



# BEPS Update: Country-by-Country Reporting

## PRACTICE AREAS

International Tax

Tax

Tax Controversies

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## **OECD Releases Discussion Draft on Transfer Pricing Documentation**

On January 30, 2014, the Organisation for Economic Cooperation and Development ("OECD") released its *Discussion Draft on Transfer Pricing Documentation and CbC Reporting* ("Discussion Draft"). This initial draft proposes revisions to guidance regarding transfer pricing documentation standards and was prepared in response to Action 13 of the OECD's July 19, 2013 Action Plan on Base Erosion and Profit Shifting. While the Discussion Draft specifically acknowledges that it reflects a limited consideration of potentially relevant issues, and therefore does not represent consensus views by relevant OECD working teams, taxpayers nevertheless should be aware that the envisaged approach may materially increase the burdens and costs of tax compliance and tax controversy for enterprises operating in the global marketplace. The OECD has requested comments to the Discussion Draft by February 23, 2014. Public consultation will follow in late March 2014.

By way of background, the stated objective of Action 13 is to "[d]evelop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business." As thus framed, the objective is a laudable one that seemingly endeavors to strike a balance between the provision of information that plays a central role in transfer pricing analysis and the burden of providing information that is merely ancillary to the exercise. As borne out in the Discussion Draft, however, its implementation would clearly and significantly tip the balance in favor of tax administrators and foment a disclosure of information that arguably extends well-beyond that which is necessary



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for traditional OECD (i.e., arm's length) transfer pricing analysis. Accordingly, tax and finance executives should consider taking an active role in the ensuing Action 13 dialogue (through appropriate channels, as necessary) to ensure that business and pragmatic considerations (e.g., confidentiality, resource-allocation) are adequately represented as the OECD finalizes this proposal for potential adoption by country tax administrations.

### **Two-Tier Reporting System**

At its core, the Discussion Draft proposes a two-tier system of transfer pricing documentation and country-by-country reporting. Multinational enterprises would be required to prepare and submit a voluminous master file containing information related to the global enterprise and individual group members. In addition, a local file would be prepared for each constituent member (including, potentially, each branch or permanent establishment) operating in a particular jurisdiction.

#### Master File

As proposed in the Discussion Draft, the global parent of a multinational enterprise would prepare (in English) a master file containing detailed information regarding the group, including:

- Its organizational structure
- Written descriptions of the drivers of business success
- Various charts describing material supply chains and important intercompany arrangements (including royalty, service fee and interest streams)
- Written descriptions relating to the group's strategy for intangible development, ownership and exploitation
- The title and principal location of key employees (e.g., the R&D team, the most highly compensated individuals in each business line, etc.)
- Lists and brief descriptions of various company tax positions (including APAs and rulings) and pending or recently resolved transfer pricing matters in MAP

In addition, the master file would contain a country-by-country chart of information (further broken down for each entity, or effective business unit, organized within the country) that would reflect the geographical array of the enterprise's economic activity, depict how its global profits are allocated and identify where (and to what extent) it pays taxes.

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Notably, the Discussion Draft anticipates that the master file would be provided to each local affiliate - ostensibly for the purpose of ensuring that the file is within the jurisdictional reach of local tribunals (i.e., rather than requiring invocation of an exchange of information mechanism under existing treaties).

#### Local File

The Discussion Draft also envisages a network of local files that will supplement the master file, with each local file operating to ensure that the enterprise has utilized the arm's length principle in arriving at material transfer pricing positions that impact the local filing jurisdiction. In this sense, the local file is a Discussion Draft analogue of local transfer pricing reports presently prepared by multinational enterprises, and it similarly focuses on the analysis of transactions that take place between the local country affiliate and related parties. Accordingly, the local file will include relevant financial information regarding related-party transactions, a comparability analysis and information regarding the selection and application of the particular transfer pricing methodology for the fiscal year in question. The Discussion Draft also proposes that the local file include certain information not typically found in current local country reports (e.g., information regarding the persons and jurisdictions to which local management reports) and, not surprisingly, contemplates that it will be prepared in the local language.

#### **Initial Thoughts**

Implementation of the various proposals set forth in the Discussion Draft will inevitably increase tax-related compliance and controversy costs for multinational enterprises, particularly given the expansive scope of disclosure contemplated by the newly-envisaged "master file" concept. Nevertheless, changes to the landscape of global transfer pricing compliance are afoot, and the momentum for such change is at this point unrelenting. As a result, we are of the view that tax and corporate executives should:

- Take advantage of the opportunity to provide comments to the Discussion Draft, notwithstanding the uncharacteristically short comment period provided.
- Identify proprietary or sensitive data that may potentially be subjected to wider dissemination within the organization under the proposed "master file" system, and consult with legal, finance and similarly relevant teams to evaluate potential approaches for managing "master file" security.
- To the extent not already in place, use the Discussion Draft as a catalyst to meaningfully evaluate and articulate a consistent global transfer pricing strategy.



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- Evaluate present team dynamics and ascertain whether internal relationships can be optimized (e.g., between global audit defense and local finance teams) to adequately manage global tax risk under the proposed two-tier system.
- Contemplate the potential changes to enterprise systems that may be required in order to efficiently migrate into a post Discussion Draft era.

Our team is presently working to submit written comments to the OECD on discrete matters raised by the Discussion Draft.

*[View OECD Discussion Draft on Country-by-Country Reporting](#)*