Research

OECD BEPS Action Plan 13 Transfer Pricing Documentation: Country-by-Country Report, Master File, and Local File

GORDON GRAY | FEBRUARY 17, 2016

EXECUTIVE SUMMARY

- The OECD last year released and the G20 endorsed 15 action items targeting base erosion and profit shifting (BEPS).
- Action 13 recommends a three-tiered reporting requirement for multinational firms to provide foreign governments with high level visibility into their international tax operations:
- A country by country report submitted by the home country of a multinational firm to a foreign government;
- A "master file" submitted by a multinational directly to a foreign government; and
- A "local file" filed by the multinational company with local tax authorities.
- Action 13 would impose significant new compliance burdens on global companies and, force disclosue of sensitive and proprietary information.
- Many nations are moving forward with implementing some or all of these reporting requirements, which will unavoidably affect many U.S. global companies.

INTRODUCTION

In 2013, the Organisation for Economic Co-operation and Development (OECD) released the *Action Plan on Base Erosion and Profit Shifting* (BEPS). BEPS addresses concerns over the ability of multinational corporations to minimize taxation through sophisticated tax planning, and thus reduce tax revenues in affected nations.[1] The OECD Action Plan set forth 15 action items designed to limit untaxed or "stateless" income. Of particular and immediate concern to U.S. firms is action 13, which recommends a three-tiered reporting regime for multinational firms. The U.S. Treasury has proposed regulations on country by country reporting and some foreign nations have already put such rules in place.[2][3]

Action 13

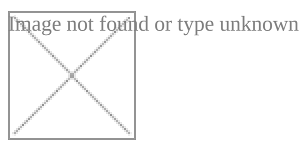
In October 2015, the OECD released, and the G20 endorsed, its final report on each of the 15 BEPS action items, including action 13, which recommends the development of three new reports by multinational enterprises (MNE): country-by-country reports (CbC), master files, and local files. Generally, the country-by-country report aims at providing a financial picture of an MNE broken out by tax jurisdiction, the master file is intended to provide a "high-level" blueprint of an MNE's global operations, and the local file is intended to provide information on an MNE’s operations in a specific tax jurisdiction.

THE COUNTRY-BY-COUNTRY REPORT (CBC)

Action 13 recommends that MNEs file with their home tax authority, the U.S. Treasury Department for example, the country by country report, which shows the global allocation of its income and taxes paid and the tax jurisdictions of its economic activity. The CbC report includes three tables on income, tax and financial and additional economic activity among tax jurisdictions.[4] Table 1 should include, on a group-wide, per jurisdiction basis:

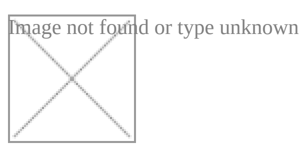
1. Revenue, both related-party (within the MNE group) and unrelated-party (outside the MNE group) revenues, including service, royalty and interest income,
2. Before tax profits,
3. Income tax paid on a cash basis,
4. Income tax accrued for the current year,
5. Stated capital,
6. Accumulated earnings,
7. Number of employees, and,
8. Tangible assets.

Table 1: “Overview of allocation of income, taxes and business activities by tax jurisdiction”



The second table required by the new CbC reporting standard should provide a list of constituent entities of the MNE group organized by tax jurisdiction. The table should further specify the primary business activity of the constituent entity.

Table 2: “List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction”



The CbC provides for a third table for any additional information the taxpayer deems necessary to provide.

Country by country reporting only applies to MNE groups with annual consolidated group revenue in the immediately preceding fiscal year of more than EUR 750 million or a near equivalent amount in domestic currency as of January 2015. According to the OECD asserts that this limitation would exclude approximately 85 to 90 percent of MNE groups, but capture approximately 90 percent of corporate revenues.

Implementation

On December 21, 2015, the U.S. Treasury and IRS released proposed regulations to implement CbC reporting consistent with action 13.[5] The requirements closely track OECD's recommendations, and would apply to a U.S. MNE group that has annual revenue for the preceding annual accounting period of $850 million or more. The proposed regulations are open to comment until March 22, 2016, and will be applicable to taxable years beginning on or after the date of publication of final regulations. Once implemented, reporting information will be collected by the U.S. Treasury and exchanged with foreign jurisdictions pursuant to bilateral treaties and exchange agreements that recognize the importance of confidentiality and appropriate use, and include penalties for violating those precepts.

The Treasury regulations, which likely would apply to tax years beginning in 2017, could pose a challenge for U.S. MNEs since some countries have already begun to implement reporting requirements for 2016 tax years. Thus, U.S. MNEs could be required to submit country by country reports directly to foreign governments if they have operations in countries with a2016 CbC reporting requirement. Reports submitted directly to foreign countries by companies would not have the same confidentiality and appropriate use protections as CbC reports transmitted from one country to another.

THE MASTER FILE

Action Item 13 also recommends that countries require MNEs to submit a "master file," to "provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context."[6] This "blueprint" of the MNE group will contain five categories of information a) the MNE group's organizational structure; b) a description of the MNE's business or businesses; c) the MNE's intangibles; d) the MNE's intercompany financial activities; and (e) the MNE's financial and tax positions."

Like the CbC file, the master file is a comprehensive look at an MNE group.[7] Both the CbC reports and the master file include sensitive information beyond activity in the country requesting the information.[8] There is serious concern, however, that the master file reporting regime would require MNE's to disclose an "unprecedented" degree of highly sensitive firm information to foreign governments without adequate controls for confidentiality or appropriate use.[9] Unlike the CbC report, the master file would be submitted by a MNE directly to a company, and thus does not enjoy the protections of the information exchange process and is not subject to safeguarding beyond that which may apply locally, which has raised serious concern over the security of this sensitive information.[10]

THE LOCAL FILE

The third tier of the new BEPS reporting regime is a "local file" reporting requirement. While the master file contains a high-level review of the MNE group, the local file provides more detailed information relating to specific intercompany transactions and transfer pricing within a given tax jurisdiction.

Broadly, the local file report requires three areas of information.

- Descriptive information on the local entity, including the management structure of the local entity, a local organizational chart, a description of the individuals to whom local management reports, and a detailed description of the business and business strategy pursued by the local entity including any business restructurings or intangible transfers;
- Information on transfer pricing, specifically, on controlled transactions involving the local group affiliate; and
- Relevant financial information on the local affiliate.

The local file will contain similar information traditionally included in transfer pricing documentation reports.[11] Like the master file, the local file can be collected directly by foreign tax authorities, which has raised some concerns over the security of this sensitive information.

The OECD did not recommend an implementation schedule for the master and local files in the same manner as the CbC reporting requirement. However, several countries have already begun implementing requirements consistent with master and local file reporting, requirements that could affect U.S. firms by 2017.[12]

CONCLUSION

Taxing power is an essential sovereign right, but that authority has been complicated by increasingly interconnected markets, and highly mobile capital. Moreover, radically different perspectives among the world's developed economies on taxation paired with sophisticated tax avoidance strategies by multinational firms contributes to a complex international tax regime that raises the specter of taxing some income too much, and some not at all. The OECD has attempted to lend greater clarity to this miasma with its BEPS initiative and associated action items. One of these items, action 13, would impose a three-tiered reporting requirement on multinational firms. While this development may provide taxing authorities greater insight into large multinational firms, it is far from a costless endeavor. It will impose new burdens on firms, while potentially leading to the exposure of the sensitive, proprietary information firms will be compelled to disclose. Despite these costs, many nations are moving forward with implementing these policies, which will unavoidably subject U.S. firms with interests in those jurisdictions to the new reporting requirements irrespective of legislative or regulatory action in the United States.

[1] http://americanactionforum.org/insights/base-erosion-and-profit-shifting-in-a-global-economy