

February 2014

## **OECD Discussion Draft: (i) proposes significant changes to transfer pricing documentation guidance, and (ii) contains draft template for country-by- country reporting.**

Multinational companies face increased disclosure requirements and an increased compliance cost burden if proposals contained in an OECD discussion draft are adopted.

### **Introduction**

On 30 January 2014, the Organisation for Economic Cooperation and Development (OECD) released a *Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (the Discussion Draft).

The Discussion Draft has been issued in response to Action Item 13 of the OECD's *Base Erosion and Profit Shifting (BEPS) Action Plan* and proposes to replace Chapter V (Documentation) of the OECD's *Transfer Pricing Guidelines (OECD TP Guidelines)* with revised guidance and also contains an initial draft template to give effect to country-by-country reporting. If finalised in their current form, the proposed changes could result in increased disclosure requirements and compliance costs for multinational companies.

It will, however, be interesting to see how the Australian Government reacts to these OECD initiatives given last year's introduction of new transfer pricing record-keeping rules as part of the package of legislation introduced by *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* and also amendments to the *Taxation Administration Act 1953* to require the Commissioner of Taxation to publish certain information obtained from tax returns of companies with an income of \$100 million or more.

The OECD has invited submissions on the Discussion Draft by 23 February 2014.

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## Background

The issues of tax morality and tax transparency have become debates in the public forum and continue to captivate the attention of governments, tax authorities, semi-governmental bodies such as the OECD and company executives and directors. As governments look to repair their fiscal position, a large number of countries are considering, or are in the process of implementing, substantial reforms to their tax systems. One area attracting increasing government attention is the tax paid by multinational companies and whether the widely reported incidence of low amounts of tax paid by some multinational companies is as a result of BEPS activities.

On 19 July 2013 the OECD issued an Action Plan on BEPS containing 15 work areas to address BEPS issues in a coordinated and comprehensive fashion. The OECD BEPS Action Plan was endorsed by G20 Finance Ministers the same day. Under Action Item 13, the OECD was directed to “[d]evelop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into account the compliance costs for business. The rules to be developed will include a requirement that MNE’s provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template”. The deadline for completion of Action Item 13 is September 2014.

In December 2013, at the launch of Australia’s presidency of the G20, Prime Minister, Tony Abbott, announced Australia would lead stronger international cooperation in the G20 to combat BEPS, including better global exchange of tax information.

## Overview of the Discussion Draft

The Discussion Draft identifies three objectives of transfer pricing documentation rules:

1. Providing tax administrations with information necessary to conduct a transfer pricing risk assessment.
2. Ensuring that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in reporting the income from such transactions in their tax returns.
3. Providing tax administrations with information they require to conduct a thorough transfer pricing audit of entities subject to tax in their jurisdiction.

## Proposed changes to transfer pricing documentation guidance

### A two-tiered approach to transfer pricing documentation

The Discussion Draft recommends the implementation of a two-tiered reporting regime to present a comprehensive picture of a multinational company’s global and local operations through the preparation of a master file and a local file.

Under the OECD’s suggested approach, a master file would be prepared for the multinational group and include:

- the group’s organisational structure
- a description of the group’s major business lines, including the title and country of the principal officers of each of the 25 most highly compensated employees in each business line
- a description of the group’s intangibles including which entity(ies) owns them
- a description of how the group is financed including details of intercompany financing arrangements
- a description of the group’s financial and tax positions including country-by-country information regarding the group’s global allocation of profits, taxes paid, and other indicators of the location of economic activity among countries in which the group operates.

Note: Country-by-country reporting is discussed in more detail in the following section.

The local file would supplement the master file and would document the local taxpayer's material transfer pricing positions with its foreign affiliates to demonstrate the arm's length nature of those positions. The local file would include:

- the local entity's organisational structure and management chart
- a description of the local entity's material transactions with foreign affiliates including a detailed functional analysis of the local entity
- a description of why the transfer pricing methods selected and applied were the most appropriate for the material transactions with foreign affiliates
- details of the comparability analysis(es) undertaken
- relevant financial information for the local entity.

## Compliance issues

The Discussion Draft identifies the following issues that countries should consider in developing transfer pricing documentation rules or undertaking transfer pricing compliance activities:

**Timing** – The OECD recommends that countries implement a contemporaneous documentation requirement for both the master and local files. Among other things the contemporaneous documentation should confirm the arm's length nature of the transfer pricing position existing at the time of the filing of the tax return.

**Materiality** – The Discussion Draft recognises the burden potentially imposed by compliance requirements and, as such, recommends the establishment of materiality thresholds that would allow for the documentation of the most important transfer pricing positions.

**Document retention** – The Discussion Draft suggests that documentation be retained for a 'reasonable period of time' consistent with the requirements of domestic law at either the parent company or local entity level.

**Frequency of updates** – The Discussion Draft recommends reviewing the factual information in the master and local files on an annual basis, and updating when changes have taken place.

**Language requirements** – Recognising the complication of having to translate documentation into local languages, the OECD recommends the preparation and submission of the master file in English and preparation of the local file and relevant parts of the master file into the local language.

**Penalties** – The Discussion Draft calls for a 'measured approach' with respect to documentation-related penalties, with leniency for taxpayers that demonstrate a good faith effort to produce reliable documentation.

**Confidentiality** – The Discussion Draft calls on countries to maintain confidentiality of taxpayer information (e.g. not expose trade secrets).

**Benchmarking** – In conducting benchmarking analyses, the Discussion Draft states that local comparables rather than regional comparables will usually be required, where local comparables are reasonably available, so as to satisfy the requirement to use the most reliable information.

## Draft template for country-by-country reporting

The Discussion Draft includes an initial draft template to give effect to country-by-country reporting. The country-by-country draft template forms part of the master file and requires the listing of all countries and all 'constituent entities' of the multinational group (includes companies, permanent establishments, trusts and partnerships) organised under the laws of each country to be disclosed.

The country-by-country draft template requires disclosure of certain indicators of economic activity for *each* 'constituent entity' of the multinational group in *each* country in which the multinational group operates as follows:

- place of effective management
- revenue
- income taxes paid to country of organisation
- withholding taxes paid
- number of employees
- tangible assets
- business activity
- earnings before tax
- income taxes paid to all other countries
- stated capital and accumulated earnings
- total employee expenses
- intercompany payments/receipts of royalties, interest, and service fees

## KPMG observations

Australian taxpayers are already subject to extensive transfer pricing record-keeping rules following last year's passage of *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* and may also be subject to significant disclosure requirements such as the International Dealings Schedule. In this respect, the Discussion Draft contains welcome recommendations on the issue of materiality affecting the compliance obligations of taxpayers. However, the Discussion Draft clearly contemplates much more detailed disclosures of a taxpayer's international structure and affairs.

A key compliance related issue is how documentation-related penalties would be imposed where a multinational company does not complete a country-by-country reporting template. Nevertheless, it could be inferred that such penalties would be imposed given the country-by-country reporting template forms part of the master file.

Further on the compliance front, the Australian Taxation Office (ATO) has already begun asking taxpayers to provide it with much of the information that would be included in the country-by-country reporting template. For example, in late 2013 the ATO commenced its International Structuring and Profit Shifting (ISAPS) field review program which focuses on both corporate tax and transfer pricing aspects of complex and high-value cross border transactions. This includes financing transactions, intangible property transactions and corporate restructure transactions. The ATO is expected to send around 125 review notification letters to taxpayers requesting detailed international data and a presentation to the ATO. The reviews are expected to take 6 to 9 months, resulting in a risk rating or escalation to audit.

A key controversial issue associated with these reviews is the ATO's desire to review information associated with the overseas aspects of taxpayers' global structures so they can understand the broader context of transactions and operations. This includes details of global corporate value chains including sales, profits and tax paid for each jurisdiction in which the group operates, payments to and from low tax jurisdictions, e-commerce and tax risk governance.

## Next steps

Your KPMG adviser can help you assess the potential effect of the OECD's Discussion Draft on your business, and to prepare for forthcoming changes to the international tax landscape.

Please contact your KPMG client service representative for assistance or further information.

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