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The Challenge of BEPS Documentation

The reality of preparing global documentation may be expanding from a process of producing one or a small number of clearly defined reports to one of collecting and managing potentially significant amounts of data. This article considers how processes and technology habits may need to change to react effectively to the documentation challenges sparked by the Organisation for Economic Co-operation and Development's ("OECD's") base erosion and profit shifting ("BEPS") project.

The OECD's new guidance on transfer pricing documentation recommends that countries adopt this guidance starting in 2016 with the first reports provided to tax authorities in 2017. The recommended documentation comes in three parts:

- A country-by-country ("CbC") report that covers selected financial data for all countries, which is to be shared with all tax authorities
- A "master file" that describes a multinational enterprise's global supply chain, which also is to be shared with all tax authorities
- A "local file" that provides more detailed guidance, which is to be shared with local tax authorities.

The CbC report is entirely new, and while the master file and local file sound similar to what companies are already preparing, they ask for a substantial amount of additional information. (The detailed master file and local file requirements can be found [here](#).)

Trends Accelerated by the OECD Documentation Guidance

The new OECD guidance may accelerate two trends that have been developing over the past several years. The *first* is a desire on the part of tax authorities to require that taxpayers be more transparent about their supply chains, including providing the information that tax authorities need to help identify the location of nontaxed or lightly taxed income. This trend could increase the likelihood of audits, particularly given the current political focus on "double nontaxation."

The *second* and equally important trend is the significant growth in the volume of data that has to be collected and processed to comply with transfer pricing requirements. When the United States first issued its documentation requirements, taxpayers could focus on providing a single report that was often prepared on an aggregated basis (i.e., all transactions were tested as one) and had just 10 specific documentation requirements. Now—and even more so and assuming countries incorporate some form of the new OECD guidance into their regulations and expectations—even a medium-size multinational may have to prepare extensive reports. For example, assume a medium-size multinational is required to prepare reports for 40 different countries with an average of three legal entities per country, five discrete transactions per legal entity (tangible property sales, tangible property purchases, intangible property payments, services payments, and intercompany interest payments), and perhaps 20 discrete pieces of data per transaction. This could lead to a requirement for approximately 12,000 data items if documentation is prepared for all legal entities, and 6,000 data items if documentation is prepared for just half of all legal entities. The number of data elements can further increase if transactions are further subdivided into sales to and sales from specific individual legal entities within the multinational group. Consider the following summary:

	Number	Cumulative
Number of Countries	40	40
Legal Entities Per Country	3	120
Transaction Per Legal Entity	5	600
Data Items Per Transaction	20*	12,000
% of Legal Entities Documented	50%	
Adjusted Data Items	0	6,000

* This assumption comes from the 20 different items listed in the OECD's local file guidance.

Processes Needed to React Effectively to the OECD Documentation Challenges

Some of the key processes that multinationals should consider putting into place to react effectively to the challenges posed by the new OECD documentation initiative can be broken down into three discrete categories:

Data Collection

Data collection could be responsible for the largest and most challenging part of the overall documentation effort. A number of issues are inherent in the data collection process, particularly when there are multiple enterprise resource planning (ERP) systems and the need to collect data from potentially hundreds of legal entities or businesses units. At the same time, this is an area where there may be relatively easy opportunities for substantial improvements in processes and costs savings.

Data Structure and Analysis

The ability to use data, once collected, is highly dependent upon how the data is structured and how a multinational's analytical and reporting tools are built around these data. A key objective of this analysis is to be able to extract information from large amounts of interconnected data in a way that provides useful insights into relevant questions, when some questions are likely to be related to risk, others project management, and others cost. This should also allow for an evaluation of how different ways of structuring and presenting data can change the story told by documentation reports and other communications with tax authorities. Flexibility and adaptability can be key at this phase of the analysis, as they allow the creation of a customized approach that is tailored to each company's needs.

Development of Robust Processes

While flexibility can be key to the initial analytical process, the preparation of transfer pricing documentation is an annual process rather than a one-time event. The production of the information needed to produce and evaluate data should, therefore, be incorporated into a robust and replicable process with carefully controlled workflows to safeguard the accuracy and quality of the data and reports generated from the data. However, a robust process may be locked down and subject to tight

controls, which in turn implies the need for a carefully thought through change management process. Because locking the process down prematurely may lock in inefficiencies, the development of the robust process should potentially come at the end of the project once the data and analytical needs of the multinational enterprise have been clearly specified.

Technology Habits May Need to Change

The need for the systematic collection and analysis of large amounts of data suggests the need to rely on appropriate technology. The good news on the technology front is that recent advances in collaborative and business intelligence (“BI”) software have made it much easier to work with large amounts of diverse data. The key challenge, however, may be that the effective utilization of this modern technology requires breaking old habits that potentially undermine the effectiveness of the new technology.

The existing tools used by many tax departments to collect, process, and evaluate information generally relies upon a combination of software-based technologies that may have been introduced decades ago and existing processes put in place to work with these tools may undermine the effectiveness of modern collaborative and BI tools. Changing existing habits and practices is often difficult and requires the implementation of a change management process that, in turn, may require the adoption of different work flows and the development of different skill sets and training.

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