

OECD releases discussion draft on transfer pricing documentation and country-by-country reporting

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In brief

Multinational enterprises (MNEs) will face materially increased compliance burdens as a result of the hotly debated proposals to report to tax administrations, on a country-by-country basis, extensive details of their income, taxes, and business activities. Further, extensive changes to the current requirements for transfer pricing documentation reporting will also add to this burden. These are the broad consequences of the proposals made by the Organisation for Economic Cooperation and Development (OECD) in a discussion draft released on 30 January 2014.

The guidance from this discussion draft is intended to replace the transfer pricing documentation guidance contained in Chapter V of the OECD's current Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines), which was adopted in 1995. Unlike the current version of Chapter V, the discussion draft requires a mandated list of documents to be included in a transfer pricing documentation package. The OECD will be giving further consideration to whether information relevant to other aspects of the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) should also be included.

The discussion draft also requests specific comments on a number of issues. A list of the OECD's questions is included below. Public comments on the discussion draft are requested according to a very tight timetable and are due by 23 February 2014.

Join our webcast on 13 February 2014 to discuss the OECD's discussion draft on transfer pricing documentation and country-by-country reporting. Register for the webcast [here](#).

In detail

This initial discussion draft was created in response to the BEPS Action Plan, published on 19 July 2013. Item 13 of that Action Plan directed the OECD to "[d]evelop rules regarding transfer pricing documentation" in an effort to enhance transparency for tax

administration. Pursuant to this call for transparency, the BEPS Action Plan also directed the OECD to "include a requirement that MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template," i.e.,

country-by-country reporting. For prior coverage of the BEPS Action Plan, see our previous Bulletins: for an overview [OECD's Action Plan published on Base Erosion and Profit Shifting \(BEPS\)](#) and for more considered comments [Momentum behind the Action Plan on Base Erosion and Profit Shifting \(BEPS\)](#).

Two-tiered approach to transfer pricing documentation

The discussion draft adopts a two-tiered approach to transfer pricing documentation: a “master file” containing standardised information for all MNE group members, which the OECD suggests should be completed in English, and a “local file” that provides specific information related to the transactions of a local taxpayer, which the OECD suggests should probably be provided in the prevailing local language.

The master file is intended to provide a complete picture of the MNE’s global business. The information in the master file would be organized into five categories: the global organizational structure; descriptions of the MNE’s business; descriptions of the MNE’s intangibles, intangible development activities, and transfers of intangibles; descriptions of any intercompany financial activities; and details regarding the MNE’s financial and tax positions, including allocations of income and taxes. Although some of the required information is commonly found in transfer pricing documentation, e.g., functional and industry analyses, the discussion draft also requests a number of novel items. For example, the new approach would require the title and principal office location but not the names of the 25 most highly compensated employees in each business line, charts showing the supply chain for material products and services, and lists of relevant advance pricing agreements (APAs), tax rulings, and transfer pricing matters pending under a tax treaty’s Mutual Agreement Procedures.

Observation: The local file/ master file approach does not clearly achieve the uniformity and simplicity that was the stated goal of the OECD’s work on documentation given that taxpayers

will now have to assemble the master file documentation package on top of the existing and varying local country documentation requirements.

Additionally, some of these requirements appear to extend the principles of tax reporting beyond transfer pricing documentation, e.g., by requiring information regarding APAs and tax rulings. Likewise, some of these requirements might not be the type of information to which tax directors normally have access, e.g., data on the 25 most highly compensated executives. The language requirements appear to be fairly strict as well, e.g. local files and translation of (parts of) the master file where needed.

As part of the master file, Annex III to Chapter V would require the completion of a “country-by-country reporting template.” The template seeks to collect income and tax details regarding each “Constituent Entity” in the MNE’s global group, organized by country, during the prior year. This information would include, *inter alia*, each entity’s revenues and profits, income and withholding taxes paid, stated capital and accumulated earnings. The template also seeks information on “certain indicators” of the location of economic activity (tangible assets, number of employees and total employee expense). Also requested is information on intercompany royalties, interest, and service fees paid or received.

Observation: While these disclosures are to be made to tax administrations, they currently go well beyond any of the other country-by-country initiatives. This applies both in terms of the elements covered and how the breakdown by entity would be required. Additionally, the reporting of intercompany payments of interest, royalties, and service fees seems to indicate that while these are legitimate business expenses for

unrelated parties, they will be closely scrutinised when they occur between related parties because of their potential for base erosion.

To implement the master file tier of the OECD’s proposed approach to documentation, it will become important that master file information is consistent from country to country. As a result, the OECD recommends that master file documentation be completed under the direction of the parent company of the MNE group and shared with each local affiliate around the world. This would allow local taxing authorities to collect the master file from the local affiliates or, in the alternative, to request the documents from another jurisdiction under treaty exchange of information mechanisms.

Observation: Although the OECD stresses the need for tax administrators to handle carefully any confidential taxpayer information to avoid inadvertent disclosures, the draft’s planned implementation of the master file scheme appears to generate greater risks of exposure of confidential client information. Specifically, the draft’s recommendation that the master file be shared with every affiliate so that it can later be shared with the relevant tax administrators during an audit seems to unnecessarily expose taxpayers to greater disclosure risks for their confidential information. There may also be business reasons why this level of information would not be shared with all affiliated entities. The exchange of information under a relevant tax treaty might be a more appropriate and secure method for sharing confidential information.

With respect to intercompany financial transactions, a description of how the group is financed is requested as well as the place of effective

management of (central) financing entities.

The local file would supplement the master file and ensure that the MNE has complied with the transfer pricing provisions of a specific jurisdiction. The focus of the local file would be the transfer pricing analysis of the transactions that take place between a local country affiliate and associated enterprises in different countries during the year at issue. Annex II to Chapter V would require certain specific background information about the local entity, as well as detailed factual and financial information about the transactions which are covered. For example, the local file should contain a description of the management structure of the local affiliate, a local organisation chart, and descriptions of the individuals to whom local management reports, as well as a discussion of any relevant business restructurings or intangibles transfers.

Observation: Some of the information requirements for local files might already exist in a robust and well-crafted functional analysis. Other detailed requirements – e.g., identification of the individuals that have direct or indirect reporting relationships – might be of only limited value to tax administrators while simultaneously increasing compliance burdens on local tax payers.

Timing

The OECD emphasises that transfer pricing documentation should be based upon information reasonably available at the time the transfer price was determined. The OECD also acknowledges that mismatches in the due dates of transfer pricing documentation in various jurisdictions can make it difficult for tax payers to prioritize global documentation obligations and to provide relevant information to tax

administrations on a timely basis. As a result, the discussion draft indicates that it is a best practice to prepare transfer pricing documentation contemporaneously with filing of the tax return for the fiscal year at issue.

The draft also notes that 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. Accordingly, the discussion draft would extend the date for completion of the country-by-country reporting template until one year following the last day of the fiscal year of the ultimate parent entity of the MNE group.

Observation: The relevant cash tax figure may not be known in the time envisaged with the result that, even the extended time envisaged for reporting country-by-country information, may not be long enough in some instances.

The draft guidance acknowledges that taxpayers should not be obliged to retain documents beyond a reasonable period and that tax administrations should restrict requests for documents from prior periods.

Materiality

The OECD recognises a balance between the tax administrations' desire for information and the compliance burdens placed on taxpayers. As a result, the discussion draft recommends that local jurisdictions adopt specific materiality thresholds that take into account, *inter alia*, the size of the transaction and nature of the local economy. The discussion draft does not, however, provide any guidance on what would constitute an immaterial transaction, but it does seek public comment on whether more specific guidance could be provided.

The discussion draft recommends simplification measures that would

limit the transfer pricing documentation requirements for small and medium-sized enterprises (SMEs) on the basis that smaller enterprises should not be required to produce the same amount of documentation that might be expected from larger enterprises. Nevertheless, the draft takes the position that SMEs should be required to provide information and documents about their material cross-border transactions.

Observation: Although it appears that SMEs might be spared from some of the compliance burdens of transfer pricing documentation, SMEs would still be required to complete the country-by-country reporting template (i.e., Annex III). As a result, despite the proposed balancing of benefits and burdens, it does not appear that SMEs will escape much of the compliance burdens placed on larger taxpayers in practice.

Comparables consideration

Although the discussion draft recommends that transfer pricing documentation be updated annually, it does acknowledge that business descriptions, functional analyses, and comparables may not change materially from year to year. As a result, in those situations, the OECD suggests that searches for new comparables in the local file could be updated every three years. Financial data for the comparables, however, must still be updated annually to determine an arm's length amount.

Observation: Although the draft guidance appears to accept that business conditions may not change materially from year to year, it does not adopt any flexibility regarding comparable data.

The discussion draft also notes that local comparables generally should be used over regional comparables

because of the general requirement to use the most reliable information.

Penalties

The OECD notes that penalties, as well as penalty protection, can provide a powerful incentive to comply with transfer pricing documentation requirements. Nevertheless, the discussion draft indicates that it is “unfair” to impose large documentation-related penalties on tax payers that make a reasonable, good faith effort to demonstrate the arm’s length nature of their covered transactions through documentation. In addition, the draft notes that penalties should not be applied to tax payers that fail to submit information to which they did not have access.

The takeaway

The OECD’s strategic objectives of making transfer pricing documentation more efficient and better targeted should be supported. The approach, as originally developed, sought to streamline and rationalise information requirements to benefit both tax administrations (i.e., with better information) and tax payers (i.e., by delivering a more efficient process). However, based on the proposals in the current discussion draft, it is not clear that these goals have been achieved as, overall, the package seems somewhat one-sided with little clear benefit to business.

Overall, the discussion draft proposes a large number of significant changes which could result in a very short period for business to adjust to life with increased reporting obligations, including country-by-country information. The OECD will need to carefully consider whether the reporting of tangible property, number of employees and payroll expense in practice might lead to adjustments more in line with a formulary apportionment type of

transfer pricing system, along with all the potential for increased disputes and double taxation that entails. The OECD has also posed a number of difficult questions, to be answered in a very short timeframe. Consequently, we recommend full and active participation by all interested stakeholders in the brief consultation period.

It will, in particular, be important to ensure that the consultation process is pursued to deliver as much flexibility as possible. Securing the confidentiality of information will also need to be a major priority.

Finally, the OECD statement in the draft that it will be 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 means that the documentation requirements may be expanded well beyond transfer pricing risk assessment purposes.

The update to the Guidelines in Chapter V is planned to be finalised by May 2014.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

On transfer pricing and country-by-country reporting

Collin F. Imhof, *Washington, DC*

+1 202 414 1475

collin.f.imhof@us.pwc.com

Kathryn Horton O'Brien, *Washington, DC*

+1 202 414 4402

kathryn.horton.obrien@us.pwc.com

David Ernick, *Washington, DC*

+1 202 414 1491

david.ernick@us.pwc.com

Isabel Verlinden, *Brussels*

+32 2 710 4422

isabel.verlinden@pwc.be

Aamer Rafiq, *London*

+44 (0)20 721 28830

Aamer.rafiq@uk.pwc.com

Laurel A. Korb, *Washington, DC*

+1 202 312 7964

laurel.a.korb@us.pwc.com

Adam Katz, *New York*

+1 646 471 3215

adam.katz@us.pwc.com

Pete Calleja, *Sydney*

+61 (2) 8266 8837

pete.calleja@au.pwc.com

Ryann Thomas, *Tokyo*

+81-03-5251-2356

ryann.thomas@jp.pwc.com

David McDonald, *Hong Kong*

+852 2289 3707

david.mcdonald@hk.pwc.com

Andrew Packman, *Uxbridge*

+44 (0)1895 52 2104

andrew.packman@uk.pwc.com

Neville Howlett, *London*

+44 (0)20 721 27964

neville.p.howlett@uk.pwc.com

On BEPS generally

Richard Collier, *London*

+44 (0)20 7212 3395

richard.collier@uk.pwc.com

Phil Greenfield, *London*

+44 (0)20 7212 6047

philip.greenfield@uk.pwc.com

Questions for consultation raised by the OECD

1. Comments are requested as to whether work on BEPS Action 13 should include development of additional standard forms and questionnaires beyond the country-by-country reporting template. Comments are also requested regarding the circumstances in which it might be appropriate for tax authorities to share their risk assessment with taxpayers.
2. Comments are specifically requested on the appropriate scope and nature of possible rules relating to the production of information and documents in the possession of associated enterprises outside the jurisdiction requesting the information.
3. Comments are requested as to whether preparation of the master file should be undertaken on a line of business or entity wide basis. Consideration should be given to the level of flexibility that can be accommodated in terms of sharing different business line information among relevant countries. Consideration should also be given to how governments could ensure that the master file covers all MNE income and activities if line of business reporting is permitted.
4. A number of difficult technical questions arise in designing the country-by-country template on which there were a wide variety of views expressed by countries at the meeting of Working Party 6 held in November 2013. Specific comments are requested on the following issues, as well on any other issues commentators may identify:
 - 4.1. Should the country-by-country report be part of the master file or should it be a completely separate document?
 - 4.2. Should the country-by-country template be compiled using “bottom-up” reporting from local statutory accounts as in the current draft, or should it require (or permit) a “top-down” allocation of the MNE group’s consolidated income among countries? What are 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?
 - 4.3. Should the country-by-country template be prepared on an entity by entity basis as in the current draft or should it require separate individual country consolidations reporting one aggregate revenue and income number per country if the “bottom-up” approach is used? Those suggesting top-down reporting usually suggest reporting one aggregate revenue and income number per country. In responding, commenters should understand that it is the tentative view of WP6 that to be useful, top-down reporting would need to reflect revenue and earnings attributable to cross-border transactions between associated enterprises but eliminate revenue and transactions between group entities within the same country. Would a requirement for separate individual country consolidations impose significant additional burdens on taxpayers? What additional guidance would be required regarding source and characterization of income and allocation of costs to permit consistent country-by-country reporting under a top-down model?
 - 4.4. Should the country-by-country template require one aggregate number for corporate income tax paid on a cash or due basis per country? Should the country-by-country template require the reporting of withholding tax paid? Would a requirement for reporting withholding tax paid impose significant additional burdens on taxpayers?
 - 4.5. Should reporting of aggregate cross-border payments between associated enterprises be required? If so at what level of detail? Would a requirement for reporting intra-group payments of royalties, interest and service fees impose significant additional burdens on taxpayers?
 - 4.6. Should the country-by-country template require reporting the nature of the business activities carried out in a jurisdiction? Are there any features of specialist sectors that would need to be accommodated in such an approach? Would a requirement for reporting the nature of the business activities carried out in a jurisdiction impose significant additional burdens on taxpayers? What other measures of economic activity should be reported?

5. Comments are requested as to whether any more specific guideline on materiality could be provided and what form such materiality standards could take.
6. Comments are requested regarding reasonable measures that could be taken to simplify the documentation process. Is the suggestion in paragraph 34 helpful? [That tax administrations allow searching in databases for comparables every three years but financial data for comparables every year.] Does it raise issues regarding consistent application of the most appropriate transfer pricing method?
7. Comments are requested regarding the most appropriate approach to translation requirements, considering the need of both taxpayers and governments.
8. Comments are requested as to measures that can be taken to safeguard the confidentiality of sensitive information without limiting tax administration access to relevant information.
9. Comments are requested regarding the most appropriate mechanism for making the master file and country-by-country reporting template available to relevant tax administrations. Possibilities include:
 - 9.1. The direct local filing of the information by MNE group members subject to tax in the jurisdiction;
 - 9.2. Filing of information in the parent company's jurisdiction and sharing it under treaty information exchange provisions;
 - 9.3. Some combination of the above.
10. Comments are specifically requested as to whether reporting of APAs, other rulings and MAP cases should be required as part of the master file.

SOLICITATION