



MEMORANDUM ON TRANSFER PRICING DOCUMENTATION AND COUNTRY BY COUNTRY REPORTING

3 October 2013

Action 13 in the BEPS Action Plan calls on the OECD to develop requirements for taxpayers to report income, taxes paid, and indicators of economic activity to government according to a common template. The language of the BEPS Action Plan makes it clear that such country-by-country reporting to governments will be an essential element of transfer pricing documentation proposals developed by WP6. On 12 – 13 November, the OECD will hold a public consultation on various matters including its 30 July White Paper on Transfer Pricing Documentation and associated issues including country by country reporting under the BEPS Action Plan.

There are, however, a number of important implementation issues to be addressed in developing a credible proposal regarding country-by-country reporting. In order to facilitate a more meaningful consultation, we summarise below some of the questions that are relevant to the development of a country-by-country reporting template.

1. What information should be required?

An initial question is what information should be required to be reported in the country-by-country reporting template the Working Party is obliged to develop. In answering that question, a balance needs to be sought between the usefulness of the data to tax administrations for risk assessment and other purposes, and the compliance burdens placed on taxpayers. The first question is what information of a country-by-country nature governments require to perform effective risk assessment and enforce transfer pricing rules. Several potential items that might be reported are discussed below. Compliance burdens must also be considered. There would be compliance related advantages if it were possible to limit the required information to data readily available to corporate management so that companies will not need to go through a time consuming and expensive process of constructing new data. Balancing of various interests will be required.

The most critical item of required information will be a report of income earned in a country. Several different approaches to reporting such information might be possible.

- Requiring reporting of net income before tax for each legal entity in the MNE Group, with numbers to be drawn from individual entity statutory financial statements. Legal entities could be grouped by country according to the country of organisation and / or place of management and control of the legal entities. For those countries that require preparation of statutory financials, such an approach would provide a relatively simple and straight-forward mechanism for aggregating data on the basis of existing information. Such an approach would have a number of drawbacks, however. These would include at least the following: (i) Grouping companies either by place of organisation or by location of management would not necessarily indicate where the income of such companies is generated or where that income is subject to tax. As one of many possible examples, reporting by place of organisation would not distinguish between resident and non-resident companies in a country which bases residence on place of management. It should be noted that resident and non-resident companies might face very different tax regimes in some countries. Those differences have been highlighted in much of the public reporting on BEPS. (ii) Some countries do not require statutory financials for every group company organised or managed in the country so that a workable substitute would have to be identified for at least some legal entities; (iii) The sum of income reported in statutory financials likely would not add up to the total consolidated income of the group as the sum of financial statement income numbers may not fully reflect consolidating eliminations.
- Income reported in the template could be based on taxable income as reflected on tax returns filed in a jurisdiction. Again, tax return data should be readily available within the MNE Group so the reporting burden should not be excessive. The difficulty with such an approach is that

some companies in an MNE Group may not be obliged to file a tax return in any country and may not be obliged to report some portion or all of their financial statement income on a tax return in any country. Thus, reporting on the basis of tax return data would run a serious risk of excluding a portion of the MNE group's income from the reporting obligation. One could argue that the mere existence of a difference between the total of income reported in tax returns and consolidated income would itself be a strong indicator of transfer pricing risk, but it might be difficult to identify in which situations that risk arises, particularly if some countries exempt certain income from tax. Use of tax return data would also likely result in large differences between the total of tax return based income and consolidated financial statement income because of tax / book differences under the law in many countries, the existence of tax exemptions for some types of income, and other reasons. Requiring explanations of such differences may be useful but could be a difficult compliance exercise in some cases depending on the level of detail required in an explanation.

- The template could require a segregation of consolidated MNE group income among countries calculated by reference to accounting segment reporting rules. While this might eliminate distortions arising from eliminations, it would undoubtedly require production of data that many companies would not keep in the ordinary course. Segment reporting rules do not require reporting income on country-by-country basis. Moreover, such reporting would require determinations of separate country income, particularly information regarding the source of income and expense by country which might not be necessary either for tax or accounting purposes. This approach would therefore impose a significant compliance burden on businesses and, to the extent it would require devising a common set of source and expense allocation rules, could require a great deal of OECD work as well.
- The template could require reporting data taken from the company's internal consolidating income statements relating to each company's contribution to consolidated income after eliminations. It would be necessary whether such information is readily available and to evaluate how meaningful it would be for transfer pricing risk assessment purposes. The fact that such information would in all likelihood exclude eliminated income from related party transactions may mean that such income is not of significant use in evaluating transfer pricing risk.
- There are undoubtedly numerous other possible approaches.
- Business is requested to be prepared to discuss at the November consultation which approaches to the reporting of income would be most useful to governments and most readily available from existing accounting records.

A second important element of the data to be reported includes taxes paid by country. In this regard a number of questions will need to be resolved.

- Should taxes be reported on a cash or accrual basis? Governments would ordinarily be most interested in cash taxes paid in a given year, or alternatively cash taxes paid with respect to the income reported in a given year, for risk assessment purposes. While tax accruals would perhaps align better with accrual based financial statement income (assuming income from statutory financials is ultimately what is reported), there could be a question as to whether reporting tax accruals as opposed to cash tax paid would introduce distortions related to deferred tax accounting, tax provisions and other accrual accounting issues. Advice is sought at the consultation as to whether reporting cash tax paid or tax accruals is more useful and more practical.

- Should tax reporting be limited to national level income taxes or should reporting of income taxes paid to other levels of government (states, provinces, cantons, municipalities, etc.) be required. If sub-national level taxes are reported, should they be segregated from national level income taxes?
- Is there any reason to require reporting of taxes other than income taxes? Such reporting would often seem to be largely irrelevant to transfer pricing risk assessment, e.g. property taxes, employment taxes, VAT collections etc. are not particularly helpful for transfer pricing risk assessment. There is also a question as to whether the template should require reporting of gross basis withholding taxes imposed as a substitute for a net income based tax. Consideration should be given to whether withholding tax is best reported by the payor or by the recipient of the payment that is subject to withholding tax.

The project will need to consider whether the country-by-country reporting template should include data on measures of economic activity other than income and taxes. WP6 will consider which of the following items should be reported on a per legal entity and / or per country basis. Some may argue that inclusion of such information in the template would encourage unwarranted reliance on formula - based income allocations. Others might argue that such information is useful for discerning the location of economic activity and whether there are discrepancies between the location of economic activity and the geographic location where income is reported. There is also a question as to whether such measures should be reported by the geographic location of the item (e.g. where an employee resides) or by the place of organization or place of management of the employer.

- Revenues by location of customers – some might argue that such information is not maintained or not readily available. The geographical source of revenue likely says very little about whether there should be an associated income tax liability. However, it may be a useful measure of economic activity leading countries to make further inquiries when revenues from a country are high but taxes paid in the country are not.
- Tangible assets by location
- Employment, either by number of employees, total payroll or both
- Research expenditures by company / country
- Marketing expenditures by company / country
- Location of intangibles by country
- Location of senior management (e.g. the geographic location of the 25 or 50 most highly compensated employees of the MNE group)
- Other

A key question in connection with all these items is whether their reporting will provide any meaningful guidance for risk assessment purposes about the location of real economic activity. Business is requested to be prepared to discuss these issues at the consultation.

It will be necessary to consider currencies in which information should be presented in the country by country template. Should information be reported in functional currencies of each individual entity, should information be translated to a single consistently used currency (functional currency of the ultimate

parent), or some combination. Governments should consider which approach would be most useful to them and business should be prepared to discuss which approach should be adopted.

Consideration should also be given to whether aggregate information on certain types of income and expense. Is information readily available on a company by company or country by country basis with regard to related party royalties paid, related party royalties received, interest paid and received from related persons, management and other service fees paid to and received from related entities, etc.

2 *What mechanisms should be developed for reporting and sharing country-by-country data?*

In addition to defining the information that should be reported in the country-by-country template, consideration will need to be given to the administrative mechanisms by which such information can be made available to relevant countries. Consideration in this regard should be given to what the OECD can accomplish through guidance and what recommendations should be made for implementation through local country legislation. Following are some of the approaches that might be possible.

- It could be suggested that the required template be completed by the parent company in its home jurisdiction (place of incorporation / place of management) and then shared with other countries under treaty exchange of information mechanisms, including potentially automatic exchange. This would raise questions about what one should do about countries that, for one reason or another, do not modify their own reporting rules to require production of the template by locally based multinationals. This could be one example of the reference to non-cooperative countries in the G8 communique. Consideration should also be given to whether such a system would give developing countries a basis to acquire the information in the template if they do not have extensive treaty or TIEA networks.
- Consideration should be given to whether the information sharing system should be structured in a way that excludes delivery of information to countries where adequate provisions do not exist to protect the confidentiality of competitively sensitive data and how this might be accomplished.
- It could be suggested that the template be made available as part of the global master file to every country in which the MNE has an affiliate subject to tax and could further be suggested that local countries modify their domestic documentation and reporting rules to require any local affiliate of an MNE group to deliver the template.
- Business is invited to suggest other possible approaches.

The OECD looks forward to a productive discussion of these issues at the consultation on 12 – 13 November and requests business input into the resolution of these questions and any other questions business may believe to be relevant to the development of a workable country by country reporting template.