Three steps to improved foreign tax provision data collection

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To actively participate in today's global marketplace, U.S. companies are continuing to increase their operations overseas. As a result of this expansion, compliance requirements with local country tax reporting and related U.S. tax reporting of foreign operations also increase. Managing those requirements and efficiently gathering the required data are becoming significant issues for many companies.

Whether your business is planning its first foreign expansion into a single location or has multiple foreign entities operating in several countries, you need to know how you are going to collect the data required for the provision process. If your company has recently expanded internationally, it is also important to understand the considerations necessary to integrate foreign data into a U.S. GAAP provision calculation. Ultimately, you must determine an efficient methodology for accurately reporting the tax associated with the foreign operations.

There are three key steps to determining how to incorporate and collect foreign tax provision data:

- **Assess foreign operations.** This includes key stakeholders, GAAP knowledge of foreign controllers, technology tools currently utilized and materiality.
- **Determine requirements.** Companies must consider both foreign and U.S. provision and compliance requirements for foreign operations.
- **Analyze tools.** Many technology tools are available to integrate the foreign provision calculation with the domestic calculation.

Assess foreign operations

Assessing foreign operations is an important first step toward understanding the current local country tax processes and determining optimization opportunities for your tax department. A strong assessment provides a reality check of the time and effort needed to streamline the process, allowing you to prioritize your approach and appropriately manage resources. A good assessment begins with interviewing foreign controllers, which gives you valuable insight that may include information, such as:

- The absence of a foreign controller in a particular country
- Foreign local country tax calculations are typically outsourced to a local accounting firm
- Current tracking of foreign tax provision information is detailed in some foreign jurisdictions, while very high-level in others (i.e., pre-tax book income x the tax rate)

Each situation above creates additional considerations in the design and implementation of the foreign data collection process. Knowing the personnel involved in providing the foreign data including data required to perform the return to provision calculation—is key in evaluating how to optimize the process. In addition to identifying the personnel involved and assessing their knowledge of U.S. GAAP, familiarity with technology tools and willingness for change are crucial to designing a data collection process that will be effective in practice, not just in theory.

It is equally important to gather information on any existing foreign tax provision calculations and to review the methodology. The fundamental principles of this review will be the identification of areas for consistency among jurisdictions, and the categorization of countries based upon materiality. This process phase can be completed by performing a tiering analysis, which is accomplished by breaking the foreign jurisdictions out between Tier 1, Tier 2, Tier 3, etc., and developing a process for gathering and presenting the detail required for the foreign provision calculations.

For example, for Tier 1 entities (the most material entities), the requirement could be to have a current and deferred provision calculation, with the deferred items broken out on an item-by-item basis. Meanwhile, the jurisdictions falling into a Tier 2 category would also have a foreign current and deferred provision, but their deferred provision would detail out the five most material deferred items, and group the rest in an "Other" category. In addition to defining the scope of the foreign provision, a tiering analysis will help drive the data requirements related to foreign operations.

Determine requirements

Once the scope is defined for the foreign provision, you will need to create a list of all data requirements and data sources. Data requirements for the provision are broken out by provision type and are typically as follows:

- Local country tax provision
  - Local country tax rates
  - Foreign exchange rates
  - Identification and quantification of local country permanent and temporary differences
  - Local country return-to-provision analysis
  - Documentation of local country year-end temporary differences
  - Identification and quantification of uncertain tax positions
  - Income tax payable reconciliation
- Domestic provision on foreign operations
  - Foreign base company sales income and other potential Subpart F income
  - Analysis of intercompany transactions and accounts
  - Tracking of earnings and profits of the foreign subsidiary
  - Determination and tracking of foreign tax pools for purposes of determining the amount of foreign tax credit
  - Documenting permanent reinvestment of foreign earnings outside of the United States

Once data requirements are defined, data can be grouped by data source to help further prioritize opportunities to streamline and optimize data collection and reporting. Below is an example of source grouping, as applied to the requirements outlined above. It should be noted that specific requirements and sources vary based on a company's specific fact pattern.

General ledger	Data collection templates	Detailed workpapers
• Foreign exchange rates • Pretax book income in local and functional currency • Review of intercompany transactions • Identifying permanent and temporary differences that can be automated from tax-sensitive accounts • Tax payments	• Local country return information • Local country tax rates • Documentation of local country year-end temporary differences • Income sources of foreign-based sales, including related and unrelated parties	• Tracking of earnings and profits of the foreign subsidiary • Foreign tax pools • Quantification of local country permanent and temporary differences • Quantification of uncertain tax positions • Documentation of permanent reinvestment of foreign earnings outside of the United States

When performing planning, it is recommended that both the requirement and source be recorded in a single document, where each item is listed separately and the data source, including any general ledger accounts applicable to the item, is indicated in an adjoining field. In the final step, review each of the detailed workpapers to determine any additional data sources within the calculations. Once completed, this provides a comprehensive, search- and sort-friendly list, with relevant documentation of the existing sources for the foreign and domestic provision calculation related to foreign operations.

Analyze tools

A company that has expanded internationally—or is preparing to do so—is likely complex enough to either have a tax technology platform or to consider adopting one. It is typically most efficient to utilize tools available in the same product line as the provision software, though specific business factors may warrant a broader technology review to identify the optimal solution. Regardless of the technology in use, the foreign data collection process needs to be reviewed and optimized.

As referenced above, creating an inventory of existing workpapers helps identify and document the foreign provision scope. With the workpaper inventory list complete, each of the workpapers is evaluated to determine which can be executed within the core tax provision software system versus which would be managed outside of the core software.

For items outside the core system, technology solutions, such as Web-enabled data collection packages or automated Excel-based workpapers, should be evaluated based on the current software system. Once an approach is determined and implemented, the new tools should be tested for a selected prior period, modified as necessary, and finalized in preparation for the company's "go live" date for the new or optimized foreign tax provision data collection approach. Because even the most intuitive system will require some level of custom configuration and training before being used in a live provision, you should ensure your implementation plan includes adequate time to meet the identified training needs of all users prior to undertaking a live provision.

Conclusion

Expanding international operations means expanding data collection requirements. Companies should thoroughly review their foreign tax provision data collection process using the steps above to assess opportunities for improvement and achieve overall confidence in data accuracy and timeliness. With appropriate planning, evaluation, documentation and implementation, the integration of the foreign tax provision into the global provision calculation can be both efficient and effective. This, in turn, improves the accuracy of the overall provision and the level of internal controls over the provision process.

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