



IRS issues draft instructions for Form 8975

Global Transfer Pricing Alert 2017-007

The IRS on February 24 released draft instructions for draft Form 8975, *Country-by-Country Report*, and accompanying draft Schedule A, *Tax Jurisdiction and Constituent Entity Information*, that were issued in December 2016. These draft forms and instructions are based on Action 13 of the Base Erosion and Profit Shifting (BEPS) project undertaken by the Organization for Economic Cooperation and Development (OECD). The IRS is accepting comments on the draft forms and instructions, and plans to finalize them by June 2017.

The final country-by-country (CbC) reporting regulations, found in Treas. Reg. §1.6038-4 (TD 9773), provide the basic rules and definitions to be used when filling out Form 8975 and accompanying Schedule A. Nevertheless, gaps in the regulations persist, and these draft instructions, though not final or binding authority, appear to clarify some of those issues. Of note are the following:

- *US single-member LLCs*: The draft instructions provide that US single member LLCs that are otherwise disregarded for federal income tax purposes will be treated as resident in the United States so long as they are directly owned by a US resident. Specifically, the draft instructions state, "A business entity that is a limited liability company that is organized in the United States, and is wholly owned (directly) by another business entity that has its tax jurisdiction of residence and is organized in the United States, will be considered a U.S. business entity that has its tax jurisdiction of residence in the United States." It appears that this rule extends to a chain of US single

member LLCs so long as the US LLCs are tiered directly under a U.S. resident business entity.

- *Penalties for failure to file:* The draft instructions state that monetary penalties under IRC §6038(b) may apply. The penalty affecting foreign tax credits in IRC §6038(c) is not listed as potentially applying.
- *Examples:* The draft instructions provide various examples that help illustrate some of the rules in the final regulations.
 - Reporting income for tiered partnerships: In a tiered partnership or similar structure with fiscally transparent entities, which have no tax jurisdiction of residence, the CbC financial and employee data for each constituent entity is reported once in the aggregate for all such “stateless entities” and then once again at the owner’s jurisdiction of tax residence. In the Example, US Corp (a tax resident of the United States) owns 90 percent of partnership P1, which in turn owns 80 percent of partnership P2. All three constituent entities have \$100 of revenue and no expenses, not including the shares of revenue that P1 has through P2 and that US Corp has through either of the other partnerships. The total amount of revenue on Schedule A for the stateless entities P1 and P2 is \$200, not \$280. In addition, the total revenue and profit on the United States Schedule A is \$262, because it only includes the \$100 US Corp has outright and the \$162 of revenue and profit as its share from P1.
 - Reporting of withholding taxes: The term “taxes paid” includes taxes paid in cash by a constituent entity to its tax jurisdiction and to all other tax jurisdictions. In the Example, Company X, a constituent entity, earns interest income from another company in tax jurisdiction Y, which is subject to withholding. The Schedule A for tax jurisdiction X should include: (i) the income taxes paid by Company X on income in tax jurisdiction X; and (ii) the withholding taxes paid to tax jurisdiction Y.
 - Reporting of taxes paid by a PE: Taxes paid by a PE are reported in the tax jurisdiction in which the PE is located and consequently included on the Schedule A for that tax jurisdiction. However, the taxes paid by the PE are not reported on the Schedule A of the owner’s tax jurisdiction. In the example, Company X has a PE in tax jurisdiction Y. The income tax paid by Company X to tax jurisdiction X should be reported on the Schedule A for tax jurisdiction X. Nevertheless, the income tax paid to tax jurisdiction Y on income earned by the PE should go on the Schedule A for tax jurisdiction Y, not the Schedule A for tax jurisdiction X.

The following procedural clarifications are also noteworthy:

- *Electronic filing:* Electronic filing is mandatory if a taxpayer files its tax return electronically. The paper form applies only to taxpayers who are not filing electronically (for example, taxpayers filing a Form 1120-REIT). In general, all taxpayers are encouraged to file electronically to ensure the timely automatic exchange of information. The

electronic filing of Form 8975 and accompanying Schedules A is expected to be on XML schema similar to [the OECD's version](#).

- *Naming convention for permanent establishments (PEs):* The draft instructions adopt the OECD naming convention for PEs that includes name of entity to which the PE belongs.
- *Taxpayer identification numbers (TINs):* The TIN is a mandatory field for electronic filing. Consistent with the OECD schema, if a constituent entity does not have a TIN, then the taxpayer must enter "NOTIN."
- *Explanatory notes:* The draft instructions give more detail on how to provide explanatory notes, including codes to reference correctly the item in table 1 to which the explanation applies.

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