

## Analysis

# Transfer pricing documentation and country by country reporting

## Speed read

Action 13 has, without a doubt, generated widespread activity amongst tax authorities and legislators. It is clear that as a result of Action 13, tax authorities will have significantly more information available to them to undertake transfer pricing risk assessments. This increase in transparency has inevitably led to concern amongst MNEs – as has the likely increase in compliance requirements which puts further strain on MNEs' resources. The UK, as an early proponent of CBCR, has moved quickly to implement the recommendations laid out in Action 13. Effective for accounting periods beginning 1 January 2016, UK MNEs with group annual turnover greater than £586m must start putting in processes and strategies now, so that there are no surprises post 2017.



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In days past, transfer pricing documentation and all that it entails rarely made headlines or warranted detailed discussion amongst taxpayers and advisers. Documentation was simply yet another (thankless) compliance task that the overburdened transfer pricing department had to manage. However, when the OECD published its 15 point Action Plan for BEPS in July 2013, it was clear that the importance and relevance of transfer pricing documentation had multiplied considerably. The words 'Action 13' were soon to be repeated in tax departments of multinational enterprises (MNEs) across the globe.

The discussion that follows provides an overview of Action 13 (Transfer pricing documentation and country by country reporting), the potential impact on MNEs and how the OECD recommendations may be implemented in practice – with a particular focus on how the UK is proposing to address country by country reporting (CBCR).

## An overview of Action 13

The foundations of the OECD's 15 point Action Plan have been based on three pillars:

- coherence in countries' domestic rules that impact cross-border activities;
- substance; and
- transparency and certainty.

Action 13 sits squarely within the third pillar: transparency. We are all aware of the very public debates led by politicians and the media with respect to MNEs

being perceived to be engaged in aggressive tax planning. One of the outcomes of this debate was increased pressure on jurisdictions to demand greater transparency on the international footprint of MNEs. From an OECD perspective, the focus on transparency led to the goal of establishing a framework for transfer pricing documentation that was suitably modern to reflect the increasingly global nature of business models. Such transparency, in the view of the OECD, would close the information gap between taxpayers and tax authorities.

The 'final' report with respect to Action 13 was published on 16 September 2014 after much public consultation. In this report the OECD stated that: '[Action 13] recognises that enhancing transparency for tax administrations by providing them with adequate information to conduct transfer pricing risk assessments and examinations is an essential part of tackling the base erosion and profit shifting problem' (*Guidance on transfer pricing documentation and country by country reporting* (OECD), 16 September 2014, executive summary, page 9).

As a result of the recommendations of Action 13, the entire text of Chapter V of the OECD *Transfer pricing guidelines for multinational enterprises and tax administrations* has been replaced. The 'new' Chapter V is detailed in the final Action 13 report issued on 5 October 2015.

One of the key features of the updated guidelines is the 'three tiered' approach to transfer pricing documentation. The aim of the three tiered approach is to provide a standardised and consistent approach to transfer pricing documentation. The three tiers are as follows:

- master file;
- local file; and
- country by country report.

The OECD is of the view that if tax administrations adopt this standardised approach to transfer pricing documentation, then they will be better positioned to undertake a more robust transfer pricing risk assessment of the MNE.

Of the three tiers, the most contentious has been CBCR. Before discussing CBCR in more detail, for completeness I have set out the main aspects of the master file and local file.

The master file should include standard information that is relevant to all members of the MNE. It is a key element of an MNE's transfer pricing documentation, as it focuses on the overall profit/value drivers within the group and importantly the group's overall transfer pricing policies, including allocation of income and economic activity. Interestingly, the recommended master file template includes providing descriptions of the group's unilateral advance pricing agreements and any other tax rulings.

The local file should document transactions that are material to the local entity, including the application of the arm's length principle to determine prices.

## Country by country reporting

As indicated above, CBCR is without doubt the most contentious aspect of Action 13's three tiered approach to transfer pricing documentation. The format of the template has been criticised extensively by businesses, given the potential to misinterpret the data when viewed in isolation. The template itself appears quite innocuous. For each jurisdiction in which the MNE operates, disclosure of the following is required:

- revenues (split between related and unrelated entities);
- profit or loss before income tax;
- income tax paid (on a cash basis);
- income tax accrued (current year);

- stated capital;
  - accumulated earnings;
  - number of employees; and
  - tangible assets (other than cash and cash equivalents).
- Such disclosure clearly results in a greater degree of transparency and potentially highlights some areas of risk for the taxpayer.

### Practical implications associated with Action 13

As indicated above, the OECD's 'final' recommendations were issued in September 2014. At this time, it was recognised that some practical considerations remained outstanding and as such the intention was to issue guidance in 2015. The guidance (*Action 13: Guidance on the implementation of transfer pricing documentation and country by country reporting*, at page 3) sought to clarify the following points:

- the timing with respect to filing CBCR – here, the recommendation was one year subsequent to year end, resulting in the earliest reporting requirement of 31 December 2017;
- which MNE groups would need to file CBCR – groups with annual consolidated revenue above €750m;
- the conditions underpinning the obtaining and use of CBCR by jurisdictions – these included confidentiality, consistency and appropriate use (i.e. they did not introduce formulaic adjustments); and
- the framework for the exchange of CBCR – which requires timely reporting from ultimate parent entities on an automatic basis with the jurisdiction in which the MNE operates. Secondary mechanisms for providing CBCR should also be developed in local legislation. This latter point has been adopted by the UK (see below).

### How has the UK responded to Action 13?

The UK has been an early adopter of CBCR and has therefore acted swiftly to ensure that the OECD recommendations are enshrined in UK law. In December 2014, a tax information and impact note was published, setting out a two staged approach to introducing CBCR.

The first phase was introduced as part of FA 2015 s 122, which in effect allowed the introduction of regulations once the OECD had completed its work on CBCR. The second stage is, of course, the draft regulations themselves. On 5 October 2015, HMRC published a draft statutory instrument to implement CBCR.

Key features of the draft statutory instrument include the following:

- MNEs with a UK resident parent entity and a combined annual consolidated group revenue of £586m or more (12 month accounting period) are to submit an annual CBCR to HMRC for the following period.
- Regulations take effect for accounting periods beginning on or after 1 January 2016; therefore, they require first filing by 31 December 2017.
- The template follows that included in the Action 13 report; and therefore the data referred to above must be included in the template (electronic filing).
- The filing obligations are set in regulation 3.
- Regulation 4 allows for voluntary filing by a constituent entity ('surrogate parent entity'). Broadly, this circumstance would apply where the ultimate parent entity is not required to file in its own tax jurisdiction or where that jurisdiction has not entered into exchange arrangements with HMRC with respect to the CBCR.

### Who will implement Action 13?

As with all the Action Plans, the success of the BEPS initiative is dependent on implementation. This is not lost on the OECD. As it has indicated, 'the focus will shift to designing and putting in place an inclusive framework for monitoring BEPS and supporting implementation of the measures, with all interested countries and jurisdictions invited to participate on an equal footing.'

In addition to the UK, there have been some early adopters with respect to Action 13. These include Australia, Spain and Poland. While it is anticipated that a significant number of jurisdictions will ultimately implement the recommendations laid out by the OECD, concern is evident with respect to the ability of certain jurisdictions to implement the measures in a timely manner.

There is no doubt that the data required to be submitted under Action 13 is considerably more comprehensive than most jurisdictions require under their existing law. In terms of implementing the recommendations quickly, much of the concern/debate revolves around whether the recommendations would require a change in law; or whether such recommendations could be made effective by the tax authorities themselves without the need for legislative change. This question appears pertinent in the US, for example, where the Treasury's view that legislative change is not required is yet to be confirmed by Congress.

### What action should UK MNEs undertake?

MNEs are likely to face significant practical challenges in gathering and reconciling the data required to prepare CBCR. When Action 13 was first released in draft, there was significant concern among taxpayers that they would not have the human and technological resources to cope with its demands. This concern was in part based on a lack of understanding in some quarters, with respect to the ability of a group's enterprise resource planning system being able to produce the requisite information.

As a result, many MNEs are undertaking trial runs on CBCR which serve two purposes in particular. First, they would identify the capability of the existing systems to produce the required information and provide an opportunity to develop a process to resolve any gaps that may exist. Second, an assessment could be made as to how a tax authority might interpret the results of the CBCR and therefore allow for such interpretations to be addressed.

In addition, the resourcing concerns have dissipated somewhat, given the threshold requirements of CBCR. Having said that, to ensure that an MNE is 'Action 13 compliant' there is no doubt that upfront investment will need to be made. However, experience shows that the task is not as daunting as first envisaged.

The concern with respect to transparency is real. More than ever before, tax authorities will now have significantly increased access to an MNE's global data. Profits (or losses) in each country will be visible, as will substance (in number terms) in each of these jurisdictions. This information will undoubtedly carry weight when tax authorities are undertaking a transfer pricing risk review.

It is relatively clear from a UK perspective what an MNE must do to be Action 13 compliant. If you have not already done so, planning for 2017 should be put into place. BEPS has moved transfer pricing documentation requirements from the back office to being a key strategic element of an MNE's tax affairs. With the worldwide footprint of taxes being visible to tax authorities across the globe, it is essential that transfer pricing reflects commercial activity and therefore withstands the spotlight that it will be under. ■