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OECD Documentation, CBC Reporting Requirements Elevate Importance of Preparation in IT and Controllershship Processes

Proposed new documentation standards from the Organization for Economic Cooperation and Development will require multinational enterprises to report financial information across jurisdictions in ways they have never been expected to do in the past. These proposals raise questions about the capacity of corporate information systems and controllership processes to generate the level of financial detail that the OECD believes should be readily available to multinational taxpayers. In this article, the authors urge multinationals to assess their readiness to respond to the proposed new reporting requirements and to prepare to adopt changes in internal processes to meet those demands.

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On Jan. 30, 2014, the Organization for Economic Cooperation and Development released its discussion draft on transfer pricing documentation and country-by-country reporting. The draft is intended to replace existing Chapter V (Documentation) of the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, which was last revised in 1995. The draft originally recommended a two-tiered approach to transfer pricing documentation, consisting of a local file and a master file that included a new template imposing certain country-by-country reporting requirements. As it stands now, the country-by-country template will be a stand-alone document, apart from the local file or master file.

As of press time, the OECD is proceeding at break-neck speed to analyze feedback on the country-by-

country template included in the draft, with the aim of publishing final guidance by September 2014. Working Party No. 6 of the OECD will hold a public consultation on the discussion draft on May 19, with the goal of reaching agreement by June on proposed changes to the OECD's transfer pricing guidelines. Rapid change is therefore expected, and several jurisdictions are already signaling their intentions to implement country-by-country reporting requirements as soon as the proposal is final.

Upon initial consideration, the idea of a uniform standard for transfer pricing documentation across jurisdictions appeals to both multinational enterprises and tax authorities; many taxpayers, in fact, have previously lobbied for such coordinated guidance. However, when closely read and considered, the discussion draft would impose unprecedented administrative burdens on taxpayers. The country-by-country template is especially daunting and disconcerting to taxpayers and for various reasons, unlikely to result in the desired uniformity across jurisdictions. Multinationals are particularly apprehensive about the capacity of their financial reporting and human resources functions and management information systems (MIS) to supply all the information required while maintaining the security of sensitive data.

The discussion draft is still in flux, and the final form of the guidance not yet certain. Nevertheless, multinationals are actively considering the practical impact of these proposals—both in terms of new investment in IT

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systems and the ensuing impact on accounting control-ship. Neither area lends itself to rapid change; therefore, significant work may be required in 2014 if companies are to position themselves to comply with the proposals upon adoption. Specifically, multinationals may be well advised to assess their data systems and processes to determine if they have the capability to gather the necessary information and provide segmented data by function. As part of this exercise, multinational enterprises should assess the challenges in accessing core enterprise resource planning (ERP) functions and business intelligence platforms to meet compliance obligations. They also should identify the support required of finance and tax executives to drive the necessary changes in process and culture at the local level.

Finally, proactive organizations may consider completing the country-by-country template—even if only with best estimates—and using it as the basis to evaluate potential “BEPS issues” that they might face, with a particular focus on substance.

Overview of Documentation, Country-by-Country Proposals

The OECD discussion draft originally proposed a two-tiered approach to transfer pricing documentation comprised of a master file—which provides a holistic view of a multinational’s global business dealings and operations—and a local file, akin to the transfer pricing documentation already being prepared by multinationals for jurisdictions where they operate.

The discussion draft originally proposed that the master file include a model template for reporting information on the global allocation of income, economic activity, and taxes paid on a country-by-country basis for each business unit within a multinational’s global group. The OECD has since announced that this country-by-country template likely will be a separate document, apart from the master file.

Master File

The master file is organized into the following five categories:

- global business structure;
- description of the multinational’s business;
- description of intangible assets, discussion of intangible development activities, and transfer of intangibles;
- description of intercompany financial activities; and
- details regarding the multinational’s financial and tax positions, including allocations of income and taxes.

Taxpayers may recognize that this information is typical of the details included in functional and industry analyses under existing transfer pricing documentation requirement. However, a number of nonroutine items are included as well. One example is the presentation of charts showing the supply chain for material products and services and listing relevant advance pricing agreements (APAs), tax rulings and transfer pricing matters pending under a tax treaty’s mutual agreement procedure (MAP). The inclusion of these peripheral items is particularly concerning to taxpayers, not only because this information is broad and general—seemingly beyond the scope of pure transfer pricing documentation—but also because it might not be read-

ily available to a multinational’s tax department. To obtain it, tax personnel might have to pull data cross-functionally across different systems or, even in some cases, collect it manually.

Another concern is that the discussion draft specifically suggests that the master file be shared with every affiliate of a multinational, and that it could then be obtained directly by local taxing authorities from local affiliates. This approach raises the risk that confidential information might be inadvertently disclosed. As cybersecurity continues to be top-of-mind for corporate leaders, multinationals must consider how to implement this information-sharing across their business. As recent high-profile cases have shown, exposing confidential corporate or client information—or both—can have far-reaching implications for the organization and a negative impact on shareholder value.

Country-by-Country Template

In terms of sheer data points required for compliance, the country-by-country template can be viewed as the most aggressive and burdensome of the reporting mandates proposed in the discussion draft. Likened by some to an extreme version of U.S. Forms 5471 and 5472, the proposed template would require reporting on a country-by-country basis of revenues, pre-tax earnings, cash taxes and current tax accrual, stated capital and accumulated earnings, number of employees and tangible assets. However, based on comments from taxpayers, tax professionals, and the public at large, the OECD March 31 said it would likely scale back the template in certain areas. Among the tentative changes:

- data would be reported on an aggregated basis by country, rather than broken down by legal entity; and
- the last six columns in the proposed template (which included intercompany interest, royalties, and service fees) would be omitted (22 *Transfer Pricing Report* 1444, 4/3/14).

The exact form of the new reporting requirements cannot be known until the final version is published, but taxpayers have raised concerns about how the proposed template will be used by tax authorities.

Because final statutory financial statements relevant to the country-by-country data requirements may not be available until after the due date for tax returns in some countries, the discussion draft also provides an extension for completion of the template until one year following the last day of the fiscal year of the ultimate parent entity of the multinational group.

The exact form of the new reporting requirements cannot be known until the final version is published, but taxpayers have raised concerns about how the proposed template will be used by tax authorities. Notably, the draft template uses the location of tangible assets and employees as proxies for the location of economic activity, raising the specter that the country-by-country

template could be misused to make transfer pricing adjustments consistent with a formulary apportionment approach.

Local Files

Finally, it should be noted that the OECD contemplates novel requirements for additional information pertaining to the local files. However, this detailed information—such as identification of the individuals that have direct or indirect reporting relationships—may be of only limited value to tax administrators, while simultaneously increasing compliance burdens on local taxpayers.

Business Culture and Resource Availability

Underlying the OECD's proposals is a fundamental presumption that multinationals have access to much of the required country-by-country data through centralized MIS. For example, one of the OECD's specific requests for comment on the master file proposal asks whether the country-by-country template should be compiled using "bottom-up" reporting from local statutory accounts as in the current draft, or whether it should be changed to require (or permit) a "top-down" allocation of the multinational group's consolidated income. The OECD seeks input on this question in order to determine the additional systems requirements and compliance costs, if any, that would need to be taken into account for either the "bottom-up" or "top-down" approach.

However, this phrasing implies an assumption that the compiler of the master file—presumably headquarters or corporate personnel—would have access to local statutory accounts maintained in real time and that, potentially, the system already would be so configured that no additional requirements or compliance costs would arise. This is not a realistic assumption. Clearly, some accounting effort would be required under either approach for intercompany eliminations, in order to avoid double counting.

But in the authors' experience, although there are many multinationals with such platforms in place, there are equally as many that do not take a centralized view because their business culture and system configuration militates against it. For those companies with dispersed business intelligence systems—and particularly those with decentralized controllership and management structures—the country-by-country reporting requirements may present a significant execution challenge in terms of both systems and supporting organizational resources.

Addressing Tensions Between Local Compliance and Global Consistency

Transfer pricing has always been the most "globally connected" of the areas of tax compliance, considering the multinational connectivity brought about by APAs, tax treaties' MAP articles, and other similar activities. However, in the context of country-by-country reporting, multinationals need to consider carefully how the data submitted locally through the template could create unnecessary confusion if it is not carefully reconciled at the center of the organization.

The OECD's approach suggests that centralized coordination will be a standard part of the reporting pro-

cess. However, frequently subsidiaries collect data that the parent does not automatically have access to. Typically, the information collected at the central hub is generally more aggregated than the data housed by the local operations.

Additionally, business culture must be carefully considered. A key premise of many tax authorities' approach to addressing transfer pricing is that related parties will act together to shift income and expenses so as to benefit the consolidated group as a whole. In reality, however, many multinationals foster a culture in which affiliates actively compete against one another, and management's incentive compensation is directly tied to local or entity-specific profitability and efficiency, rather than to broader corporate goals. In such competitive environments, cross-entity information sharing may be difficult to achieve in practice and could raise concerns around internal data confidentiality. Even in organizations where such active intercompany competition does not occur, corporations that have emphasized business-line autonomy may find it difficult to engage local controllership resources in furtherance of the wider goal of meeting country-by-country compliance requirements.

Multinationals need to consider carefully how the data submitted locally through the country-by-country template could create unnecessary confusion if it is not carefully reconciled at the center of the organization.

Consequently, a multinational's business culture will affect how the required data is extracted. For many multinationals, efforts to comply with the template also will precipitate a cultural adjustment, changes to controllership activities, and likely repeated interaction between the head office and the subsidiaries. At some companies, sensitivities may also arise in the context of employment data. Even though the data is reported in the aggregate, for a subsidiary that employs only one or two key executives, maintaining the confidentiality of internal compensation and payroll data could be a challenge.

Data Capture and Attitudes Toward Legal Entity Reporting

To address the documentation requirements set forth in the discussion draft, corporate tax personnel must know how functional and financial data is captured, analyzed, and reported within their organization. Building this understanding will be time-consuming, given that the sophistication of data systems may vary within the organization, but familiarity with the different systems and procedures in place will help identify the potential sources of data as well as their potential benefits and limitations.

Although many multinationals may employ an ERP system as part of their MIS portfolio, there are often legacy systems in use as a result of acquisitions. Growth is not always followed by systems integration, and often

organic growth outpaces the ability of the MIS function to expand concurrently. Further, it is not unusual for new businesses to start out with several desktop-based tools to manage transfer pricing and financial reporting. These systems tend to be harder to scale and less robust than enterprise systems, which aim to synthesize and integrate virtually all functions across a business. Similarly, many companies rely on spreadsheet models to determine overhead and headquarters cost allocations, which can become degraded over time as new cost centers are added and local tax rules are modified. Thus, multinationals initially may find that the proposed new documentation rules require them to produce a tremendous volume of data with no effective or practical means of doing so.

Even multinationals employing robust ERP systems may not be immune to these challenges. Such systems were originally envisioned as running on a single database serving an entire company, eliminating redundancies in information and effort across functions, business units, and geographies. But in practice, ERP systems are often hampered by bandwidth constraints, prohibitive costs, and a lack of trained personnel to manage these issues. Further, in some organizations, competition among business units can lead managers to demand a customized version of the software, thus defeating the purpose of standardization across the organization. Consequently, there are many multinationals which run multiple instances of ERP software, resulting in the potential for data conflicts and other issues without careful monitoring.

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But even in organizations that run a single global instance of ERP, producing legal entity information at the country level may be an afterthought. Nearly all multinationals are configured to gather information under the generally accepted accounting principles (GAAP) of the parent company's country of organization. However, reporting granular data under local GAAP is often a different matter. Frequently, the local legal entity accounts are prepared some months after year-end—possibly too late to support a centralized view of the country-by-country template detail. Companies will need to reevaluate how they prioritize local entity data in their controllership processes. This inherent tension in the discussion draft between “bottom-up” reporting from local statutory accounts versus a “top-down” allocation of the multinational group's consolidated income among countries will be a key factor influencing the approach taken by multinationals. According to the OECD's March 31 statement, the country-by-country data may originate from either from the parent company's GAAP or local GAAP, but whichever approach is employed, it must be consistent across the organization.

What Should Multinationals Be Doing Now?

Given how quickly the BEPS project is moving, taxpayers should act swiftly to assess their ability to produce granular data efficiently and accurately. Controllership processes, organizational culture, and core IT systems capability will be key to this implementation. Multinationals are well advised to consider the following key practical considerations and potential actions as a means to better prepare themselves for the anticipated reporting requirements.

Address Uncertainty in Country-by-Country Template

For each data element in the proposal, there may be challenges in determining what the definition actually means for the organization in question. Even for a seemingly straightforward item, such as number of employees, questions may arise about how to account for independent contractors and part-time employees. Further, multinationals may find this information spread across divergent payroll systems, necessitating more difficult collection procedures or manual adjustments. With nearly all of the terms in the country-by-country template, there is tremendous subjectivity, with little to no guidance on resolving conflicts in definitions. These difficulties will only be magnified to the extent that countries deviate from the recommended template when they put the country-by-country reporting regime into practice—a not unlikely scenario.

In addition, the current draft indicates areas where taxpayers will be at liberty to choose how to comply. One area of particular concern is choice of accounting methods, where multinationals will likely differ in their perspectives as to whether adopting a “top-down” or “bottom-up” approach to data collection presents the easier option. For those multinationals that perceive the top-down approach to be the most feasible, an issue may arise as local corporate tax reporting will continue to be made in local GAAP, which could give rise to a large volume of requests from tax authorities to reconcile the two positions. In other words, irrespective of the GAAP used to complete the return, some organizations may need also to plan for local GAAP numbers in readiness for tax audits.

Proactive companies will want to stay ahead of the curve and anticipate potential pitfalls.

From a risk management perspective, companies rightly will want to ensure that the information is consistent across the organization. For example, some local accounting rules require reporting in statutory accounts detailing the average number of employees per year and not the number of employees on the last day of the year, as required by the draft template. Different conventions may be used by groups in different countries for determining the number of full-time versus part-time employees. Given that the stated purpose of the discussion draft is to enable a more risk-focused approach on the part of tax authorities, this approach to reporting, although compliant, will require companies

to capture large volumes of data to satisfy the inevitable requests for reconciliation by tax authorities.

Proactive companies will want to stay ahead of the curve and anticipate potential pitfalls. Developing an approach to compliance that is consistent across the organization will help to alleviate some of the tension between the broad definitions in the guidance and the practical reporting required for the template.

Key questions to be addressed:

- Is there agreement internally on definitions of key terms in the template?
- Can the multinational build flexibility around reporting systems to allow for adaptations when implementing jurisdictions disagree on definitions of key terms?
- What steps is the multinational taking to ensure consistency of information?
- How is the multinational developing a consistent approach to compliance across the organization?

Understand Data Capture and Storage

Understanding how data is captured and stored in the organization is of paramount importance in creating a plan to comply with the new country-by-country reporting standards. As the information required for compliance crosses multiple corporate functions, tax executives must collaborate with their MIS, human resources (HR) and other financial management colleagues to determine which systems can provide the necessary source data and what additional processes or steps may be required. The level of centralization presumed by the discussion draft is uncommon, and frequently, granular operating data is held locally and may not be stored on a system compatible with the one used by the headquarters company. Thus, preparing a source map detailing the data sources linked to each category of information may be a helpful first step in understanding the systems landscape and preparing a collection strategy.

The standards for data reporting also come into play when data is captured in a multi-tiered fashion. For example, typically a local subsidiary may maintain books under U.S. GAAP as well as books for statutory purposes prepared under local GAAP. It is common to find that adjustments are not made for U.S. GAAP and statutory reporting purposes at the same time or in a coordinated fashion. As a result, corporate tax personnel must be vigilant when collecting data for country-by-country reporting purposes to ensure that the appropriate adjustments are reflected in the documentation.

Key questions to be addressed:

- Regarding existing ERP system configuration, does the fundamental data exist to complete the country-by-country template?
- Where multiple legacy ERP systems are in place, what process and work-flow solutions are available to fill the gaps?
- Regarding configuration of HR systems, what is the ease of accessing employee numbers by entity on a global basis?
- Regarding legacy systems and new investment, what existing business intelligence can be leveraged for country-by-country reporting purposes?
- Are there future initiatives that could be leveraged for country-by-country reporting purposes?

Assess Necessary Controllability Support Requirements

Local controllership functions will be a critical part of a multinational's global compliance plan for country-by-country reporting. In many organizations, these personnel are already stretched thin with monthly, quarterly and year-end close processes—which can take on even greater significance and require tremendous effort within publicly traded companies. Organizations will need to actively plan for accommodating the schedules of the local controllers and their teams around the country-by-country reporting requirements. Many multinationals will need to develop a new process to integrate country-by-country requirements into their existing financial reporting procedures, which will likely entail adoption challenges, including systems and personnel resource constraints and the need to resolve conflicting priorities.

Key questions to be addressed include:

- Is the prime point of entry capturing the level of granularity required to enable identification and segmentation downstream?
- How much effort will be required to produce a local country consolidated analysis?
- Do legal entity and local GAAP processes currently occur in a timely enough manner to support future country-by-country compliance?

In regard to share service centers, taxpayers also must ask how resource levels and workflow processes will need to be modified to enable finance centers of excellence to support compliance.

Impact on Existing Information Returns

One of the stated purposes of the proposed new documentation guidance is to allow tax authorities to adopt a more risk-focused approach, but it remains to be seen how the guidance in the discussion draft will be implemented. In the U.S., for example, taxpayers are already required to report their related-party transactions through a variety of information returns (e.g., Form 5471, Form 5472) depending on each filer's relationship to its affiliates. Although multiple, commonly controlled U.S. entities may file a consolidated federal income tax return, information returns are required for each foreign affiliate with whom one or more members of the consolidated group conduct business.

Even though the template likely will not require reporting on an entity-by-entity basis, variations in the way that individual countries chose to adopt the final guidance upon publication may result in a "perfect storm" for taxpayers. Some jurisdictions still might require information returns to be produced on an entity-by-entity basis—as the U.S. does with Forms 5471 and 5472—while others hew to the template, which seemingly would present data at the aggregated country level. In this case, taxpayers will need the flexibility in their systems and processes to produce data to fulfill both sets of obligations, a potentially formidable task.

Key questions to be addressed:

- Does the multinational have a current system in place to support global information return requirements?
- If so, how can the system be leveraged in the country-by-country reporting context?

Readiness for Compliance

As the OECD's target deadline for finalizing the discussion draft rapidly approaches, now is the time for multinationals to consider how their tax departments can work cross-functionally with their MIS, IT, HR, and accounting and financial reporting counterparts to assess user requirements, develop special budget requests to comply with the new documentation requirements, and begin efforts to make senior management familiar with the project.

However, many companies appear to be unprepared. In a poll of senior tax executives conducted earlier this year, a majority confirmed that they have "barely" been able to leverage their multinational's ERP or business intelligence configuration to meet organizational transfer pricing objectives. The same survey also revealed that most did not have among their tax and transfer pricing personnel individuals who could navigate the systems and understand how to access and manipulate the data. Finally, when asked how challenging they expect the implementation of the country-by-country template requirements to be in terms of their organization's existing IT and HR systems, a clear majority believed it would be difficult or highly difficult primarily because current systems configurations were not in place to meet all of the draft template requirements (see Figure 1).

Proactive Self-Assessment

Although the additional costs and compliance burdens likely to be imposed by widespread implementation of country-by-country reporting requirements may appear daunting and encourage a defensive mindset, multinationals would be well advised to take a more proactive approach. It is not unlikely that some tax administrations will view the country-by-country template as their transfer pricing "audit roadmap." And it may eventually become a complete "BEPS audit roadmap," as the discussion draft indicates that the OECD is giving further consideration to whether information relevant to other, non-transfer pricing aspects of tax administration and the BEPS Action Plan should also be included in the common template. Consequently, after considering what changes will need to be made simply to gather the data necessary to complete the country-by-country template, multinationals should consider completing the template—even if only with rough estimates—and using it as an internal assessment tool to evaluate what potential "BEPS issues" the template may flag, with a particular focus on substance.

It is not unlikely that some tax administrations will view the country-by-country template as their transfer pricing "audit roadmap."

When doing so, it will be important to remember that, because the template uses the location of employ-

ees and tangible assets as indicators of the location of economic activity and value creation, it is likely to trigger certain types of challenges by tax authorities. For example, tax administrations may use the information ultimately reported in the template as a basis for challenging the use of principal structures and holding company structures, as well as in situations where there is relatively low headcount and functionality—especially from a strategic perspective—at the level of the principal in comparison to entities characterized as low-risk service providers, and in instances where risk or capital or both are predominant in determining the income of the principal. Proactive multinationals may wish to invest the time now to use the template to identify in advance these possible areas of challenge by tax authorities and take whatever steps are necessary to counteract them.

Summary

The OECD's draft guidance is intended to create a uniform standard and approach to transfer pricing documentation applicable across multiple jurisdictions, facilitating a risk-based approach to tax audits. Although the results of this initiative will not be known until the draft is finalized, it is already apparent that compliance with the revised Chapter V of the OECD guidelines potentially will have far-reaching and troublesome impacts. Specifically, multinationals are most concerned about the ability of their financial reporting and information systems to supply the depth and breadth of the data required for compliance, concurrently with maintaining data security and sensitivity, and whether internal financial reporting resources will be able to support the new regime.

The OECD has offered only a very truncated public comment period, with the aim of producing final guidance no later than September 2014. Given this highly accelerated timetable, multinationals are well advised to take steps to assess, invest in, and update their MIS platforms over the course of the next 12 to 24 months or less to prepare for the new reporting environment. Specifically, multinationals may want to consider undertaking a systems readiness assessment, ensure appropriate staffing levels of trained personnel to gather and analyze the data, and focus on closing gaps between automated reporting and manual processes. After that step, those multinationals with the ability to do so may be best advised also to consider using the country-by-country template as a tool to perform a self-assessment in order to anticipate and mitigate potential challenges by tax authorities. By collaborating across corporate functions and appropriately engaging with external advisors, multinationals can best position themselves to address the changing regulatory landscape and better reduce enterprise risk.

Figure 1. Responses to senior tax executives' polling at TP Minds Americas Conference in Florida, February 19-20, 2014

