Technology solutions in a post-BEPS world

There has been a complete paradigm shift in global taxation with the rise in audit risks caused by new global initiatives like the OECD's BEPS Project. JD Choi, CEO at Tax Technologies, explores the technology solutions that should be administered to mitigate these audit risks in a post-BEPS world.

The implementation of the OECD's BEPS Project represents a fundamental change in taxation from the legalistic approach, under which tax minimisation is a generally accepted practice, to the fairness based approach where tax liability in each country should be a fair representation of the economic activities in that country.

This shift will cause disagreement on what constitutes fair taxation across countries and result in double taxation through concurrent multinational audits on cross-country economic activities. Integrated technology solutions will allow companies to adequately prepare for multinational audits by being able to quantify fair allocations of tax amounts that are acceptable to the auditors across countries. The same technology solution should also allow companies to collaborate across concurrent audits so the companies can reduce the risk of double taxation.

Having robust digital tools to manage tougher compliance regimes could prevent the risks of an audit

Paradigm shift in global taxation

The current taxation system is based on a "legalistic" model. The axiom for global taxation is based on an old US tax case, *Gregory vs. Helvering*, 293 U.S. 465 (1935). This case established two important legal doctrines. The first being business purpose, and the second being substance over form. Besides these two doctrines, this case also established legal justification for a legalistic approach, minimising tax burdens.

The case became the cornerstone for all tax planning. It simply means that as long as there is valid business purpose and substance, business arrangements can be made to minimise tax liability. Notice that there is no notion of fairness nor societal duty on the part of the corporation to increase its share of tax liability.

Now, BEPS is shifting the nature of taxation from one that is legalistic, which excludes notions of societal duty, to the one that is more grounded in economics and fairness.

Business risks under BEPS

Fairness is a subjective notion, especially from the perspective of global taxation. Corporate tax behaviour that may be fair in one country may not be viewed as fair in others. Thus, taxation based on fairness under BEPS standards will entail a high degree of uncertainty on various cross-border tax planning implemented under a legalistic approach of taxation to minimise global tax liability.

There are two main approaches within the BEPS initiatives to effectuate fair tax administration across countries: to harmonise the legal framework across countries and to enhance the audit capabilities of the auditors. As the audit capabilities are enhanced and more data is made available to auditors through the implementation of BEPS measures, audit risks will emerge, threatening many companies that relied on the legalistic approach of taxation.

Global harmonisation of tax rules under BEPS

As part of the BEPS implementation, the OECD is working with many countries to change domestic tax rules to harmonise tax laws so that the practice of shifting profits can be stopped. However, it is unlikely that harmonising domestic tax rules across countries will be achieved.

The underlying problems of profit shifting were already highlighted in the Study of Intercompany Pricing as early as 1988. Thereafter, many countries implemented transfer pricing rules along with administrative provisions to harmonise transfer pricing under their existing domestic legal framework. However, countries, for no fault of their own, failed to synchronise the tax rules across countries for nearly 30 years. It failed because different countries have different economic priorities and compete for investments from multinational corporations by providing different tax options based on their own economic priorities. Given the state of the economy, which is under global market saturation and stagnation, competition for corporate investments will not stop and, therefore, any attempts to harmonise domestic tax rules across countries to remove incentives to shift profits will fail.

Increase in global audit activities

Enhancing the capabilities of auditors will be very effective under BEPS. The drivers of BEPS (OECD, UN, IMF, World Bank) have already put in place the tools and are working with various tax administrators' organisations to implement the fair taxation approach through coordinated global audits. In fact, it has already demonstrated significant success. Under this approach, the Tax Inspectors Without Borders project was launched in July 2015 by the OECD and UNDP. This project produced more than $260 million in additional tax revenues through eight pilot audits in Africa, Asia and Latin America as of November 2016. In addition, there had been several high-profile cases, including when Google's office was raided by tax authorities in India, the Apple case in Ireland with the European Commission, and similar cases against

Facebook, Amazon, and McDonalds, which all point to the rise in global tax audits.

The implementation of BEPS will provide auditors with additional data, which will be essential to building their version of fairness assertions under a new taxation paradigm. Auditors will be able to gather standardised financial data across companies and industries (cross-sectional analysis) and will also be able to accumulate this data over time so they can track changes across the global tax landscape (time series analysis). They will also be able to access very sensitive corporate internal documentation through collection of master files and local files. Each country auditors' fairness assertions based on their own version of fairness could create inconsistent or contradicting outcomes across countries, thereby causing double taxation to the corporate taxpayers.

Technology solutions to mitigate global audit risks

The OECD estimates that the loss of global tax revenue from "legal but artificial profit shifting" is approximately $100 to $250 billion per year. The question is how much of this will come from your company?

The solution offered by many advisors is simple: your company needs to be prepared for concurrent global audits. But how? Why are the current technology solutions to handle global transfer pricing inadequate for a post-BEPS world?

Current technology solutions for transfer pricing were built under the old paradigm of legalistic approach whereby meeting each country's transfer pricing documentation rules were sufficient. They are not equipped to handle cross-border proactive transfer pricing analysis under the fairness approach of taxation.

The necessary global collaboration tool

Uncoordinated multi-country audits will undoubtedly result in double taxation due to inconsistent positions taken by each country's auditors. Yet, it is not in the interest of one country's auditors to collaborate with the other countries' auditors to help companies avoid double taxation. Therefore, the most important aspect of global audit defence is global collaboration by your company to avoid double taxation. Also, the cross-country allocation of taxes under the fairness approach should be based on cohesive value chain analysis in order for the companies to defend its transfer pricing positions across countries.

Further, there are many compliance requirements for countries participating in BEPS that necessitate similar information. If not managed centrally, this reporting may cause inconsistent information to be disseminated across different countries, which will also produce double taxation in the end. Thus, for both compliance and audit defence purposes, companies should implement technology solutions managed by a BEPS control centre.

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The following is a list of key technical requirements for an effective global collaboration and compliance solution that are discussed in further detail below:

- Global data collection;
- Data analysis;
- Global reporting;
- Global financial data reconciliation;
- Security management; and
- Project management.

Global data collection

Global audit defence should start with the appropriate global data collection, review, and correction before the information is provided to auditors. The data collected from around the world should be reviewed by BEPS control centre participants for consistency based on master file and local file contents. This review and proactive adjustments will show cohesive implementation of transfer pricing based on the economic fairness model under the BEPS approach.

BEPS compliance will require non-financial data in a variety of formats. Most of these data are generally not available in a central database. Thus, the technology solution should facilitate collection of multiple format data from a large number of participants and facilitate review by a small number of people in a BEPS control centre.

Here is a list of data elements (with most likely data formats) that are required to be collected through a global data collection tool:

- Master file:
  - Overall transfer pricing policy (Word or PDF format);
  - Supply chain analysis (Visio, Word or Excel format);
  - Intercompany service agreements for R&D (Word or PDF format);
  - Intangible management (Word or PDF format);
  - Intercompany financing (Word, Excel or PDF format);
  - Unilateral APAs (PDF format);
  - Tax rulings (PDF format); and
  - Global financial statement (Word or PDF format).
- Local file:
  - Business activity description (Word or PDF format);
  - Competitor analysis (Word, Excel, PDF or database format);
  - Controlled transaction reporting (Word, Excel, PDF or database format);
  - Intercompany payments (Excel or PDF format);
  - Related party agreements (Word or PDF format);
  - Comparability analysis and functional analysis (Word, Excel, PDF or database format);
  - APAs (Word or PDF format);
  - Tax rulings (Word or PDF format);
  - Local country financial statement (Word or PDF format); and
  - Financial data supporting the transfer pricing method that is tied to annual financial statements (Excel or PDF format).

The variety of data formats, complexity of contents, and the need for a centralised review and synchronisation of the data collected, requires a sophisticated data collection technology solution. With the advancement of SaaS or cloud solutions, companies can either develop the contents or license out-of-box content solutions to meet the needs for global data collection.

Data analysis

Once the data is collected, companies should analyse their data prior to filing country-by-country reports. Thus, the technology solution should provide cross-country transfer pricing models based on value chain analysis from the data collected. It should also provide cross-sectional analysis and time-series analysis that supports a company's version of fair allocation of profits based on the activities performed in each participating country. This proactive analysis may provide the best defence against the auditors' version of fair allocation of profits.

Global reporting

There are many reporting requirements for global BEPS compliance. Most BEPS reporting requires similar data contents even though they are required by different countries in different formats. For example, there are related party reporting requirements in several countries. It is likely that the compliance burden will increase as BEPS compliance is adopted by many countries. Companies should be able to handle the increase in global reporting without corresponding increase in compliance costs. Comprehensive database that provides BEPS normalised data should be able to produce all local country variations of reporting. Since not all reporting requirements are known at this point, the technology solutions must have flexible reporting capabilities to help companies minimise the compliance burden even with potential increase in global reporting.

Global financial data reconciliation

BEPS reporting and its corresponding audits will require reconciliation across the BEPS country-by-country report, global financial reports, local financial reports, and local tax returns. Although BEPS reporting does not require reconciliation between the BEPS country-by-country report and underlying financial records, it is expected that local country auditors will require reconciliation across all data sources as they are required to be provided under BEPS CbCR.

Companies will need workpaper functionality tools that can provide flexible reconciliation between financial data and tax returns. The software should also have flexible consolidation and complex translation capability. Preferably, these functionalities should be integrated with data collection mentioned above so the entire process can be made efficient.

Security management

BEPS will require reporting on sensitive data. Accordingly, strict security is required for access within the company based on the role of each participant, not to mention strict security from external threats. While facilitating global data collection from participants around the world, limited access to local country participants should be implemented to reduce risks, especially during the local audits. At the same time, BEPS control centre participants should have full access to the global data so as to provide coherent transfer pricing data that will allow the company as a whole to avoid double taxation across multiple audit participants.

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Technology solutions must include internal data security as much as external data security. Internal data security can be provided using a role-based or an entity-based access limitation logic. External data security is handled through network and data security handled by the internal IT group. Thus, when evaluating a software solution, companies should focus on the review of internal data security and the strength of a role-based or an entity-based security.

Project management

As part of the BEPS compliance and handling of global audits, it is critical that all participants to the BEPS control centre know the exact status of all global activities. From a compliance perspective, there are many local country requirements, such as notification filings or surrogate filings, which should be managed centrally to avoid inconsistent data content filings, as well as unnecessary penalties from missing filings. From the global audit perspective, the same participants must understand the local auditors' assertions from concurrent audits and evaluate it against the positions from other countries to achieve overall results that avoids double taxation.

A good technology solution should manage entire processes – data collection, analysis, compliance, and audit activities – by all participants using a built-in project management mechanism. Web-based technology tools can also facilitate participant training across the world to ease the transition into a new paradigm under post-BEPS world.

An integrated solution

The best technology solution should be a simple solution – a single, integrated solution that satisfies all technical requirements. Fragmented solutions will result in inefficient management of global activities and will increase compliance and audit risks. Audit battles will be won eventually in courts by solid documentation on fair transfer pricing strategies and their implementation. It is a question of how that documentation can be prepared and used that will determine whether your company can manage avoiding double taxation while managing the overall costs associated with BEPS. The key is an optimal technology solution that allows global collaboration from the beginning to the end.