessing how items such as permanent establishments, branches, minority investments, joint ventures, and subpart F income would be treated and adjusted for on their CbC report. These companies have also realized that the data to be collected is of commercial value while being a powerful tool in the hands of the tax authorities. Finally, they are taking a holistic approach to proactively performing a dry run with 2015 data during 2016 in order to analyze how their CbCR data could look, how it could be interpreted by the tax authorities, and what data anomalies might create or highlight potential risks and exposures.

The second group are adopting a "wait and see" approach, holding off taking action until they see the proposed legislation in their headquarter country. This group is on the decline as the first filing deadline looms closer and the scale of the compliance effort comes into focus.

## Why is complying with CbCR an issue?

The existing global tax environment is already challenging for MNCs. Most countries' tax laws were written last century; in many cases they are outdated and unsuited for addressing today's digital, globalized economy. In response to these developments, tax authorities have introduced: 1. e-filing; 2. data requirements in a more structured form, such as XBRL or iXBRL supported with standard tax charts of accounts (taxonomies); and 3. mandated access to ledgers or individual transactions for compliance purposes and to calculate liabilities. In response to this evolving environment, MNCs have started to transform their tax functions and the BEPS project is accelerating the need for change.

In an ideal world, the data required to comply with CbCR would reside in a tax-sensitized, group-wide ERP or consolidation system. In reality, such a system is still likely to be an an aspiration for most MNCs. The situation is further complicated as group tax departments have previously had no requirement to gather this data (and thus lack the mechanisms for doing so) and tax compliance at the local level has often been a largely standalone process with little or no involvement of the head office tax function. Equally the process of gathering group-wide information for financial reporting purposes has generally resided in the finance function; that data has been collected for a different purpose with different requirements as to the materiality, definitions, and granularity. For CbCR, it is necessary to go beyond locally consolidated data to entity level information, as current OECD guidance indicates that the data should be reported on an aggregated (rather than consolidated) country basis. Unsurprisingly, in some MNCs, discussions are taking place about who is responsible and accountable for these new data needs.

On top of this challenge–which can be summarized as "how do I get it, how do I check it, and how do I analyze it?"–are complications which may arise if a legal entity map denoting permanent establishments and branches and partnerships is incomplete or does not exist. In addition, a decentralized corporate culture in which new processes and information requests of the sort necessary to comply with CbCR, could likely be seen as unwelcome head office "interference." Taken together, the tax function would not have a complete picture of the data it needs to collect and help in building that picture may be reluctantly given.

A typical tax function is staffed by tax technical and compliance specialists. These resources may lack the experience necessary to develop and manage an automated process for gathering information from disparate sources and assessing it from a risk perspective. In addition, they may not possess the workflow to aggregate the data for compliance given that information may have been prepared and presented under differing local rules. Data harmonization is a key step in the CbCR process.

## The transparency and consistency agenda; a board room issue

In parallel and interlinked with the BEPS project is the increased expectation of transparency leading to heightened focus on consistency in the tax affairs of MNCs. A wide variety of stakeholders including the investment community, the media, and tax justice activists are scrutinizing the tax conduct of large MNCs, creating increased reputational risk associated with both aggressive and what may be perceived as artificial structures at one end if the scale or straightforward reporting errors at the other. Inevitably CbCR increases this risk, providing tax authorities and whistleblowers with additional data which can be used to highlight tax behavior. Although it is intended for CbCR to be confidential, heads of tax need to be aware of the risk that they could enter the public domain and put an appropriate public relations strategy in place.

Research undertaken since the BEPS project's launch estimates annual losses for tax authorities at four to ten percent of global corporate income tax revenues or USD 100–240 billion per annum.[2] This is the context in which tax authorities will be examining MNCs' CbCR, using analytical techniques to identify where their efforts should be focused to increase the opportunity to recoup income. This will not just happen in developed countries; many non-OECD and non-G20 countries have been actively involved in the BEPS project and there is a common commitment to building capability in developing countries so they too benefit from the project's tax fairness objectives.

[2] *http://www.oecd.org/ctp/beps-about.htm*

## Tax risk management and data analytics

As tax authorities and MNCs have responded to the challenges and opportunities presented by digitalization, technology and automation are playing an increasingly important role in the tax compliance process. Revenue authorities are building up their own tax data warehouses with tax risk management systems and using analytical techniques to validate and benchmark data so that they can direct audit and enquiry activities towards higher risk taxpayers. In some jurisdictions, tax authorities are adding statistical and quantitative expertise to refine and reinforce their scope for more sophisticated analytics. Data reported under CbCR can expect to receive similar treatment.

MNCs and other taxpayers are using analytics for their own tax risk management both for hindsight–to gain a better understanding of the risk associated with what has already happened–and to gain foresight through scenario planning of alternative future strategies or the impact of variables on tax outcomes. Such exercises can be incredibly powerful given the scope for working with live data and taking into account a group's own tax risk appetite.

Tax data analytics is currently helping forward-thinking MNCs to risk assess their CbCR using inputs from earlier years. This allows them to replicate the insights which tax authorities might generate, identifying anomalies for further examination and explanation. It is certainly beneficial to be able to correct data errors, fill gaps, and take strategic actions prior to the first period on which they have to report.

In the area of transfer pricing, tax data analytics goes beyond identifying inconsistencies in policies, errors, and anomalies; it is now possible to identify their root causes. In many cases these can be attributed to:

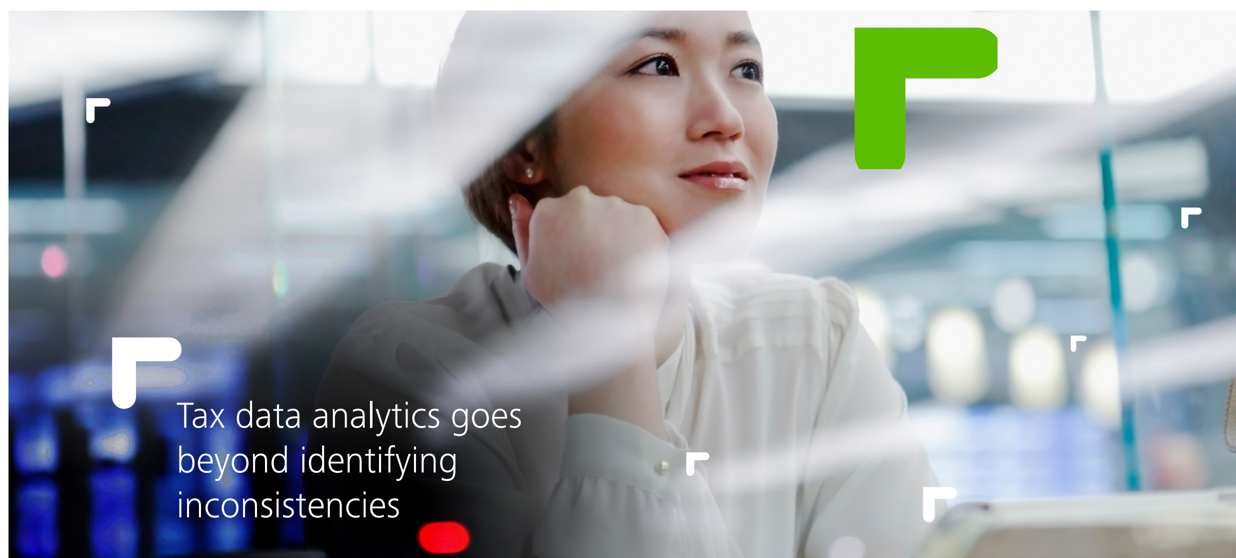
- The incorrect or partial application of a transfer pricing policy, because the tax department that designed it is not responsible for its day-to-day implementation; or
- Transfer pricing policies which work at a group reporting GAAP level, produce divergent results under local GAAP; or
- Actual results differ markedly from forecasts based on standard costs implementation.

These and other insights from analytical tools and processes help MNCs to take corrective action where necessary, explain deviations and inconsistencies, and decide the requisite level of detail to provide an explanation from both a quantitative and qualitative perspective.

While analytics will still be relevant once CbCR is a fact of life, using analytics on reportable historic data provides a "heads up" on likely areas of tax authority interest and also an opportunity to proactively analyze and impact what needs to be reported. For MNCs that have not already started to collect and examine the data which will be used for their CbCR, there is no time like the present. If post-filing errors are uncovered by tax authority enquiries or unexplainable anomalies are identified, potential monetary impact could result (e.g., due to audit adjustments) and the reputation of the tax function could suffer. And as tax authorities will automatically be sharing BEPS data with the authorities in all relevant jurisdictions, a MNC's tax function will need consistent policies and approaches across all countries of operation so that the reporting makes sense when the group is benchmarked against itself. To achieve this, the tax function must evolve from its traditional role as a passive consumer of historic data, to a proactive business partner able to use the data it gathers, validates, harmonizes, collates, and reports to provide input into strategic decision-making.

Over time, MNCs will integrate these analytics into their ERP, consolidation, and tax compliance systems, but for now most will need to run analytics on extracted data. Starting to use analytics early in the BEPS journey is one way to gauge the readiness of the organization, as a whole, to collect and aggregate the data required for CbCR and identify any challenges in data collection which will need to be overcome in order to meet the 2017 reporting deadline.

In the near future, the vision is that end-to-end tax data analytics techniques will enable MNCs to assess the impact of decisions made for one tax purpose on all relevant taxes. For example, if a business makes an adjustment to intra-group arrangements based on a desired transfer pricing and corporate income tax outcome, what will be the customs duty and other indirect tax implications? A holistic tax overview of this type will help enhance decision making and avoid unintended consequences.



## Hindsight and foresight to manage risks and facilitate tax-sensitized scenario planning

### Crunchy questions for CbCR

Tax data analytics can help MNCs manage the risks associated with CbCR. Key questions MNCs need to start asking themselves include:

- Who is responsible for data gathering and who is accountable for its accuracy?
- Do taxes paid and accrued and profits before tax tell a consistent story?
- Do the outputs make sense when benchmarked against past performance?
- Are consistent results achieved across similar entities in the group?
- Is the CbCR headcount consistent with other reportable information and taxable status per jurisdiction?
- Can the CbCR data be reconciled to other local reporting?
- Are the outputs of the CbCR in line with transfer pricing policies (and is the policy consistent)?
- What impact could proactive monitoring of transfer pricing policies against targets have on future CbCR?
- Are there anomalies in the CbCR data or policies which may need correction or explanation?
- Could the outputs of the CbCR lead to tax audit or reputational risk?
- Who provides the budget to implement and maintain the CbCR compliance process?
- To support more efficient CbCR in the future, is a change to technology strategy and infrastructure needed?
- What new skills are needed in the tax function for a robust, end-to-end, analytics-enabled CbCR process?

### How Deloitte can help

Deloitte can assist your business to better understand the implications of CbCR and how scalable tax analytics solutions provide hindsight and foresight to help manage inherent risks and facilitate tax-sensitized scenario planning.

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