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Preparing for New Country-by-Country Reporting Requirements — Are You Ready?

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Tax transparency is now a worldwide phenomenon: The Organization for Economic Cooperation and Development (OECD) recently finalized a country-by-country (CbC) reporting template that provides global visibility into company tax matters and poses challenges from data management to reputational risk (see the sidebar on the next page). The introduction of CbC reporting poses the following challenges:

- Data management challenges to properly prepare the report
- Expected increase in tax controversy
- Increased reputational risk

Given the global visibility into company tax matters the template provides, affected multinational enterprises (MNEs) are well advised to take proactive steps now in preparing for this game-changing new tax disclosure to effectively manage their tax and reputational risks.

To get started, tax departments at MNEs should ask four critical questions.

1. Can Our Accounting Systems Provide the Right View of Data?

The CbC reporting template allows MNEs flexibility as to the financial data that can be used to prepare the report. Data can be sourced from an MNE's consolidated worldwide financials, separate entity statutory statements, regulatory financial statements, or internal management accounts. If they choose local statutory statements, it is required to convert these statements to the MNE's reporting currency of record.

Depending on how a company's ERP system is configured, it may not support the ability to aggregate data by country. If the ERP system only gathers information along business lines rather than by legal entity or location, the company will have to manually manage data by converting business unit financials to the legal entity and then splitting the legal entity details by country before reconciling to local statutory statements and local tax returns.

Technology that can assist an MNE with sourcing transactions to specific countries while creating an audit trail of how each transaction is reported for financial statements, tax returns, and transfer pricing documentation, and so forth, would be helpful to ensure accuracy and consistency of data year over year, and would provide the ability to reconcile across all external reporting.

2. Do We Have Control Over the Data Required to Prepare the Template?

This will depend on the extent of manual workarounds needed to prepare the report. Most of the data can be sourced at the trial balance level. However, if your ERP system does not maintain trial balances by legal entity or by country, or if it does not support local statutory as well as consolidated reporting under Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), then the controls within your ERP system will be of limited or no benefit.

Another factor in controlling the data is how the process is set up. Who will prepare the CbC reporting template: corporate, local country controllers, or a combination of the two? Is the data sourced from multiple ERP systems with different charts of accounts, different accounting ledgers, and so forth? In some cases, MNEs may have trouble when using separate, local legal entity statutory financial statements because the underlying data used in compiling the local statutory financial statements is often outside the control of the corporate tax department. With such enterprise-level tax technology, MNEs can implement sufficient centralized controls and processes that support the preparation of the template and related reconciliations.

> Multinational enterprises need to prepare for country-by-country reporting not only to effectively manage their global tax matters, but also to ensure that their data and reputation are safe.

Details of the Country-by-Country Reporting Template

As part of its effort to address perceived tax abuses of multinational enterprises (MNEs), the Organization for Economic Cooperation and Development (OECD) finalized a new country-by-country (CbC) reporting template in October 2015. The OECD was directed by the G20 to address base erosion and profit shifting (BEPS) practices of MNEs. The final BEPS report consists of 15 action plans designed to close gaps in international tax rules that allow MNEs to legally, but artificially, shift profits to low-tax or no-tax jurisdictions.

The CbC reporting template, part of Action 13, requires high-level financial data to be aggregated by country, including revenue, profit before taxes, taxes paid and accrued, number of employees, stated capital, accumulated earnings, tangible assets, as well as the main activities of every entity within those countries.

Endorsed by G20 leaders, the CbC reporting template is quickly gaining adoption by member countries, typically with a January 1, 2016 effective date and December 31, 2017 first-filing date. For those countries, the template must be filed by MNEs with group revenue of €750 million or more. Generally, the report is filed in the tax jurisdiction of the ultimate parent entity, but, if that is not followed, the rules provide for a "secondary mechanism" that effectively transfers the filing obligation to lower-tier entities in certain circumstances.

3. Do We Need to Implement New Processes to Supplement Data from the Accounting Systems?

This depends on how your financial systems are currently configured. CbC reporting rules require companies to split certain required financial data by country. If an MNE chooses to use a consolidated data source, it may struggle to reconcile because there is generally a lack of visibility into each legal entity in certain consolidated financial sources that will be needed for local statutory legal entity accounts and tax returns.

The ideal accounting system setup captures all data by legal entity and by country, with both a local statutory accounting ledger and a consolidated reported GAAP ledger. It should also support different currencies and related currency translation.

4. After the Data Is Sourced and Collected, Can It Be Easily Reconciled?

Even though not explicitly required, best practices dictate that MNEs be able to reconcile the financial information disclosed in the CbC reporting template to their:

- Public consolidated worldwide audited financial statements
- Legal entity books on both a worldwide consolidated financial basis and local statutory basis
- Local country tax returns
- Transfer pricing documentation, including the master and local files now required by the new OECD transfer pricing guidelines[1]

These reconciliations become even more complicated when factoring in new acquisitions, intercompany transactions, global expansion, operational changes, and tax planning structures. But they are essential to ensuring the accuracy of the report and defining a clear audit trail with drill-down capability. Technology that comprehensively manages data for income tax purposes with an audit trail and record retention can help with the filing and reconciliation of the financial data to the template, as well as tax returns.

Learn More

Vertex has spent more than 20 years delivering success for SAP customers with tax and regulatory requirements affecting the corporate tax life cycle. To learn more about how to reduce risk and comply with the new CbC reporting requirements, visit us at **www.vertexinc.com.**

[1] OECD, "Transfer Pricing Documentation and Country-by-Country Reporting" (October 2015; http://dx.doi.org/10.1787/9789264241480-en).