BEPS reporting and compliance considerations

32nd Annual TEI-SJSU High Tech Tax Institute
November 7-8, 2016
Presenters

BEPS reporting and compliance considerations

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Country implementation summary

Source: KPMG International member firms

Implemented
Draft bills/Public discussion draft
Intention to Implement
BEPS reporting and compliance considerations

— Country by Country Reporting
  - Do we have to comply? What if we don’t?
    — Penalties
    — Audit risk
  - Where/when do we need to file?
  - What about public disclosure?

— Master File
  - When?
  - How much information should we include?
    — “A” versus “C” report
    — Value chain analysis: yes or no?
  - What about countries that don’t have the same $$ threshold?
BEPS reporting and compliance considerations (continued)

— Local Files
  - Centralized versus decentralized approach
  - When?
    — Should we prepare for countries that haven’t yet implemented LF requirements?
  - How much information?
  - What about China?
Consider a more strategic approach

Fact Gathering & Documentation

BEPS Risk Assessment

Value Chain Analysis

Transparency Considerations

Recommendations & Stakeholder Communications

BEPS Strategy
What we see

Linear approach

CbC  Master File  Local File
What we’d like to see

Integrated approach

Action 13 Strategy
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.
Accounting and Data Challenges and Solutions
Typical challenges ‘at the coal face’

Companies initially viewed CbCR as a purely compliance burden, but this has quickly evolved into a broader evaluation of system capability for tax and legal entity reporting.

### Challenges

#### Entity level data
- Significant effort required to map management reporting to legal entity activity
  - Ledger configuration
  - Alignment legal to tax.
  - Offline calculations and reallocations.

#### Local variation for intercompany transactions
- Where I/C transactions recorded e.g. retained earnings (or similar)
- Elimination of activity is subject to significant variability

#### Complex data and technology landscape
- Multiple disparate local and aggregated ledgers
- Decentralized location for collection, manipulation and management of general ledger and transactional data
- Process related to periodic review and control of legal entity structure
- Workflow needed to integrate multiple data sources.
Fundamental challenges – 1. tensions between global and local reporting

Local statutory accounts/tax returns → Local file

Global financial statements → Master file

CbCR?
- Alignment to local file
- Faster compilation
- Time intensive, and greater system challenges
- Reconciliation challenges on audit
Fundamental challenges – 2. additional accounting tasks

Aggregated approach to country results build up:

- Addition of P&Ls/balance sheets without elimination
- Deconsolidation/gross-up of financial/operational/taxation results?
- Stripping out ‘negative cost’ in cross allocation processes to identify related party revenues

Anticipated reconciliations and audit trail:

- Ability to reconcile the CbCR to:
  - local statutory statements
  - worldwide audited statements
  - legal entity books
  - local tax returns
  - transfer pricing documentation
  - local international reporting (5471)

- Ability to provide audit trails:
  - Auditable trail back to source data
  - Record retention of the data over multiple years for consistency
  - Versioning control
Fundamental challenges – 3. Culture and IT landscape

Data Management to prepare for the end to end process of CbC reporting may be a challenge for numerous MNCs. Many companies we talk to are initially thinking they can get the data from their ERP and that may or may not be true.

Business culture, resource availability, and timing of data

Core ERP and Business Intelligence systems capability/configuration to handle data granularity

Supporting processes in the controllership function are critical
**High Level Data Flow for CbC Reporting**

- **LE/BU mappings**
- **Cash taxes**
- **Exchange rates**
- **HR systems**
- **Revenue sub ledgers**
- **Fixed Asset Systems**
- **ERPs**
- **A/P & A/R**

**Active processing**
- **Data warehouse**
- **Consolidation system**

**Tax applications**
- **Provision & compliance tools**
- **Self service reporting**
- **Tax data mart(s)**

**Collected & Loaded**
- **Validated & Transformed**
- **Reported, Reconciled & Retained**

*CbCR Table #1*

*CbCR Table #2*
Data & Systems for Reporting & Reconciliations

IT Systems
- ERPs
- Sub-Ledgers
- Tax Provision & Compliance Software
- HR & Fixed Asset systems

Tax pre-processing process
- G/L BU
  - Legal Entity Books
  - Country
    - Country Consolidations
    - Reconciliations

CbC Template Data & Reconciliation Needs
- G/L & sub-ledgers
- HR/Payroll
- Fixed Assets
- Transfer Pricing Documentation
- WW Audited Consolidated Fin’l Stmt
- Local Statutory Statements
- US Forms 5471, 8858 and 1118
- Country Income Tax Returns

Tax Provision
Further considerations

Data and Systems
- **Degree of centralization** of ERP and Business Intelligence systems
- **Degree of standardization** in the charts of accounts
- **Stable platform** of centralized and standardized system and processes
- **GAAP rules** of the local companies can be easily converted to parent company GAAP rules

Data Errors
- **Early Detection**: find errors early before final reports and filings are completed
- **Account Balances**: Rules can highlight accounts that don’t balance
- **Easily Determine Root Cause**: Drill down to lowest level of detail to determine source of problem

Accurate data translations
- **Business Unit and Cost Center** financial data aggregated and consolidated
- **Financial details translated** as necessary to Parent MNE reporting currency, by legal entity and by country
- **HR and Fixed Asset data** aggregated by Country
- **Business Activity data** by legal entity
- In a repeatable, reliable, and accurate process

Data in **multiple source systems** with different formats and different meanings.

Data errors, identified too late in the process, increase risk.

Data translation (from Finance view to Tax view) is complex and error prone if done manually.
Key Questions

ERP and Business intelligence landscape

• Single instance globally or fragmented?
• Stable platform, or ‘in transition’ (ERP rollout or acquisitive behavior)
• System optimized for legal entity reporting; reconciliation capability local GAAP to U.S?
• Standardized chart of accounts or ERP templates?
• Degree of BI centralization, maturity of reporting, and business support available
• Difference between management and legal entity accounting…and reconciliation capability

Current tax processes

• Degree of centralization and cultural values
• Maturity and stability level of systems?
• Existing processes to leverage (5471s, provision, management allocations, FTC, tax cashflow forecasting)
• Plan for data mapping & reconciliations
• Plan for workflow approach (build v buy, insource v outsource)
• Does the complexity of your corporate structure require that you run several trials?
• Record Retention
Learnings & Best Practice Recommendations

It is critical to create cross-organization momentum

- Identify drivers in other functions that align with the CbC agenda (e.g. FP&A and insights into fully loaded profitability/customer analysis)
- Leverage organizational investments in IT wherever possible
- Focus on time/resource impacts for the finance organization to support analysis, as a driver to support the investment in technology
- Engage with shared services/GBS/GFS type functions and start the ‘service level agreement’ discussion early
- Present the issues as related to transparency and intercompany accounting/reporting as opposed to ‘tax compliance’
- Elevate the reputation and confidentiality risk issues associated with the granular reporting of profitability data
- Establish a task force/sponsorship group across tax, finance, and IT
- Maximize the use of technology for data collection, validation, transformation, and reconciliation to ensure overall transfer pricing story is properly told and to provide an audit trail.
- Start preparing now
Common Issues Around CbC Reporting, Master File & Local File

October 2016
**Introduction**

• In this presentation, we will discuss the common issues companies experience when navigating Country by Country ("CbC") Reporting, Master File ("MF") and Local File ("LF") filing requirements.

• The common issues can be classified in the following categories:
  • CbC Reporting Interpretation
  • Technical Issues
  • Gray areas in the CbC reporting that are addressed in MF/LF
  • Gray areas in MF/LF

• The following slides showcase a list of sample issues Clients has encountered while preparing for the CbC, MF and LF filing.
CbC Reporting Interpretation Issues

- **Interpretation of “Total accrued tax expense” in CbC Reporting**
  - Should total accrued tax expense be net of foreign tax credits for US tax purposes?
  - Should deferred taxes and provisions of uncertain tax liabilities be excluded from total accrued tax expense?

- **Treatment of stateless income in CBC reporting**
  - How should income from the various types of entities such as the following be treated for purposes of CbC reporting?
    - Reverse Hybrid
    - Cayman Company
    - Partnership
    - Branch registered in Ireland with no income tax

- **Treatment of related party revenues for CbC and MF purposes**
  - Should revenue from entities, where Clients holds less than 50% of its ownership, be included in the US CbC reporting.

- **Should dividend income be excluded from profit/loss before tax?**
  - There were no clear guidance on whether dividend income should be included in profit/loss before tax in the CbC reporting.
Technical Issues

• **Which jurisdictions allow for surrogate parent filing**
  - To date, the U.S. income tax treaty and tax information exchange agreement (“TIEA”) network cover approximately 95+ countries. However prior to automatic exchanging information, the IRS must enter into a competent authority (“CA”) arrangement specifying the rules under which such exchange will take place. For jurisdictions within the US treaty and TIEA network that the US does not enter into CA arrangement with for the exchange of CbC info, they may require secondary filing of the CbC report under local rules similar to the OECD model legislation.
  - Currently there are concerns around exchange of information with/from Chile, China, Singapore, Switzerland and Taiwan, where Clients have significant businesses.
  - China for example, is an “in network” country but since it does not have a BDI automatic exchange relationship with the US under FATCA, Clients China may be required to meet local filing requirements in China.
  - To avoid additional local filing requirements, Clients could utilize a parent that have passed legislation or otherwise indicated that they are willing to serve as a surrogate.
  - May need to conduct analysis to compare between US treaty network and the networks of the following potential surrogate countries:
    - Mexico
    - Japan
    - Australia
    - Canada
    - UK
    - Netherlands
Gray areas in the CbC reporting which has to be outlined in the master file/local file.

- Should LF be provided on an entity by entity basis or aggregated for the entire Clients business operation in that jurisdiction?
  - These are done through on a country by country basis to understand local filing requirements for respective jurisdictions.

- Reporting contract labor in CbC and MF/LF
  - US CBC regulation §1.6038-4(d)(3)(iii) writes that “independent contractors that participate in the ordinary operating activities of a constituent entity may be considered employees of such constituent entity.” Therefore do companies have the flexibility or exclude contract labors in the reporting of total employees?

- Main Business Activity: Should companies check one or multiple boxes in CbC Reporting form if the entity is involved in multiple business lines?
  - Do business lines reported in the CbC Reporting form need to agree with the descriptions in the MF.
Gray areas in MF/LF

• Clarification on MF requirements and presentation of the legal ownership chart in the MF
  • Should the organizational chart include holding and dormant entities? Should the entities included in the organizational chart reconcile with entities listed in the CbC reporting?

• Local file reporting requirements for holding companies and dormant entities
  • What are the minimum LF reporting requirements for holding and dormant companies that perform little to no functions?

• Clarification on MF requirements for top 5 products/service offerings
  • What is the definition of product line? Can it be interpreted that Client’s top 5 business segments are the top 5 products/service offerings?

• Should intangibles be reported for business segments that account for less than 5% of Client’s overall business?
  • Should constituent entities such as business unit’s intangibles be reported in the MF even though these entities account for less than 5% of Client’s overall business?