



BEPS Action Plan 13

**Master File and Country
by Country reporting:**
Navigating challenges
with tax, accounting and
IT service offerings

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Introduction

As one of the pioneers and major contributors to the Base Erosion and Profit Shifting (BEPS) initiative of the Organisation for Economic Co-operation and Development (OECD) and G-20 countries, India introduced a few BEPS Action Plans as part of the recently enacted Finance Act, 2016. The major one has been the introduction of the concepts of Master File and Country by Country (CbC) reporting in the Indian transfer pricing (TP) regulations with effect from the fiscal year beginning 1 April, 2016, in line with BEPS Action Plan 13.

Action Plan 13 had provided for a three-tier structure of TP documentation, namely – (a) Master File (b) local documentation file, and (c) CbC reporting. A majority of the countries having TP regulations, including India, already provide for mandatory TP documentation for the

local entities with respect to the transactions entered into with their overseas Associated Enterprises (AEs). It is thus only the preparation of Master File and CbC reporting which are added obligations cast upon multinational enterprises (MNEs), under the revised TP documentation guidelines.

The Finance Act, 2016 provides for the prescription of detailed rules with respect to the manner of preparation of Master File and CbC reporting, which the Indian Revenue Board is expected to release in due course of time. However, given the intentions of the Parliament, as manifested in the relevant object's clause of the Finance Bill, 2016, it is apparent that India intends to introduce the concepts of Master File and CbC reporting exactly on similar lines as BEPS Action Plan 13.

Three-tier structure of TP documentation



Master File

- Introduced by Finance Act, 2016; effective from FY16-17
- High-level blue print of MNE group's global operations
- Value drivers, supply chain model, etc.
- Prepared centrally; submitted with tax authorities of all countries
- Ideally prepared by ultimate parent for consolidation
- No monetary threshold prescribed.



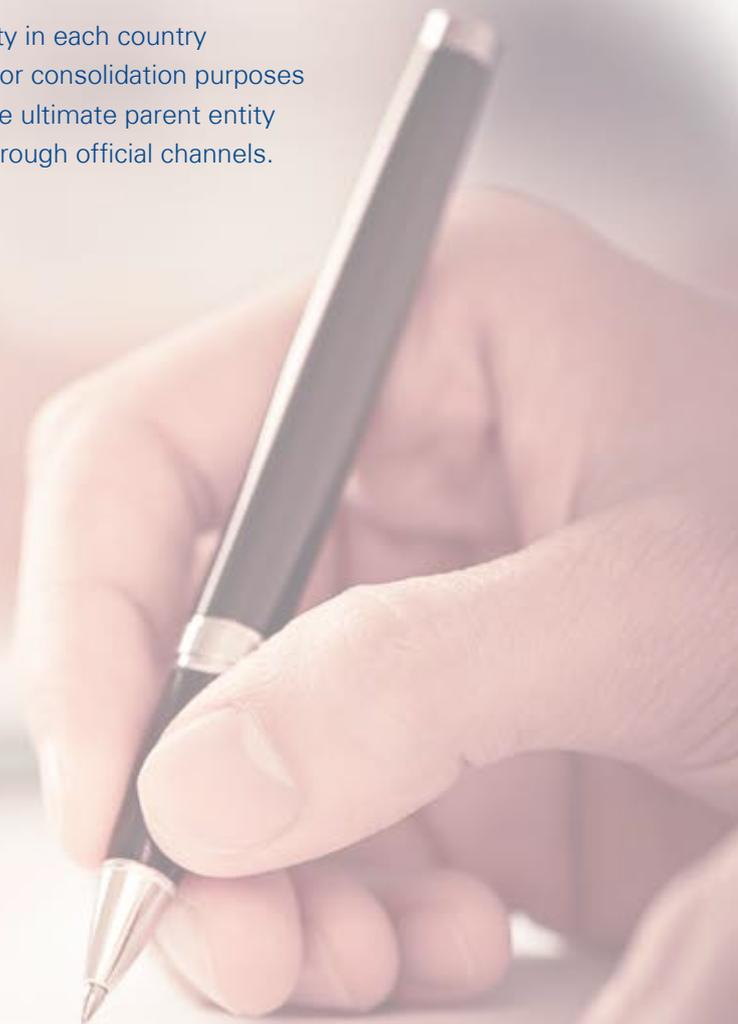
Local documentation file

- Local country TP documentation
- To be prepared by each local entity; and submitted to local tax authority
- In place in India since 2001
- Local file shall comprise functional and economic analysis of international transactions undertaken by the local entity.



CbC report

- Introduced by Finance Act, 2016; effective from FY16-17
- MNEs having consolidated annual revenue greater than EUR750 million
- Summary data and economic activity in each country
- Prepared by ultimate parent entity for consolidation purposes
- Submitted to the tax authority of the ultimate parent entity
- Shared with other tax authorities through official channels.





01

Overview of the Master File

The Master File is expected to provide an overview or blue print of an MNE group's global business model, specifically covering the following aspects – (a) organisational structure, (b) description of the various businesses, (c) intangibles used in the businesses, (d) intercompany financial transactions, and (e) financial and tax positions.

There are no set formats provided in BEPS Action Plan 13 with respect to the manner of presentation of, or the exhaustive list of details to be mandatorily incorporated in, the Master File, since that would have restricted the flexibility of taxpayers to prepare the Master File in a manner appropriate for their respective businesses. This is especially relevant as the business model of each MNE group may be quite unique and different from the others.

The guidelines have asked the taxpayers to use prudent judgment in determining the appropriate level of details for the information to be incorporated in the Master File, keeping in mind its objective to provide tax administrators with a high level overview of the MNE group's global operations and policies. Given the flexibility provided, as above, each MNE group is encouraged to prepare the Master File as a real-life novel, depicting the overall TP policy and supply chain model for each of the businesses run by it, in a manner that any person reading the document may understand the intercompany pricing policies adopted by the group.

An MNE group should map each of the business lines separately, and provide a complete blue print of each such business line, apart from its overall legal and ownership structure, specifically covering some of the key aspects, namely:

- Value drivers of the business, i.e. what propels the premium returns of the business, which could be unique intangibles, marketing strategies, etc.
- Overall global supply chain model of the business vertical, covering the following information with reference to adequate functional analysis:
 - Whether the MNE group follows a centralised business model

or a regional principal structure, where there is an overall principal or entrepreneur in the system, which houses the valuable intangibles and also key strategic functions, and appoints various entities within the MNE group located in different countries for rendering specific services against payments of arm's length remuneration, e.g. contract or toll manufacturing, contract Research and Development (R&D), procurement, shared functions, selling, either through buy-sell distribution or agency models, etc.

- In case the MNE group follows a de-centralised business model, with entities located in the various countries independently carrying out manufacturing, distribution, procurement and other functions, whether and to what extent, the legal owner of the valuable intangibles or ultimate operating parent company of the MNE group, retains operational control, over the different group entities, namely through intercompany licenses, intragroup services, etc.
- Strategy around development, ownership and exploitation of intangibles, namely which entity within the MNE group owns valuable intangibles, and the strategy adopted for ongoing development and exploitation of present and future intangibles, i.e. through contract R&D structure, license agreements, cost contribution arrangements, etc.
- Policy around leveraging of finance by the MNE group, specifically covering information on whether the group has any entity playing central treasury functions, strategy around intercompany loans and guarantees, etc.
- The MNE group's consolidated financial statements, and information regarding unilateral Advanced Pricing Agreements and other tax rulings relating to allocation of income, which might have been obtained in different countries.



02

Overview of CbC report

The CbC report is required to be presented in a tabular format, setting out crisp information about the functions performed, assets owned, personnel employed, revenue generated, profits earned, taxes paid, capital structure, retained earnings, etc., with respect to each entity of the MNE group located in different countries, as highlighted in Annexure III of the revised Chapter V of OECD’s TP guidelines, being a fallout of the BEPS Action Plan 13.

Thus, the CbC report is the platform to vindicate the veracity of the blue print provided in the Master File. The CbC report can highlight any possible mismatch between the level of profits or revenues residing in, or intangibles owned by, an entity of the MNE group; and the functions carried out by, or

capital infused in, the said entity, thus raising an alarm for tax administrators to examine the structure. For instance, justifications may be required, if, for the various subsidiaries of the Indian MNE group situated in different countries, the ratio of profit per employee is inversely proportional to operating profits and/ or effective tax rate. A low ratio of unrelated party revenue and total revenue would signify significant intra-group transactions within the MNE group, thus triggering enhanced scrutiny by tax administrators. The CbC report would assist in interpreting the TP policy of the MNE group, namely how the different profit level indicators align with the TP policy stated in the Master File and Local File; and also vary between various countries/ regions; what are the reasons for outliers, etc.?

The format of the CbC reporting template as provided in BEPS Action Plan 13 is set out below:

CbC template – Page 1									
Country	Revenue			Profit (loss) before income tax	Income tax paid (on a cash basis)	Income tax accrued – current year	Stated capital and accumulated earnings	Number of employees	Tangible assets other than cash and cash equivalents
	Related party	Unrelated party	Total						

CbC template – Page 2												
Country	Constituent entities resident in the country	Country of organisation or incorporation if different from country of residence	Activities									
			R&D	Purchasing and procurement	Manufacturing and production	Sales, marketing and distribution	Administrative, management and support services	External service business	Regulated financial services	Insurance	Holding company	Dormant

03

Filing requirements of the Master File and CbC report in India

The BEPS guidelines provide that the Master File needs to be filed by each entity of the MNE group with the tax administrator of the respective country, at the time of audit, namely in addition to the local TP documentation. The CbC report is supposed to be prepared by the ultimate parent company of the MNE group, who shall file the same with the tax administrator of its country, who in turn would share the said document with tax administrators of other countries, wherever the MNE group has footprints in the form of subsidiaries or permanent establishments (PE), through official multilateral channels for sharing of information.

Though the BEPS guidelines do not mandate as to which entity of the MNE group should prepare the Master File, given that CbC reporting is the obligation of the ultimate parent of the MNE group, it is imperative that the Master File should also be prepared by the same entity, namely the ultimate parent. This is because firstly, from an efficiency standpoint, the same entity is better suited to prepare the two documents, which are complimentary and harmonious to each other; and secondly, the ultimate parent is likely to be the only entity with a panoramic view of the overall blue print of the various business lines of the MNE group.

BEPS Action Plan 13 provides for a minimum threshold of consolidated annual turnover of EUR750 million for MNE groups to be obliged to comply with CbC reporting, which the Indian government also seeks to follow. Incidentally, no threshold has been provided for the maintenance of Master File by MNE groups in BEPS Action Plan 13. One has to wait and see as to whether the Indian Revenue Board prescribes any monetary threshold in this regard, as otherwise small taxpayers may unnecessarily be saddled with an additional compliance burden.

Indian outbound MNE groups

Both the Master File and CbC reporting have their main relevance for the headquarters or ultimate parent of an MNE group. Thus, in the context of India, the Indian outbound MNE groups need to gear up for the exercise as the requirement for compliance has already commenced effective 1 April 2016. It is most critical for the Indian outbound MNEs to carry out a clinical analysis of their businesses at the earliest to find out whether there are any exposures in terms of mismatches between risks, rewards and functions, which might not have been detected during the course of normal local TP documentations carried out thus far; and take corrective measures with respect to the supply chain models, as the new regulations get enacted.



Foreign inbound MNE groups

In line with BEPS Action Plan 13, the Finance Act, 2016 proposes that every Indian entity, being a subsidiary or PE, of a foreign parented or headquartered MNE group, needs to disclose the name and country of residence of its ultimate parent entity, with the Indian tax authorities, who can then obtain the CbC report of the MNE group from the tax authorities of the country of residence of the said parent entity under an arrangement of mutual exchange of information.

If the ultimate parent of a foreign MNE group is located in a country that does not have either requirements of CbC reporting in its domestic tax laws; or an arrangement for exchange of CbC report with India, then the Indian entity of such foreign MNE group may be required to inform the Indian tax authorities regarding an alternate reporting entity designated by the MNE group, which may be located in

a country that has both CbC reporting requirements in its domestic tax laws; and also an arrangement to exchange CbC reports with India, in which case, the Indian tax authorities shall obtain the CbC report of the MNE group from the tax authorities of the country of residence of such alternate reporting entity. Alternatively, if the MNE group designates the Indian entity to be such alternate reporting entity for the group, then the Indian entity would need to provide the desired information with the Indian tax authorities for the MNE group as a whole.

Penalties for default

A graded penalty structure has been provided in case of non-furnishing of report or necessary information in this regard, with the penalty ranging between INR15,000 to 50,000 per day, depending upon the stage and recurrence of the default. Further, furnishing of inaccurate information, might attract a penalty of INR500,000.

04

Interplay with Place of Effective Management (POEM) and supply chain planning

The concepts of Master File and CbC reporting may not be looked as a mere compliance requirement under the TP regulations and should be viewed as an opportunity to revisit the overall supply chain models of the businesses of Indian MNEs, and create value in the system through introduction of efficiencies, synergies, etc.

Also, a thorough analysis of the overview or blueprint of the

organisational and operational structures, as required by the Master File and CbC reporting, could help Indian MNEs to identify any possible exposures around tax residency rules for their foreign subsidiary companies under the new regulations of POEM, and mitigate any such unnecessary exposure through valid corrective measures, strictly within the four corners of the law.

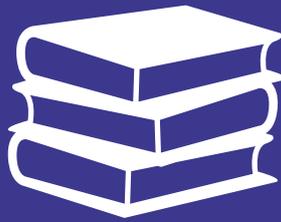
05

CbC reporting requires accounting and technology-related support

While the CbC reporting template requires information to be submitted in a simplified format, Indian outbound MNEs might face challenges in extracting necessary data from their Management Information Systems

(MIS). Challenges may also be faced on the accounting front in ensuring consistency in the manner in which data is available in different jurisdictions. Some of the issues that need to be addressed are highlighted below:

Accounting challenges



- GAAP followed by Indian parent entity is different from local GAAP of foreign subsidiary.
- Reconciliation of revenue and profits as per CbC report with the financial statements and other data sources (tax records, etc.).
- Functional currency considerations, e.g. adjustments if the CbC reporting currency is different from the group's functional currency.
- Jurisdiction-wise parallel consolidation requirements and scope of consolidation for CbC reporting for special purpose entities, associates and jointly controlled entities.
- Impact of acquisitions on CbC reporting, deferred tax and ETR considerations.

Technology challenges



- Collating data from different jurisdictions with decentralised/fragmented IT systems and processes may be a significant challenge for the MNEs. The taxpayers may be required to upgrade the MIS in order to ensure that sourcing the necessary data and reporting can be undertaken in a hassle free manner.
- Providing CbC information of global allocation of income, economic activities performed and taxes paid according to a common template.

06

Enterprise Resource Planning (ERP) sensitisation

Sourcing the required data and presenting it in the required format is not an easy task. Collating and reporting the data in the required format is also time consuming, and an excel spreadsheet approach can carry risk of errors. Automating data collection through ERP systems is a way of saving time and resources in what will be an annual compliance process. There can be challenges, for instance, in capturing taxes on a paid basis and also identifying withholding taxes in

the country receiving the income. One may need to build functionality into the ERP system of Indian outbound MNEs in order to ensure the source data is tagged correctly, so the reports running on their systems can meet the CbC reporting requirements. We can assist in reviewing the current MIS of the MNE group and offer customised services to overcome accounting challenges and capture the relevant data for preparing the CbC report and data analytics.





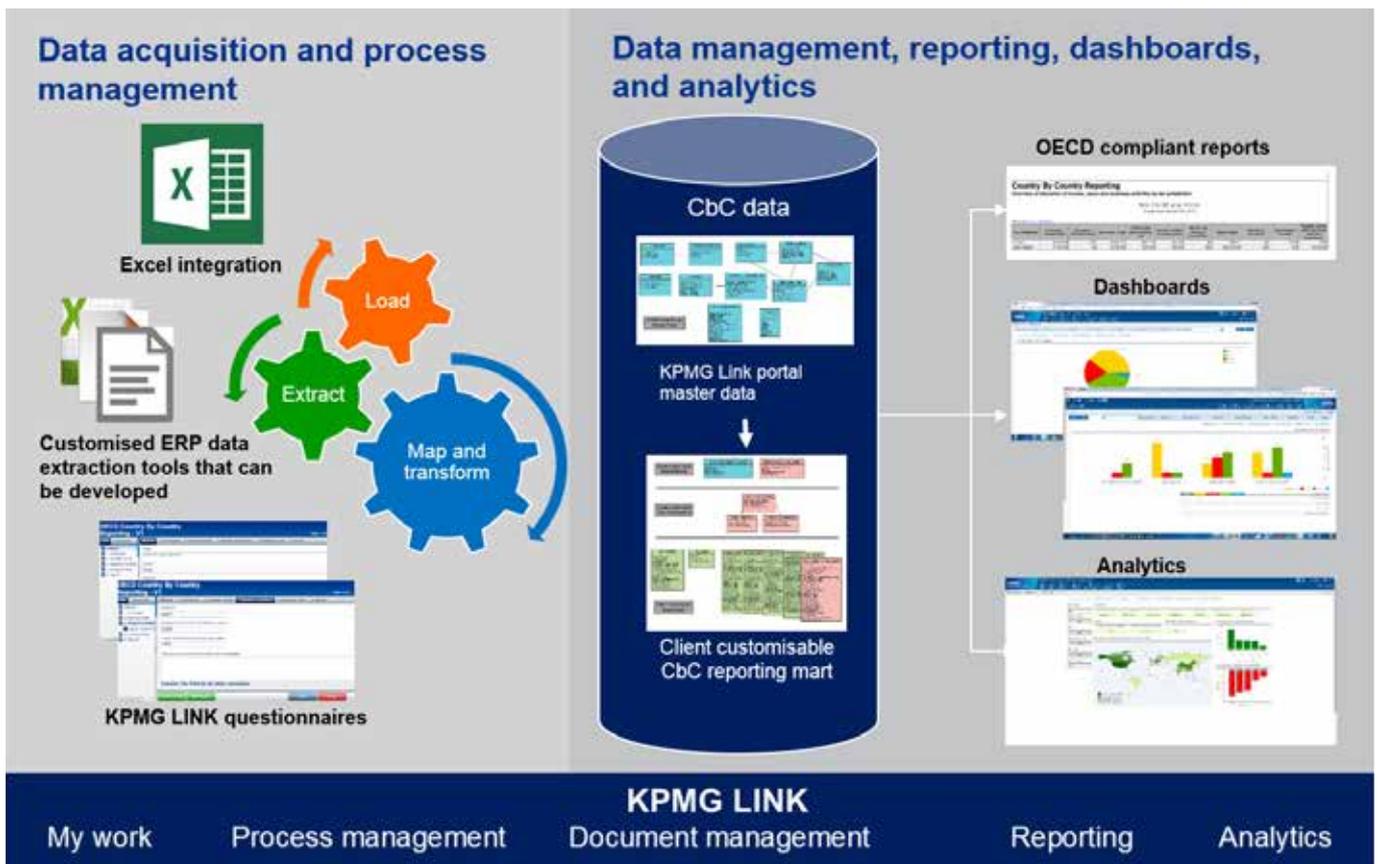
07

KPMG LINK Country by Country Reporting

KPMG International's web-based proprietary tax technology application, "KPMG LINK Country by Country Reporting", has the capability to capture, format and report data in one, easy-to-access place. The tool allows a taxpayer to:

- Gather data locally and centrally, by using flexible questionnaires and data import functionality.
- Aggregate the data from multiple sources to produce BEPS Action Plan 13 compliant ready reports.
- Analyse that the system performs key ratio analysis and country mapping to identify risks.
- Obtain control and sign off, with built-in controls, status monitoring and supporting documentation upload.

KPMG LINK Country by Country Reporting business architecture



08

KPMG's holistic support to Indian outbound MNEs on Master File and CbC reporting

Tax and TP

- Conduct training workshops on Master File and CbC reporting requirements
- Conduct value-focussed interviews for appropriately capturing functions, assets and risks
- Conduct a diagnostic review of the existing business model/ global supply chain, holding/ IP structures from the perspectives of exposure in TP and POEM
- Clinically analyse the business and strategise on the mismatches between risks, rewards and functions not detected during the local TP documentation
- Prepare a dummy CbC report based upon the earlier year's figures to identify potential risks
- Assist in the preparation of Master File and CbC report for FY 2016-17.

GAAP and company laws/regulations

- Map information available versus the information required by the CbC report
- Analyse potential differences between the consolidated data and scope of CbC report
- Define the data sources used to prepare the CbC report (GAAP, currency, etc.)
- Analyse additional adjustments to be made between the definition of aggregates in the consolidated financial statements and those required for CbC report (e.g. inter-company transactions, tangible assets, etc.)
- Assist in the preparation of consolidated financial statements/ information and highlighting of any additional checks to be performed on the tax aggregates
- Map the current group's public financial information to help ensure consistency with the CbC report.

IT systems/processes

- Provide advisory and implementation support in data collection and consolidation approaches
- Integrate and automate data collection, transformation and validation processes
- Help manage data security and authorisation
- Assist in process and workflow monitoring
- Help maintain status and analytics dashboards
- Utilise KPMG's technology tools to assist in data gathering, reporting and analytics.

Supply chain advisory

- Conduct a value chain analysis
- Understand and appropriately capture value chain versus profit captured
- Help identify gaps and build a bridge between the tax supply chain and business supply chain
- Facilitate collaboration between tax and management consulting teams.

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Printed in India. (005_BR00516)