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OECD Discussion Draft on transfer pricing documentation and country-by-country reporting

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Introduction

On 30 January 2014 the OECD has published the discussion Draft on Transfer Pricing Documentation and Country by Country Reporting ("the Draft") that would require companies to provide tax administrations with exhaustive details of how they allocate their income, taxes, and business activities on a country-by-country basis. These proposals are being released in draft form to provide an opportunity for stakeholders to comment. Although the consultation was exceptionally short (at 24 days), over 1,100 pages of comments have been submitted. Below, we have summarized the main comments of the multinational enterprises ("stakeholders").

Tax administration

The overall view is that the proposal is too extensive and goes far beyond what is needed for the purpose of doing a proper tax risk assessment. The current proposal would lead to significantly higher compliance costs. The concern is that the new rules do drive further administration and that this higher compliance effort is disproportionate to the value of the information provided. Furthermore, the volume of information requested would be overwhelming for tax authorities to review, leading to long lead times, misunderstanding of key business lines, and increased controversy and double-taxation.

Two tiered approach

The heart of the Draft is a recommendation for OECD countries to adopt a two-tiered approach consisting of a standardized master file and a local file for each jurisdiction. The master file will contain common standardized information relevant to all entities within a multinational group. The master file also will include a group's organizational structure, a description of business activities and details of intangibles and intercompany financial activities. The local file would document the material transfer pricing positions of the local taxpayer with its foreign affiliates, with the goal of demonstrating the arm's length nature of those positions.

In its request for comments, the Draft highlights several open issues in developing a standardized template for all multinationals.

Master File by entity or line of business

The Draft questions whether the master file should be prepared on a company-wide or business unit level.

The overall comment is that since the companies (and business areas within the companies) look very different the guidelines should allow for flexibility in this respect. Taxpayers should be left to decide whether to prepare Master File documentation on a company-wide or business unit level. For some highly diversified groups, the former may make most sense, for other more homogeneous groups, the latter may be the better approach.

Master file and country-by-country reporting

The Draft recommends that the master file would include a country-by-country reporting to be provided as part of the master file document which reports information regarding the group's global allocation of profits, taxes paid, and other indicators of the location of the group's economic activity among countries in which the group operates. The Draft requests comments whether the country-by- country file should be a separate file or included in the master fie.

The overall comment of the stakeholders is that the country-by-country reporting should be a separate file. This is because the country-by-country report may not be relevant to all tax authorities in countries where a multinational company is active. It should be limited to information regarding the low tax jurisdictions or to countries where the taxpayer is involved in significant intercompany transactions.

"Bottom- up" or "top-down" reporting

One of the important question was whether the country-by-country template should use a "bottom-up" allocation (from local statutory accounts) or whether a "top-down" allocation of the multinationals group's consolidated income among countries should be required or permitted.

The general view of the stakeholders was that the template should be prepared on a 'top down' basis by country. This method will result for multinational companies in the least impact to their business in terms of resource and investment in systems. A ‘bottom up’ approach would require more input. However, in order to leave enough possibilities for the companies to consider their specific circumstances in each single case, the OECD may wish to leave this decision to the companies themselves, i.e. allowing both “bottom-up” and “top-down” allocation. The stakeholders believe that a significant level of flexibility and optionality is essential.

Entity by entity basis or separate individual country consolidations

On the question whether the country-by-country template should be prepared on an entity-by-entity basis or on a separate individual country consolidation, the general approach of stakeholders is that flexibility should be provided to taxpayers in order to minimize compliance costs. Entity level reporting may create significant extra work for multinationals with multiple entities in one jurisdiction who operate a consolidated financial system. Furthermore, a taxpayer may have entities in the same country engaging in very different lines of business.

Language

The draft recommends that the master file would be prepared only in English. All the stakeholders agreed on this. Translation into several languages will be costly, time demanding and may jeopardize the idea of a reduced compliance burden resulted by the two-tiered concept.