Branch operations and accounting

Increasing agility in a global market place
Introduction
Introduction

Multinationals do business in various countries using multiple operational structures, both formally and informally.

Formal operational structures can be identified by a physical presence and typically contain one or more of the four setups:

► Legal entity
► Branch
► Partnership
► Permanent establishment (PE) — business driven versus tax driven

Informal operational structures can be identified by a management or operational virtual structure, where people may sit across geographies, across the formal operational structures and be grouped by activity or business.
Multinational companies (MNCs) are looking to change their way of working, influenced by the fast-changing environment and new possibilities to have a global footprint.

The MNCs may operate through:

► Traditional buy-sell models
► Direct sales models
► Direct manufacturing models
► MNC margin management across its total value chain
► Digital economy
► Others

We typically see a change in approach by customer type:

► Business-to-business
► Business-to-consumer
Introduction

One can set up a branch from scratch (green field) or convert a legal entity into a branch (brown field). Various stakeholders need to be involved to design the branch in a way that it can operate efficiently and effectively. The work streams that need to be considered in either a green field or brown field branch operations setup are:

- Project management
- Change management
- Corporate governance
- Direct tax
- Major program transformation
- Transfer pricing (TP)
- Business processes (source or procure to pay, plan to produce, inventory to fulfil, order to cash, record to report)
- Indirect tax (VAT, customs, excise, other)
- Legal and regulatory
- Human capital
- Information technology
- Location advisory
- Intercompany effectiveness, including finance and accounting

As can be seen from these two introduction slides, setting up a branch (either green or brown field) requires a structured, multidisciplinary approach to get it right. EY Operating Model Effectiveness (OME) and Financial Accounting Advisory Services (FAAS) teams have a tested and proven approach on how to support you in group transformation, finding the right balance in your new group structure between legal entities and branches.
Impact area

Impact of branch operations

- RACI functional design
- Expat mobility management
- PE risk management
- Roles and responsibilities
- People policies
- Job descriptions
- Performance management

- Improved organizational design
- Simplified and relevant corporate structure
- Better organizational plan and up-to-date strategy
- Updated documentation

- Procure to pay
- Plan to produce
- Inventory to fulfill
- Order to cash
- Account to report

- Improved IT setup including legacy
- Effective tax rate management
- Tax control framework
- Transaction map from “as is” to “to be”
- Licenses and permits
- Product qualification
- Customs planning
- Intrastat, Extrastat, EC sales listings
- Cash flow planning

- Global chart of accounts
- Finance and accounting close process and shared service centers
- Statutory and tax GAAP
- Integration of financial and management accounting systems
- Functional currency
- Treasury management

- PE risk management
- Critical controls
- KPI management
- IT controls procedures
- GAAP audit trail
- BEPS — audit communication
- Compliance
- Director’s liability

- Improved management reporting process
- Integration of financial and management accounting systems
- Improved KPI management
- Better standard setting and monitoring

- Internal control design and framework
- Internal control policies and procedures
- Improved control
- Risk management process
- Internal audit function alignment

- People (Human capital)
- Improved organizational design
- Simplified and relevant corporate structure
- Better organizational plan and up-to-date strategy
- Updated documentation

- Business processes
- IT systems
- People
- Corporate governance
- Finance and accounting
- Internal control
- Management or forecasting
- Budgeting or forecasting
- Transfer pricing

- Planning, budgeting and forecasting
- Budgeting control framework
- Budget to actuals management
- Sales and operations planning
- Transactional TP setup

- TP and IP planning
- Financial transactions
- TP documentation
- TP control framework
- TP automation
- Compliance
- Controversy management

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Impact area
Issues entities are facing today

- **Decentralization of control**: Entities with decentralized management structures and with a relatively large number of local sales companies have difficulties with strengthening central governance and control, and streamline their value chain. For such organizations, a lean and efficient operational model is essential to stay ahead of competition.

- **Measuring profitability**: Insufficient transparency and ambiguity in the allocation of revenues and costs in the value chain result in an inaccurate view on profitability of subsidiaries and products. This may lead to suboptimal decision-making and incorrect portfolio management.

- **Allocation of risks**: Complex groups with numerous local legal companies in the organizational structure can be exposed to higher risk embedded in the structure because of local compliance issues.

- **Complexity with reporting**: The demand for more frequent and detailed management and financial reporting is growing because of margin pressure and the desire to meet all stakeholders’ expectations. Furthermore, companies have to stay compliant with changing external financial reporting requirements (e.g., IFRS 15) as well as local statutory and consolidation requirements.

- **High-cost structure**: Decentralized accounting and control departments often lead to excessive administrative processes and high finance costs. These can be reduced by creating central functions and changes in the organization structure. Such measures can help to achieve the cost reductions that are necessary in a market place, resulting in a reduction in margin pressure as well as increased competitiveness.
Because of the ongoing globalization and fast-changing business environment, companies and group structures are becoming more and more complex day-by-day. Strengthening controls, reducing cost, increasing efficiencies and adding value require companies to have a global footprint.

Being global has its own challenges and companies are always searching for an ideal corporate structure.

To remain agile and customer focused, more and more companies are focusing on setting up or converting to local branches instead of subsidiaries. This allows a company, for example to deploy a cross-border direct sales strategy or to cope with negative sales-related tax cash flow impacts in some other countries.

Other reasons for setting up branches include excessive local reporting requirements, lack of control and increased complexities due to a local presence as a statutory company.

EY’s multidisciplinary team drawn from reporting, accounting, consulting and tax professionals can support you in group transformation, finding a better balance in your new group structure between legal entities and branches.
Are branch operations relevant to you?
Critical criteria — if one or more answer is yes, then it is relevant to you

<table>
<thead>
<tr>
<th>Question</th>
<th>Self-assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you have branches in your company?</td>
<td>□</td>
</tr>
<tr>
<td>Do you have multiple (strategic) business units in one legal entity?</td>
<td>□</td>
</tr>
<tr>
<td>Do you have a digital channel through which you sell products, software and services?</td>
<td>□</td>
</tr>
<tr>
<td>Have you identified a PE of one legal entity in another country?</td>
<td>□</td>
</tr>
<tr>
<td>Is there a PE for indirect tax compliance in a country?</td>
<td>□</td>
</tr>
<tr>
<td>Is there a PE for direct tax compliance in a country?</td>
<td>□</td>
</tr>
<tr>
<td>Do you have tax audits on deemed PEs in a country?</td>
<td>□</td>
</tr>
<tr>
<td>Does your transfer-pricing documentation contain a branch?</td>
<td>□</td>
</tr>
<tr>
<td>Does your transfer-pricing documentation contain a PE?</td>
<td>□</td>
</tr>
<tr>
<td>Do people who are critical for a global, central or regional entrepreneur (principal) sit in another legal entity or branch?</td>
<td>□</td>
</tr>
<tr>
<td>Do you have people who work on projects cross-country or cross-region?</td>
<td>□</td>
</tr>
<tr>
<td>Do you have tax rulings in countries you operate in?</td>
<td>□</td>
</tr>
</tbody>
</table>
Critical criteria — if one or more answer is yes then it is relevant to you

<table>
<thead>
<tr>
<th>Question</th>
<th>Self-assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you have advance pricing agreements in countries you operate in?</td>
<td>☐</td>
</tr>
<tr>
<td>Do you have your people support your processes that have been outsourced to third parties?</td>
<td>☐</td>
</tr>
<tr>
<td>Do you have special purpose vehicles?</td>
<td>☐</td>
</tr>
<tr>
<td>Do you have off balance sheet items?</td>
<td>☐</td>
</tr>
<tr>
<td>Are you contemplating a legal entity rationalization?</td>
<td>☐</td>
</tr>
<tr>
<td>Are you contemplating a direct sales model in your Region through one central entity?</td>
<td>☐</td>
</tr>
<tr>
<td>Are you contemplating to start operating through branches in the countries you (want to) operate in?</td>
<td>☐</td>
</tr>
<tr>
<td>Do you have an accounting assessment for operations where it is assessed there is no substance?</td>
<td>☐</td>
</tr>
<tr>
<td>Will you be affected by the BEPS action items, including country-by-country reporting?</td>
<td>☐</td>
</tr>
</tbody>
</table>
How FAAS can add value
The benefits of working with FAAS

Your objective

Managing (intercompany) business effectively, in a compliant way which drives business value throughout the value chain

Benefits of working with FAAS

FAAS can support you to achieve:

- Efficiency through improved execution and control of intercompany trade
- Business value through a review of systems and processes
- Improved compliance procedures through focus on “material compliance

Sample benefits classification and definition depending on fact pattern

<table>
<thead>
<tr>
<th>Efficiency</th>
<th>Business value</th>
<th>Tax risk and compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simplified, systemized and standardized operational, financial and tax processes&lt;br&gt;Simplified and standardized transaction flows&lt;br&gt;Reduced transaction processing times&lt;br&gt;Reduced errors and time spent dealing with nonconformities&lt;br&gt;Reduced data gathering and processing time through one consistent data base for business and tax&lt;br&gt;Reduced time on month-end and year-end closures, and internal price discussions</td>
<td>Better information for decision-making through greater transparency and more reliable data&lt;br&gt;Clear governance model including roles and responsibilities&lt;br&gt;Cross-functional approach to enhance delivery of process objectives&lt;br&gt;Better alignment of transfer pricing with KPIs to drive goal congruence, stimulate inter-company trade and reduce lost sales&lt;br&gt;Better alignment of entity classification with economic contribution&lt;br&gt;Reduced business disruptions due to missing prices, approvals, etc.</td>
<td>Integrated business and tax approach to delivering compliance facilitates seamless cooperation and avoids surprises during tax audits&lt;br&gt;More robust transfer pricing that aligns with performance measurement and reduces scope for “substance” style challenges&lt;br&gt;Strong margin management and profit split allocation processes to deliver the right results&lt;br&gt;Reduced time spent on TP documentation and compliance</td>
</tr>
</tbody>
</table>
How FAAS can help

**How FAAS can assist you**

EY can assist with changing the transformation of the financial accounting process and can help you with the accounting aspects of the restructuring.

- Change in the group structure and including new type of entities i.e., branches as compared to local companies
- Balance sheet (e.g., equity, fixed assets, inventory, accounts receivable (AR) and accounts payable (AP))
- Change in the financial reporting process
- Transition to branch financial statement
- Change in governance style and structure
- Carve-out services

EY teams can work across borders to help you understand the local reporting requirements and help compile into a dashboard. In addition, we can support the training of your teams in IFRS and local GAAP as appropriate.

Certain of our services for an audit client and its affiliates may be more limited in order to comply with applicable independence standards. Please reach out to your EY contact for further information.
Elements applicable to OME projects

<table>
<thead>
<tr>
<th>Elements</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global and local chart of accounts, including IT and compliance requirements</td>
<td>FAAS can assist in the assessment of new cost systems or models, including: cost definitions and allocations for management performance and economic performance evaluation, pricing, transfer pricing, inventory valuation, chart of accounts and statutory requirements.</td>
</tr>
<tr>
<td>Balance sheet accounting and valuation (plus accruals and provisions)</td>
<td>FAAS can assist with the preparation and presentation of financial statements including the balance sheet and other elements. FAAS can also assist in the valuation of the financial elements included in the financial statements in light with IFRS, US GAAP and other local GAAPs.</td>
</tr>
<tr>
<td>Income statement accounting and revenue recognition</td>
<td>FAAS can assist with the preparation and presentation of the income statement. Under IFRS, revenue recognition is going through significant change and FAAS can assist in implementing the changes. FAAS can assist with the implementation of the new standard, IFRS 15.</td>
</tr>
</tbody>
</table>
Elements applicable to OME projects (continued)

<table>
<thead>
<tr>
<th>Elements</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOx — segregation of duties, internal controls, input and output controls, programmed procedures, governance model (policies, procedures, labour contracts and job descriptions)</td>
<td>FAAS, working with colleagues from across EY, can assist with accounting support on the design, implementation and maintenance of accounting policy manuals or individual policy updates, including internal management reporting policies (i.e., KPI definitions). FAAS can also assist in the assessment of companies’ policy governance processes and with policy process design.</td>
</tr>
<tr>
<td>Impact on internal and external audit</td>
<td>FAAS can help provide accounting and financial reporting services with financial statement audit readiness. Such services include assisting these clients in preparing financial or other information required for an external audit, regulatory or tax review.</td>
</tr>
<tr>
<td></td>
<td>FAAS can assist in resolving observations and findings of the company’s internal auditors to help enhance internal control procedures.</td>
</tr>
<tr>
<td>Transfer pricing at managerial level with an audit trail to local statutory compliance level</td>
<td>FAAS can assist in the assessment of new cost systems or models, including pricing and transfer pricing.</td>
</tr>
</tbody>
</table>
Financial Accounting Advisory Services

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Glossary
### Glossary

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AP</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>APA</td>
<td>Advanced pricing agreement</td>
</tr>
<tr>
<td>AR</td>
<td>Accounts receivable</td>
</tr>
<tr>
<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
</tr>
<tr>
<td>BOM</td>
<td>Bill of materials</td>
</tr>
<tr>
<td>CAPEX</td>
<td>Capital expenditures</td>
</tr>
<tr>
<td>CbC</td>
<td>Country-by-country</td>
</tr>
<tr>
<td>CFC</td>
<td>Controlled foreign company</td>
</tr>
<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>CM</td>
<td>Contract manufacturer</td>
</tr>
<tr>
<td>COA</td>
<td>Chart of accounts</td>
</tr>
<tr>
<td>CWI</td>
<td>Commensurate with income</td>
</tr>
<tr>
<td>DEMPE</td>
<td>Develop, enhance, maintain, protect and exploit</td>
</tr>
<tr>
<td>DPT</td>
<td>Diverted profit tax</td>
</tr>
<tr>
<td>EC</td>
<td>European Community</td>
</tr>
<tr>
<td>ERP</td>
<td>Enterprise Resource Planning</td>
</tr>
<tr>
<td>ETR</td>
<td>Effective tax rate</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>F&amp;A</td>
<td>Finance and accounting</td>
</tr>
<tr>
<td>FAAS</td>
<td>Financial Accounting Advisory Services</td>
</tr>
<tr>
<td>FMCG</td>
<td>Fast moving consumer goods</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Principals</td>
</tr>
<tr>
<td>HQ</td>
<td>Headquarters</td>
</tr>
<tr>
<td>HR</td>
<td>Human Resources</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
</tr>
<tr>
<td>IBP</td>
<td>Integrated business planning</td>
</tr>
<tr>
<td>ICE</td>
<td>Intercompany effectiveness</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>IP</td>
<td>Intellectual property</td>
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<td>Initial Public Offering</td>
</tr>
<tr>
<td>IPSAS</td>
<td>International Public Sector Accounting Standards</td>
</tr>
<tr>
<td>IT</td>
<td>Information technology</td>
</tr>
<tr>
<td>KPI</td>
<td>Key performance indicator</td>
</tr>
<tr>
<td>LRD</td>
<td>Limited risk distributor</td>
</tr>
<tr>
<td>MLRD</td>
<td>Master limited risk distributor</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational company</td>
</tr>
<tr>
<td>NPS</td>
<td>Net promoter score</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>OME</td>
<td>Operating model effectiveness</td>
</tr>
<tr>
<td>OTD</td>
<td>Order-to-delivery</td>
</tr>
<tr>
<td>P&amp;L</td>
<td>Profit and loss</td>
</tr>
<tr>
<td>PBF</td>
<td>Planning, budgeting and forecasting</td>
</tr>
<tr>
<td>PE</td>
<td>Permanent establishment</td>
</tr>
<tr>
<td>POC</td>
<td>Principal operating company</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and development</td>
</tr>
<tr>
<td>RACI</td>
<td>Responsible, accountable, consulted, informed — a framework of documenting roles and responsibilities</td>
</tr>
<tr>
<td>S&amp;OP</td>
<td>Sales and operations planning</td>
</tr>
<tr>
<td>SGA</td>
<td>Selling, general and administrative expenses</td>
</tr>
<tr>
<td>SKU</td>
<td>Stock keeping unit</td>
</tr>
<tr>
<td>SME</td>
<td>Subject matter expert</td>
</tr>
<tr>
<td>SOX</td>
<td>Sarbanes Oxley</td>
</tr>
<tr>
<td>SSC</td>
<td>Shared service center</td>
</tr>
<tr>
<td>TM</td>
<td>Toll manufacturer</td>
</tr>
<tr>
<td>TP</td>
<td>Transfer pricing</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-added tax</td>
</tr>
</tbody>
</table>
Appendices
Appendix 1
Branch operations — scenarios
Definition of a branch

There are a number of definitions of a branch, for example:

**Tax perspective**

In local taxable presence of a parent company (such as a Principal or Master LRD company) which from a direct tax perspective is characterized as a PE put method (e.g., cost incurred)

**Accounting perspective**

IFRS do not explicitly define a branch, but in practice, it has been noted as an extension to the parent company present right to payment.

IFRS does not explicitly define a branch, but in practice it has been noted as an extension to the parent company.
Definition of a branch

IAS and IFRS definition of a branch

**IAS 21**
Foreign operation is an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

**IFRS 3**
An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.
Branch operation vs. subsidiary structure

A few high-level advantages of a branch:

<table>
<thead>
<tr>
<th>Company structure</th>
<th>Branch structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Local equity accounts</td>
<td>▶ Head office or branch office current accounts</td>
</tr>
<tr>
<td>▶ Local company has title or ownership of assets</td>
<td>▶ POC can also owns the assets</td>
</tr>
<tr>
<td>▶ Complex consolidation process</td>
<td>▶ Simplified consolidation</td>
</tr>
<tr>
<td>▶ Inter-company transactions and eliminations</td>
<td>▶ Limited inter-company eliminations</td>
</tr>
<tr>
<td>▶ Inter-company profit eliminations</td>
<td>▶ Branch being an extension of the parent will not attract intercompany company profits</td>
</tr>
</tbody>
</table>
## Branch operation versus subsidiary structure (continued)

<table>
<thead>
<tr>
<th>POC</th>
<th>Subsidiary</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policies and procedures</strong></td>
<td>Independent entity and local customs and laws can motivate varying policies and procedures to be adopted.</td>
<td>Part of the parent company and therefore can be required to follow similar policies and procedures.</td>
</tr>
<tr>
<td><strong>Financial reporting requirements</strong></td>
<td>Subsidiary being a locally registered company, might be required for independent preparation of financial statements and audit there on.*</td>
<td>It might be sufficient for the branch to furnish POC’s financial statements for local filing and this can avoid local financial statements and audit procedures.*</td>
</tr>
<tr>
<td><strong>Carve-out or closure</strong></td>
<td>Closing a subsidiary requires a formal procedure (winding-up, striking off, or the appointment of a liquidator).</td>
<td>A branch is easier to wind up or carve out when the need is over.</td>
</tr>
<tr>
<td><strong>Efficiency measurement</strong></td>
<td>Local management would be motivated to increase profit as being the benchmark for efficiency, where as, they might not being able to influence either the price or cost of the final product.</td>
<td>Local management can be compensated for their efforts in creating sales with a standard formula. KPIs could be market focused.</td>
</tr>
<tr>
<td><strong>Contractual arrangements</strong></td>
<td>Local sales or procurement contacts might be needed and may vary from one subsidiary to another in the structure.</td>
<td>Sales and procurement contract could be central, and similar terms and conditions could be applied for various geographical regions. This could work quite well especially in the EU.</td>
</tr>
<tr>
<td><strong>Tax considerations</strong></td>
<td>Tax considerations might be there and considering a local company would also qualify as a PE of the POC.</td>
<td>With careful analysis of the definition of PE, local existence can be planned effectively.</td>
</tr>
<tr>
<td></td>
<td>Transfer-pricing polices are needed to operate with group entities.</td>
<td>Limited or no transfer pricing required as the branch would be an extension of the parent.</td>
</tr>
</tbody>
</table>

* Depending on the local laws and regulations
Types of possible branches

Finding an appropriate option

Functional branch
What is a functional branch?
A functional branch would be an entity in the group structure with limited local presence and would include entities which have limited functionality, e.g., sales agents, service centres.

Relationship with the POC
► POC would have more control of the entity.
► POC can direct policies.
► Entity can use POC’s financial statements for local filing.
► Contract can be carried in the name of the POC.

How would this effect the accounting going forward?
► Limited accounting needs
► Assets including property, plant and equipment and inventories could be held on behalf of the POC

Transactional branch
What is a transactional branch?
A transactional branch would be an entity in the group structure with more local presence. The branch would also have higher number of local employees and would be liable for income taxes or social securities in the country of the branch.

Relationship with the POC
► Contracts with external parties are also maintained by the POC.
► Transactional branches actively take part in a company’s end-to-end supply chain process.
► They are, for example, the face to the client on behalf of the principal and are a part in the (cross-border) goods movement process.

How would this effect the accounting going forward?
► As the entity would be responsible for local taxes, assets including property, plant and equipment and inventories should be held by the branch to facilitate appropriate tax accounting.
Transformation of a subsidiary into a branch operations

<table>
<thead>
<tr>
<th>Step 1: Wholly owned subsidiary</th>
<th>Subsidiary</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1: Wholly owned subsidiary</td>
<td>Restructuring the group entities and consideration as a common control transaction</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transferring of all the assets and settling all the liabilities of the company as a common control transaction</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transferring of assets available in the subsidiary to the branch (which is against the equity held as investments)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets can later be used by the branch</td>
<td></td>
</tr>
<tr>
<td>Step 2: Partly owned subsidiary</td>
<td>In addition to the steps for the wholly owned subsidiary above, the share (non-controlling interest) in the company held by third parties would need to be acquired. These could be treated as acquisition of non-controlling interest as part of a common control business combination.</td>
<td></td>
</tr>
<tr>
<td>Step 3: Legal actions</td>
<td>Winding up the subsidiary</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Setting up a branch operations as an extension of the parent</td>
<td></td>
</tr>
<tr>
<td>Step 4: Post restructuring accounting</td>
<td>Post-restructuring, the parent and branch would maintain current accounts with each other and those could be used to settle the transactions between both the units of business.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Requirement of new accounting standards like IFRS 15 and IFRS 9, would need to be further considered on the basis of the new structure of the business units.</td>
<td></td>
</tr>
</tbody>
</table>
# Formation of a new branch

## Steps to convert a subsidiary into branch operations

### Step 1: Wholly owned subsidiary
- Transferring and procurement of assets for the branch
- Initial recognition of assets and creation of opening balance sheet
- Branch or head office current account to be created

### Step 2: Legal actions
- Compliance with local regulatory requirements including, but not limited to, taxation and regulatory requirements
- Setting up a new branch operations as an extension of the parent

### Step 3: Post establishment accounting
- Post establishment, the parent and branch would maintain current accounts with each other and those could be used to settle the transactions between both the units of business.
- First version of the financial statement needs to be prepared (both for the branch separately* and the consolidated F/S)
- Requirement of new accounting standards like IFRS 15 and IFRS 9, would need to be further considered on the basis of the new structure of the business units.

---

* Depending on the local laws and regulations
Reorganization or merger of two or more subsidiaries

Reorganization — merging entities to an improved group structure

### Steps to convert a subsidiary into branch operations

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Step 1:</strong></td>
<td>Wholly owned subsidiary</td>
</tr>
<tr>
<td>1.</td>
<td>Restructuring the group entities and considering this as a common control transaction</td>
</tr>
<tr>
<td>2.</td>
<td>Transferring of all the assets and settling all the liabilities as a common control transaction to the parent entity and later being used by the branch.</td>
</tr>
<tr>
<td>3.</td>
<td>Assets available have to be transferred to the parent against the equity held as investments. These assets can later be used in the merged branch operations.</td>
</tr>
<tr>
<td><strong>Step 2:</strong></td>
<td>Legal actions</td>
</tr>
<tr>
<td>1.</td>
<td>Closure of the old branches</td>
</tr>
<tr>
<td>2.</td>
<td>Setting up a new branch operations as a extension of the parent.</td>
</tr>
<tr>
<td><strong>Step 3:</strong></td>
<td>Post restructuring accounting</td>
</tr>
<tr>
<td>1.</td>
<td>Post-restructuring, the parent and branch would maintain current accounts with each other and those could be used to settle the transactions between both the units of business.</td>
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<tr>
<td>2.</td>
<td>Requirement of new accounting standards like IFRS 15 and IFRS 9, would need to be further considered on the basis of the new structure of the business units.</td>
</tr>
</tbody>
</table>
Benefits of a branch

With branches in the group structure, entities can:

- Respond better to market circumstances
- Achieve cost reduction by removing redundant functions
- Increase efficiency by focus on core activities
- Better control on functional management due to less complexities at branch operations
- Achieve better control from the head office or central company’s perspective
- Achieve better policy and process alignment within the group
- Reduce reporting requirement (on the basis of the local reporting statutes and requirements)
- Mitigate tax permanent establishment (PE) risks

Enhanced and robust documentation of the transformation process including:

- Accounting and reporting process for the new structure
- Accounting policy manual with entity specific policies and procedures
- Robust governance structure
- Roles and responsibilities for the new structure
# Challenges and considerations

## Challenges

- Local reporting requirements
- System requirements
- Accounting impact
  - Balance sheet (e.g., equity, fixed assets, inventory, accounts receivable (AR), accounts payable (AP))
  - Cost allocation
  - Movement of stock
  - Reconciliation
- Intercompany price setting (products sold through branch or sold directly)
- Substance
- Level of control (governance)
- Profit allocation
- KPIs
- Legal (e.g., regulatory licenses)

## Considerations

### Accounting

- Payroll
- Liability
- Assets
- Inventory
- Consolidation and reporting
- Working capital management
- Financial arrangements

### Tax

- OECD model convention
- Double taxation or loss of business tax deductions

### System

- Treatment of branches in various systems

### Legal

- Liability
- IP ownership
Specific accounting guidance

**IFRS framework**
paragraph 4.4

**Assets of an entity**
An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

**Liabilities of an entity**
A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

The concept guides to the decision as to which level, in a structure an asset or liability should be recorded, recognised or managed.

Para 4.6 the framework states the following:

In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality, and not merely its legal form.

Therefore, even when the assets are legally held by a branch, in substance they could be in use of the POC.
Specific accounting guidance

The Conceptual Framework for Financial Reporting – Para 4.29:

The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

Branch buys stock directly
Branch buys on behalf of the parents and the assets used or sold as per the function of the branch.

Revenue from the sale of goods shall be recognized when all of the following conditions have been satisfied:

1. The entity has transferred to the buyer the significant risks and rewards of ownership of the goods
2. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
3. The amount of revenue can be measured reliably
4. It is probable that the economic benefits associated with the transaction will flow to the entity
5. The costs incurred or to be incurred in respect of the transaction can be measured reliably
Business scenarios

Buy and sell stock transfer (raw material or capex)

Principal buys stock on behalf of branch
Central procurement function within the group and the POC transfers the asset to the branch.

Branch buys stock directly
Branch buys on behalf of the parents and the assets used or sold as per the function of the branch.

Direct sales (finished product)

Principal sells stock on behalf of branch
Branch produces good on behalf of the POC and POC makes the sale to third parties.

MRLD sells stock on behalf on branch
An intermediately entity is established and that entity procures from the branch and sells on behalf of the parent.

Branch sells stock directly
Branch sells directly to third parties but on behalf of the parent. There is an agent or principal relationship.

Branch toll manufacturing

In this case, the branch manufactures on behalf of the POC and can be setup as a manufacturing unit.
The OECD launched its BEPS project in February 2013 addressing 15 focus areas described in OECD’s Action Plan on BEPS.

The BEPS project addresses OECD and country concerns about the potential for MNCs to reduce their tax liabilities by arbitrarily shifting income to no- or low-tax jurisdictions.

In October 2015, OECD issued its final deliverables to counter BEPS. Results of the work is reflected in a variety of forms, including:

► Reports and analysis
► Changes to the OECD model tax treaty, transfer-pricing guidelines and related commentaries
► Development of a multilateral instrument to amend existing bilateral treaties
► Recommendations for changes in domestic tax law to be considered and adopted by participating countries

Other governments and international bodies, e.g., the UN and the EU, have proposed changes to international tax rules that are closely linked to the BEPS project.

Many of the BEPS action items and countries’ tax legislative developments may impact traditional supply chain (OME) and intangible property (IP) structures, particularly where PEs are used.
BEPS impact

Action 2: Neutralize the effects of hybrid mismatch arrangements
Action 3: Strengthen CFC rules
Action 4: Limit base erosion via interest deductions and other financial payments
Action 6: Prevent treaty abuse
Action 7: Prevent the artificial avoidance of PE status

Action 1: Address the tax challenges of the digital economy
Action 8: Consider transfer pricing for intangibles
Action 9: Consider transfer pricing for risks and capital
Action 10: Consider transfer pricing for other high-risk transactions
Action 13: Re-examine transfer pricing documentation

Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance
Action 11: Establish methodologies to collect and analyze data on BEPS and actions addressing it
Action 12: Require taxpayers to disclose their aggressive tax planning arrangements
Action 14: Making dispute resolution mechanisms more effective
Action 15: Develop a multilateral instrument for amending bilateral tax treaties

Direct Impact  Indirect Impact  FAAS core competencies
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