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US issues country-by-country reporting regulations

The US Treasury on December 21, 2015, released proposed regulations that require annual country-by-country (CbC) reporting by US entities that are the ultimate parent entity of a multinational enterprise (MNE) group with annual revenue of $850 million or more.

Treasury based the proposed regulations on the model template for CbC reporting developed by the OECD as part of its base erosion and profit shifting (BEPS) project and released by the OECD in October 2015 as part of the final BEPS reports. The regulations are based on the Treasury's authority under sections 6001, 6011, 6012, 6031, 6038, and 7805 of the Internal Revenue Code rather than under its authority under section 6662 of the Code for the transfer pricing documentation penalty protection regime. The CbC report will be due with the timely filed tax return (with extensions) for the parent entity of a US MNE group.

The regulations are proposed to apply to taxable years of parents of US MNE groups that begin on or after the date of publication of the Treasury decision adopting these rules as final regulations. The final regulations will likely be published sometime in 2016. Thus, the regulations will apply to a fiscal year taxpayer for a fiscal year beginning after the date of publication. Calendar year taxpayers will first apply the regulations for the 2017 tax year, provided the regulations are finalized in 2016. Other countries may require filing for the first fiscal year beginning on or after January 1, 2016, which will raise an issue as to whether members of a US MNE group that are organized or operating in those jurisdictions will be subject to CbC filing requirements for 2016. The treatment of the 2016 tax year for non-US entities is an issue that Treasury will need to address as Treasury and the IRS coordinate the US reporting rules with those imposed by other treaty partners.

The proposed regulations require that the ultimate US parent entity file, along with its timely filed annual tax return (with extensions), a form – the CbC report – that provides the following information:

Constituent entity information

- The tax jurisdiction, if any, in which the constituent entity is resident for tax purposes;
- The tax jurisdiction in which the constituent entity is organized or incorporated (if different from the tax jurisdiction of residence);
- The tax identification number, if any, used for the constituent entity by the tax administration of the constituent entity's tax jurisdiction of residence; and
- The main business activity or activities of the constituent entity.

Tax jurisdiction of residence information

Aggregate information for each tax jurisdiction in which the parent has constituent entities (and in the aggregate for all constituent entities that have no tax jurisdiction):

- Revenues generated from transactions with other constituent entities of the US MNE group;
- Revenues not generated from transactions with other constituent entities of the US MNE group;
- Profit (or loss) before income tax;
- Income tax paid on a cash basis to all tax jurisdictions, including any taxes withheld on payments received;
- Accrued tax expense recorded on taxable profits (or losses), reflecting only the operations in the relevant annual accounting period and excluding deferred taxes or provisions for uncertain tax liabilities;
- Stated capital, except that the stated capital of a permanent establishment must be reported by the legal entity of which it is a permanent establishment unless there is a defined capital requirement in the permanent establishment tax jurisdiction for regulatory purposes;
- Accumulated earnings, except that accumulated earnings of a permanent establishment must be reported by the legal entity of which it is a permanent establishment;
- Number of employees on a full-time equivalent basis in the relevant tax jurisdiction; and
- Net book value of tangible assets other than cash or cash equivalents.

The regulations specify that the US parent entity must maintain records to support the reported information, but it is not required to maintain records that reconcile the reported information to tax returns or applicable financial statements.

A constituent entity is any separate business entity of a US MNE group, but the definition does not include a foreign corporation or foreign partnership for which the ultimate parent entity is not required to furnish information under section 6038(a) (determined without regard to §1.6038-2(j) and §1.6038-3(c)), or any permanent establishment of such foreign corporation or foreign partnership. A business entity is any entity, even if it has elected to be treated as a disregarded entity under the US entity classification rules. Therefore, a single-member limited liability corporation would be considered a constituent entity. An entity that operates through a permanent establishment in another country will be treated as a resident in that country to the extent of the income attributable to the permanent establishment.

A business is considered a "resident" in a tax jurisdiction if, under the laws of that tax jurisdiction, the business entity is liable to tax therein based on place of management, place of organization, or other similar criteria. If a business entity is resident in more than one tax jurisdiction, then the applicable income tax convention rules, if any, will be used to determine the business entity's tax jurisdiction of residence. If a business entity is resident in more than one tax jurisdiction and no applicable income tax convention exists between those tax jurisdictions, or if the applicable income tax convention provides that the determination of residence is based on a determination by the competent authorities of such jurisdictions, then the business entity's tax jurisdiction of residence is the business entity's place of effective management in accordance with Article 4 of the OECD Model Tax Convention on Income and on Capital 2014.

The IRS and Treasury acknowledge in the preamble that a business entity that is treated as a partnership in the tax jurisdiction in which it is organized and that does not own or create a permanent establishment in another tax jurisdiction generally will have no tax jurisdiction of residence. In those cases, the IRS will expect the partners to report their share of the partnership items in the partners' respective tax jurisdictions of residence to determine the aggregate amounts reported on the CbC report, regardless of whether the partnership has elected to be treated as an association for US federal tax purposes. This interpretation of the regulations assumes that the income is taxed at the partner level on a residence basis. Treasury states in the preamble that it is still considering whether a different rule is needed in the case of entities that are not treated as fiscally transparent in the owner's country of residence but are treated as fiscally transparent in the entity's country of organization, and has requested comments with respect to these entities.

The regulations do not contain any requirement that a non-US ultimate parent company provide any information to the IRS. The IRS will only get CbC information from another country that provides the information to the IRS. Thus, there are no provisions to compel a U.S subsidiary of a non-US MNE to produce the report when the headquarters country does not require it. The regulations do not contain any mechanism for a non-US ultimate parent to elect to file in the United States so that the United States can send the CbC report to other jurisdictions; therefore, a so-called "Surrogate Parent Entity" is not covered.

The IRS and Treasury indicate in the preamble that the CbC report will be exchanged with tax jurisdictions that have entered into an income tax convention or tax information exchange agreement (TIEA) with the United States. The Treasury also expects that the US competent authority will enter into competent authority arrangements for the automatic exchange of CbC reports under those conventions or TIEAs that will further limit the permissible uses of such reports to assessing high-level transfer pricing and other tax risks and, when appropriate, for economic and statistical analysis.

The Treasury also states in the preamble that the US competent authority will not enter into a reciprocal automatic exchange of information relationship with respect to CbC reports unless it has reviewed the tax jurisdiction's policies and procedures regarding confidentiality, and has determined that such an automatic exchange relationship is appropriate. Moreover, the US competent authority does not anticipate allowing CbC reports to be used by other tax jurisdictions to take the place of a comprehensive transfer pricing analysis as required by the arm's length standard. The US competent authority will continually review how other jurisdictions are using the CbC reports that are exchanged, and the United States will pause such exchanges if it determines that a tax jurisdiction is not in compliance with such confidentiality requirements, data safeguards, and appropriate use standards. The Treasury has requested comments on whether there is a need for an exception to the filing requirement for some or all of the information on the CbC report for national security reasons.

Comments and requests for a public hearing on the proposed regulations are due by March 22, 2016. The Treasury is requesting specific comments in a number of areas, including:

- Whether additional guidance is needed for determining which US persons must file the CbC form or which entities are considered constituent filers;
- The procedures that a US person should be required to follow to demonstrate a national security reason to receive an exception from filing some or all of the CbC information;
- The treatment of hybrid entities in the CbC report;
- Whether further clarification or refinement is warranted with respect to the information that is requested on the CbC form;
- Whether any of the items should be further refined or whether any additional guidance is needed with respect to how to determine any of the items in proposed §1.6038-4(d)(2)(i)-(ix); and
- Whether guidance is needed regarding the treatment of other employment situations.

The proposed regulations, if implemented, would require US MNE groups to evaluate each business entity and determine the tax residence for its income and other information attributed to the entity. In many cases, this analysis will require a review of income associated with hybrid entities and hybrid transactions. The impact on tax examinations should also be considered, particularly for business entities doing business in high tax rate countries that engage, directly or indirectly, in transactions with related parties in lower-tax jurisdictions.

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Japan's proposed adoption of BEPS Action 13 includes new prescriptive transfer pricing documentation rules

The Japanese Cabinet on December 24, 2015, approved the 2016 tax reform proposal, which includes new transfer pricing documentation rules. The National Diet is expected to approve the tax reform proposal before April 1, 2016. The new documentation rules follow the three-tier documentation approach contained in the Organization for Economic Cooperation and Development's "Transfer Pricing Documentation and Country-by-Country Reporting Final Report" issued on October 5, 2015.

Country-by-country report

Under the proposal, Japanese companies that are the ultimate parents of multinational groups and meet the filing threshold must file a report containing the information in Annex III of the OECD's Action 13 Final Report for tax years beginning on or after April 1, 2016. The filing threshold is group revenue of ¥ 100 billion (€780 million) or more in the previous year. The ultimate parent company is the company required to file consolidated financial statements for the multinational group that is not included in the consolidated financial statements of any other group. The report must be filed electronically in English within one year after the end of the multinational group's fiscal year.

A Japanese company required to file the country-by-country report may appoint another company to file the report on behalf of the group. The reporting entity must provide its name and location and similar information for other Japanese constituent entities.

A Japanese subsidiary of a multinational group or a Japanese permanent establishment of a non-Japanese group company in which the ultimate parent is not a Japanese company is required to file the country-by-country report if Japan has a double tax treaty with the jurisdiction of the ultimate parent company and the country-by-country report cannot be obtained from the other jurisdiction. If Japan does not have a double tax treaty with the other jurisdiction, the Japanese subsidiary or permanent establishment is not required to file the report separately.

The proposal indicates that penalties will apply if a required report is not filed. The nature of the penalties will be the subject of further guidance.

Master file

Japanese companies or permanent establishments that are members of a multinational group that meets the filing threshold must file a master file electronically with the Japanese tax authorities for tax years beginning after April 1, 2016. The multinational group filing threshold is group revenue of ¥100 billion (€780 million) or more in the previous year. The master file is due within one year after the year end of the company or permanent establishment required to file the master file.

The master file must contain the information specified in Annex I of the "Transfer Pricing Documentation and Country by Country Reporting Final Report." It may be prepared in

Japanese or English. The proposal indicates that penalties will apply if a master file is not filed. The nature of the penalties will be the subject of further guidance.

Local file

Japanese companies and Japanese permanent establishments that meet the filing threshold must prepare a local file before they file their Japanese tax return, which, taking into consideration filing extensions, is three months after the end of the fiscal year. The local file must be provided to the Japanese tax authorities within 45 days of a request. The filing threshold is ¥5 billion of related-party transactions or ¥300 million of related-party intangible property transactions in the previous year (the current year if no previous year). Local files must first be prepared under the new rules for taxable years beginning after April 1, 2017, one year later than the first year for the master file and country-by-country report.

The requirements for the local file have been expanded to include both the current requirements and those contained in Annex II of the "Transfer Pricing Documentation and Country by Country Reporting Final Report." As a practical matter, there is substantial overlap between the current requirements and Annex II. Information not required by both includes: key competitors, segmented related-party profit and loss statements, and bilateral and unilateral advance pricing agreements (APAs) that impact the transactions.

Companies that fail to provide a local file to the Japanese tax authorities within 45 days of a request are subject to Japanese tax authorities applying a presumed transfer pricing method, which could include the use of secret comparables. In the past, Japanese rules did not include a contemporaneous requirement and a specific due date to provide the transfer pricing report to the tax authorities.

Companies that do not meet the prescribed thresholds for filing the local file are nonetheless required to provide support for their transfer prices to the Japanese tax authorities within 60 days, or be possibly be subject to the same presumed transfer pricing methods.

Conclusion

The new Japanese transfer pricing rules adopting the OECD three-tier approach are significantly more prescriptive than the prior rules with respect to both the specific information to be provided and the timing for when that information must be provided. The requirement to file the master file with the Japanese tax authorities and the requirement to prepare the local file by the time the tax return is due will require Japanese multinationals and companies doing business in Japan to maintain robust documentation to meet the new deadlines. In many cases, the documentation process will need to start before the end of the year to coordinate the information contained in all the three reports and to meet the new strict deadlines. For many companies, this will require a new level of global coordination and documentation.

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France finalizes country-by-country reporting requirements

The French National Assembly on December 17, 2015, approved an amendment to the Finance Bill for 2016, definitively implementing the country-by-country (CbC) reporting requirements in France. The measure was upheld by the French constitutional court on December 29, 2015, and thus effectively entered into force as Article 223 *quinquies* C of the French Tax Code.

Scope of CbC reporting requirement

According to the 2016 Finance Bill, the companies within the scope of the CbC requirement include:

- Companies with consolidated accounts;
- Companies that control, directly or indirectly, subsidiaries located abroad, or that have branches located abroad;
- Companies with annual consolidated group revenue equal to or in excess of EUR 750 million; and
- Companies not owned by another French entity already within the scope of this measure, or owned by a foreign entity falling within the scope of a similar provision under its foreign local legislation.

A French subsidiary of a foreign group may also be subject to the French CbC reporting requirement when it is held or controlled, directly or indirectly, by a foreign company not established in an effectively "transparent country" (discussed below) if that foreign group would have been considered subject to the French CbC reporting requirement had it been established in France. Thus, the French subsidiary will be subject to the French CbC reporting requirement if:

- It were designated by the group to fulfil the CbC reporting requirement for the group, and has informed the French tax authorities of this; and
- It cannot prove that any other entity of the group located in France or in a "transparent country" has been designated to fulfil the reporting obligation for the group.

The government is expected to publish the list of countries and territories that France considers "transparent countries." To be included in this list, the regulations of those countries would need to respect two conditions:

- They must have a CbC reporting requirement similar to the French one; and
- They must have concluded an agreement with France for the automatic exchange of CbC information.

The country-by-country report will be exchanged automatically between the pertinent tax administrations in accordance with applicable tax treaties and/or EU regulations under the condition of reciprocity, but it will remain confidential.

The annual CbC report must be filed with the French tax authorities within 12 months after the taxpayer's fiscal year-end for fiscal years that start on or after January 1, 2016. Failure to comply with this measure may trigger annual penalties of up to €100,000 for each non-complying French entity.

France has made it clear that the law is applicable as early as FY 2016, for all groups having operations in France. This might create a gap with other countries' regulations that will be applicable in 2017. Notably, US groups might have to anticipate the preparation of the CbC report for FY 2016 to meet French (and other European) requirements.

Contents of the French CbC report

The precise information to be included in the French CbC report will be defined by an administrative decree. It should include economic, accounting, and tax information (for example, division by country of turnover, profits before tax, and number of employees) for the multinational enterprises that are within scope of this measure. The administrative decree is expected to implement the recommendations of the Organization for Economic Cooperation and Development's final report on Action 13 of the base erosion and profit shifting (BEPS) project. Within the course of the parliamentary debates, there were two proposals that called for public release of the information, which were rejected. The French finance minister indicated that he would like to implement "all BEPS but only BEPS."

Other transfer pricing measures in Finance Bill

The French transfer pricing form – Form 2257 – that must be filed six months after the filing of the tax return must now be filed electronically. No paper filing will be allowed.

For companies under tax consolidation, the French tax consolidation parent company must report on behalf of all the consolidated companies.

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Ireland issues country-by-country reporting regulations

The Irish Revenue on December 23 published regulations relating to the implementation of country-by-country (CbC) reporting in Ireland that apply effective January 1, 2016.

Ireland's Finance Act 2015, released on October 23, 2015 (and later enacted into law on December 22, 2015), contains provisions that give effect to CbC reporting in accordance with action 13 of the OECD base erosion and profit shifting (BEPS) project. The OECD's final report on action 13, *Transfer Pricing Documentation and Country-by-Country Reporting*, contains revised standards for transfer pricing documentation that consist of the following:

- A CbC reporting template that includes information such as revenue, profits, income tax paid, and taxes accrued;
- A master file that provides tax authorities with high-level information about a group's global business operations and transfer pricing policies; and
- A specific local file for each jurisdiction that provides the local tax authorities with information on material related-party transactions, as well as the basis for a company's transfer pricing policies relating to such transactions.

For accounting periods commencing on or after January 1, 2016, the CbC reporting template applies to Irish-parented multinational groups with annual consolidated group revenue in excess of EUR 750 million. The deadline to file the CbC reporting template is 12 months from the end of the accounting period to which the report relates (for example, December 31, 2017, for the December 31, 2016 financial year).

Summary of regulations

The regulations outline the approach for CbC reporting for Irish companies when the primary reporting mechanism by the ultimate parent company is not in place.

Under the action 13 primary filing mechanism, a CbC report should be filed in the jurisdiction where the ultimate parent entity of a multinational group is resident and the information is shared with other tax authorities through automatic exchange protocols, such as those contained in tax treaties and tax information exchange agreements. When the law of the ultimate parent entity's country does not require that entity to file a CbC report, action 13 provides for a secondary filing mechanism, under which the multinational group can designate a group company to act as a "surrogate parent" entity and file on behalf of the entire group.

Further, if it is not possible for the ultimate parent entity or a surrogate parent entity to file a CbC report, action 13 includes guidance on local country filing as a backup mechanism The new Irish regulations provide additional information on surrogate parent entity filing and the local filing of a CbC report.

Local filing

Section 4 of the regulations outlines provisions for the local filing of a CbC report.

A local entity that is tax resident in Ireland and not the ultimate parent company or a surrogate parent company of the multinational group is defined as a “domestic constituent entity” for purposes of the regulations. This entity will be required to file an “equivalent CbC report” with the Irish Revenue if:

- The ultimate parent company of a multinational group is not required to file a CbC report in its home country;
- The home country of the ultimate parent company has not concluded an agreement for the automatic exchange of such reports;
- The home country has such an agreement, but has suspended the automatic exchange of reports or otherwise failed to exchange the reports automatically; or
- The nominated surrogate parent in the multinational group does not file a CbC report with similar conditions attached.

An equivalent CbC report will be considered a CbC report only to the extent the information required to be included in the report is within the custody or possession of the Irish domestic entity or that entity has the power to obtain such information.

The equivalent CbC report must be submitted to the Irish Revenue no later than 12 months from the end of the accounting period to which the report relates (for example, December 31, 2017, for the December 31, 2016 financial year).

Surrogate parent filing

Section 5 of the regulations outlines provisions for a nominated surrogate parent entity of a multinational group to file a CbC report. A local country filing, as detailed in section 4 of the regulations, is not required to be filed when this approach is adopted. The CbC report must be provided to the Irish Revenue no later than 12 months after the end of the accounting period to which the report relates (for instance, December 31, 2017, for the December 31, 2016, financial year).

Comments

Although the regulations’ overall approach is in line with action 13 of the BEPS initiative, there is a key difference regarding the filing requirements of a local constituent entity; specifically, the regulations introduce the term “equivalent CbC report,” which is not included in action 13. This report requires only information that the Irish constituent entity has within its possession or has the power to obtain to be included, and thus may not include relevant information for other group companies that are subsidiaries of the Irish constituent entity. To the extent the local filing takes place in Ireland, consideration should be given to the information that the Irish entity has access to, as well as the legal and confidentiality issues involved in using this information. Further, it is unclear which entities in the multinational group may be included in the equivalent CbC report, and guidance on how this approach will operate in practice currently is lacking.

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Israeli court rules stock-based compensation costs must be included in cost plus calculation

A Tel Aviv district court issued a significant decision on December 25, 2015, in a case involving the effect of an employee stock option plan on a cost plus arrangement (*Kontera Technologies Ltd. v. Tax Assessor – Tel Aviv (Unit 3)*). The court upheld the Israeli tax authorities' position and ruled that costs incurred by an Israeli subsidiary of a foreign parent company regarding an employee stock option plan should be included in the cost basis in calculating the cost plus remuneration under the cost plus arrangement with the foreign parent.

This is the first transfer pricing ruling by an Israeli court.

Facts of the case

Kontera Technologies Ltd. (ILCO) is an Israeli R&D service provider wholly owned by Kontera Technologies Inc. (USCO), a US company. In 2005, ILCO and USCO concluded an agreement under which ILCO would provide R&D services to USCO, for which it would be remunerated for its costs, plus a 7 percent markup, exclusive of expenses incurred by ILCO on social security.

During 2009 and 2010, the US parent company granted stock options to ILCO's employees, subject to a vesting period of 36 months. Additionally, in 2010, the parties amended the cost plus agreement to exclude the stock-based compensation associated with the options from the cost plus methodology used under the agreement. This change in the terms of the agreement was to be effective retroactively from January 1, 2008.

Throughout 2009 and 2010, ILCO used the "Black and Scholes" model and recorded the stock-based compensation costs associated with the options (the "ESOP expenses") as an expense for accounting purposes, but treated the expense as nondeductible for tax purposes in accordance with section 102 of the Israeli Tax Ordinance (ITO). Section 102 deals with share-based compensation granted by employers to employees and provides that an employer may choose to grant such securities to its employees under a “capital gains track,” which allows the recipients to record the resulting income as capital gains instead of regular salary income subject to the marginal tax rates. However, once the employer elects to use the capital gains track, it no longer is eligible to claim the associated expense as a tax-deductible expenditure.

During an audit of ILCO for tax years 2009 and 2010, the Israeli tax assessor noted that, when accounting for the ESOP expenses as expenditure (while not integrating them as part of the cost plus calculation), the profit margin recorded by ILCO dropped to 1.73 percent in 2009 and 0.97 percent in 2010. Given that ILCO and USCO were related parties, and in light of the transfer pricing rules in section 85a of the ITO, which require that transactions between related parties be priced on arm’s length terms, the tax assessor concluded that the margin recorded by ILCO was lower than the margin normally recorded between unrelated parties with respect to similar transactions. The tax assessor determined that the profit margin recorded was significantly lower due to the exclusion of the ESOP expenses, that ILCO should have recorded a margin of 9.1 percent, and should have included the ESOP expenses in the cost plus computation.

ILCO then appealed the decision of the tax assessor.

Decision of the district court

When evaluating the arguments presented by the parties, and in an effort to identify the core disagreement, the district court initially determined that the 7 percent margin under the agreement was reasonable given the type of business operations conducted by ILCO, and apparently did not feel it was necessary to elaborate on its reasoning for rejecting the 9.1 percent profit margin the tax authorities argued for. The main issue identified by the court was whether it was necessary to include the ESOP expenses in the cost plus computation.

The district court dismissed ILCO’s appeal, concluding that the ESOP expenses should be included in the cost plus computation under the agreement with its US parent company.

The court first reiterated that section 85a of the ITO, and the regulations thereunder, require related parties to price their transactions according to the arm’s length principle.

The tax assessor claimed that the profit margin recorded in practice was significantly lower due to the exclusion of the ESOP expenses. ILCO, however, claimed that it is common practice not to include ESOP expenses in the cost plus calculation, and supported its argument with a transfer pricing opinion that examined 355 comparable transactions and concluded that such expenses should not be covered by the cost plus methodology. ILCO also claimed that the options should not be treated as salary in kind, nor as an expense of ILCO, but rather as a cost borne by the shareholders of USCO whose ownership rights are being diluted as a result of the options.

The court dismissed the transfer pricing opinion provided by ILCO as irrelevant because the comparable transactions examined were not priced using the cost plus methodology. As a result, the court determined that ILCO failed to satisfy its obligation to demonstrate the arm’s length nature of the transaction under Israel’s transfer pricing rules.

The court also rejected ILCO’s argument that the pricing mechanism it implemented (which excluded the ESOP expenses) should be accepted by the court based on the OECD transfer pricing guidelines’ silence on the matter.

Finally, the court rejected ILCO’s argument that the ESOP expenses should be attributed to USCO on the basis that, by applying a cost plus methodology, USCO had, in essence, undertaken all the expenses associated with the services rendered by ILCO and, therefore, it was irrelevant whether a given cost was paid directly by USCO or indirectly via ILCO. Additionally, the court opined that no shareholder would agree to have its ownership rights diluted without being adequately compensated; hence, by issuing the options, the USCO shareholders likely had assumed that, in exchange for being diluted, they were increasing the value of the company, and thus preserving the economic value of their holdings.

The district court concluded that the amendment to the cost plus agreement between ILCO and USCO was mainly intended to shift profits from ILCO to USCO, and held as follows:

- ILCO was required to include the value of the stock options in its operating costs when making the cost plus computation, and the resulting taxable income should be recorded by ILCO.
- Since ILCO decided to issue the options subject to section 102 of the ITO, which prohibits recording the ESOP expenses as a tax-deductible expense, ILCO is required to adhere to this restriction.
- The social security expenses should have been covered by the cost plus mechanism used by the parties.
- The 7 percent profit margin under the agreement clearly corresponds with the transfer pricing study accepted by the court, and thus should be adhered to.

Comments

The district court in this case focused on ILCO’s inability to provide a comprehensive transfer pricing study to substantiate the pricing mechanism employed. Rather than stating outright and unambiguously that ESOP expenses must be included in the cost plus calculation’s cost base, the court used language that emphasizes the requirement that the taxpayer satisfy the burden of proof. Therefore, considering the court’s scrutiny of the transfer pricing opinion provided and the issues it identified with the opinion, it is reasonable to assume that a court could allow the exclusion of such expenses from the cost base of the cost plus calculation in a case where the taxpayer prepares a transfer pricing study that covers comparable transactions using the cost plus methodology and that supports the exclusion of such ESOP expenses from the cost base.

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31 Countries Sign Multilateral Competent Authority Agreement to Share Country-by-Country Information

The Organization for Economic Cooperation and Development on January 27 announced that 31 countries had signed the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of country-by-country (CbC) reporting data. This agreement marks an important milestone in the implementation of the base erosion and profit shifting (BEPS) Action 13 documentation rules. The MCAA includes important safeguards that will help ensure that the exchanged information is kept confidential as well as other implementation issues. The first exchanges will start in 2018 with respect to the 2016 tax year. CbC report is designed to be part of a three-tiered structure, which will also include the master and local files.

The 31 signatories includes a number of OECD and non-OECD members: Australia, Austria, Belgium, Chile, Costa Rica, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malaysia, Mexico, Netherlands, Nigeria, Norway, Poland, Portugal, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland and United Kingdom. Absent from the list of signatories are the United States, as well as Canada, China, India, and South Korea. Robert Stack, US Treasury deputy assistant secretary (international tax affairs), has said that the United States will in fact engage in the spontaneous exchange of information, but that it will do so through bilateral agreements instead. This approach is designed to make sure the United States is completely comfortable with the safeguards the other country has in place. The US will soon begin negotiations with countries with which it has double tax treaties or exchange of information agreements.

The agreement provides explicit language in Section 5 as to how the CbC information may be used. Information received through the CbC report can only be used to assess high-level transfer pricing and BEPS risks and where appropriate economic and statistical analysis. The MCAA is clear that the information from the CbC reports may not be used as a substitute for a detailed transfer pricing and comparability analysis. Rather, the CbC data may only be used a basis for further inquiries during a tax examination. If countries use the CbC information alone as the basis for a transfer pricing adjustment, section 5.2 of the MCAA makes clear that such adjustments will be conceded in any competent authority proceedings.

Other important features of the agreement include sections 3.2 and 8.1.a, which provide a start date for beginning to share data. The United States may try to use this section to try to persuade other countries to agree to a January 1, 2017, start date rather than the 2016 start date adopted by many other countries. Some countries, however, have already shown an unwillingness to do this, particularly France.

Section 1.1.e of the MCAA provides that an “excluded MNE” would be defined under the domestic law of each country. This rule might permit each country to set its own threshold, which would be honored by the other country. For example, in the proposed CbC regulations released by the United States in December, CbC reports would be required only from US parent entities with $850 million or more in annual revenue. This threshold is generally consistent, although slightly higher, than the threshold of €750 million ($819 million) recommended by the OECD in the final Action 13 BEPS Report. Most countries outside the Euro zone have also adopted local currency thresholds.

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Chile introduces new transfer pricing sworn statement

The Chilean Internal Revenue Service (referred to by its Spanish acronym, SII) on December 31, 2015, published a supplement introducing five new sworn statements for the 2016 tax season (corresponding to fiscal year 2015). For transfer pricing purposes, Sworn Statement N°1913 must be filed in addition to, and separate from, Annual Transfer Pricing Sworn Statement N°1907.

The objective of this new sworn statement is to obtain qualitative information on the business processes and transactions of large taxpayers for purposes of their tax compliance management.

Entities subject to new requirement

The new sworn statement is mandatory for taxpayers classified as "Large Enterprises," by the SSI. Taxpayers may verify their classification by logging into "My Tax Information/My Data" on the SII website.
URL: https://misii.sii.cl/cgi_misii/siihome.cgi

Filing date

The sworn statement must be filed prior to filing the income tax return (Form N°22) for fiscal year 2016.

Questions for the taxpayer

Sworn statement N°1913 includes sections requesting information regarding the taxpayer's corporate group or holding company; corporate reorganizations; financial instruments and/or derivative contracts; pre-tax profits; capital assets; and international transactions.

In each section, the taxpayer must answer a series of questions regarding the company's business decision-making processes in Chile, to determine whether these are autonomous business actions or activities carried out by related foreign entities. Examples of some of the questions include:

- What percentage of your total income is derived from transactions carried out with related companies during the previous fiscal year?
- Do any of the related companies mentioned in the previous question have no staff or relevant assets? If so, are any of those companies involved in transactions with companies in the taxpayer's group or holding company?

- Does the company spend more than 30 percent of its earnings before interest, taxes, depreciation, and amortization (EBITDA) on royalties, interest, and financial expenses, derivatives, management fees, or other items for the benefit of related parties?
- Did the company's business plan during the previous fiscal year involve foreign entities – related or not – to generate an economic or tax benefit?
- Did the company begin implementing a business reorganization involving the transfer of operations or interests in entities incorporated abroad – whether related or not – during the previous fiscal year to generate an economic or tax benefit?

These questions illustrate the qualitative nature of the information to be gathered and demonstrate precisely what makes this sworn statement so innovative compared to other sworn statements of a quantitative nature.

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