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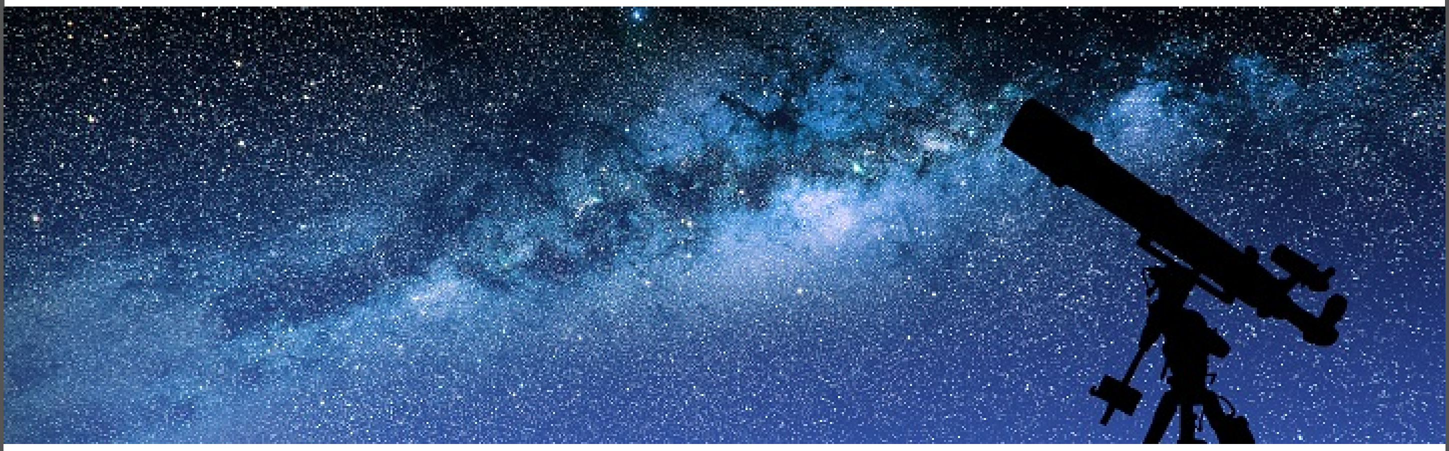

United States issues final country-by-country reporting regulations

Global Transfer Pricing Alert 2016-024

The US Treasury Department on June 29, 2016, released final 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 final 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 in October 2015 as part of the final BEPS reports. The regulations are based on Treasury's authority under §§6001, 6011, 6012, 6031, 6038, and 7805 of the Internal Revenue Code, rather than under its authority under §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 preamble to the final regulations indicates that if a taxpayer does not file the CbC report, then the penalty rules under §6038 will "generally apply, including reasonable cause relief for failure to file."

The final regulations apply to taxable years of parents of US MNE groups that begin on or after June 30, 2016. Calendar-year taxpayers will first apply the regulations for the 2017 tax year, although Treasury indicated in the preamble to the final regulations that it is working with treaty partners to accept voluntary filings by parents of US MNE groups for tax years beginning on or after January 1, 2016, and on or before June 29, 2016. Other countries require filing for the first fiscal year beginning on or after January 1, 2016, which raises 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. According to the final regulations, this voluntary filing procedure will be provided in separate, forthcoming guidance.

Treasury and the IRS intend to enter into competent authority arrangements to automatically exchange CbC reports, and have committed to do so in a timely manner, taking into consideration the need for appropriate review of systems and confidentiality safeguards in the other jurisdictions, so that US MNE groups will not need to file separate CbC reports with those jurisdictions in which those US MNE groups operate.[1]

The reporting period for Form 8975 is modified and now defined as the period of the ultimate parent entity's applicable financial statement prepared in the 12-month period that ends with or within the ultimate parent entity's taxable year. If the ultimate parent entity does not prepare an annual applicable financial statement, then the reporting period covered by Form 8975 is the 12-month period that ends on the last day of the ultimate parent entity's taxable year.

Basic framework of proposed regulations retained

Treasury issued proposed regulations on December 23, 2015 (REG-109822-15). Consistent with the proposed regulations, the final regulations require that the ultimate US parent entity file, along with its timely filed annual tax return (with extensions), a new form – Form 8975, the country-by-country report – that provides the following information with respect to the constituent entities[2] of the US MNE group for the applicable reporting period:

[1] The US competent authority may determine that a country lacks the requisite rules and infrastructure to ensure that the information will be kept confidential and used for its intended purpose. Taxpayers need to be cognizant of which US treaty and tax information exchange agreement (TIEA) partners have been approved by the IRS, which Treasury and the IRS intend to make public, and then consider how to deal with any jurisdictions with which the IRS has not agreed to exchange CbC reports.

[2] 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 §6038(a) (determined without regard to §1.6038-2(j) and §1.6038-3(c)), or any permanent

- The complete legal name of the constituent entity
- 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
- The main business activity or activities of the constituent entity

Of these requirements for constituent entity information, the only change from the proposed regulations is the addition of the requirement to provide the complete legal name of the constituent entity.

Tax jurisdiction of residence information

Also consistent with the proposed regulations, the final regulations require that the ultimate US parent entity provide on Form 8975 the following information in the aggregate for each tax jurisdiction in which the parent has constituent entities (and in the aggregate for all constituent entities that have no tax jurisdiction of residence):

- 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
- Net book value of tangible assets other than cash or cash equivalents, intangibles, or financial assets

Of these requirements, the only modification to the proposed regulations was to clarify that "tangible assets" does not include intangibles or financial assets. Treasury received comments requesting that those terms be clarified, but rejected all such requests. Treasury also received comments requesting that the above categories be expanded to include additional information, but rejected such requests to be consistent with the categories enunciated in the OECD's final BEPS reports.

Significant changes from proposed regulations to final regulations

Some of the most significant changes in the final regulations are as follows:

- ***Added flexibility with respect to sources of data***. The regulations retain broad flexibility with respect to how taxpayers may obtain information for the CbC report, and also add additional flexibility by allowing taxpayers to use information contained in records used for internal management control purposes for the reporting period. The final regulations specify that the US parent entity must maintain records to support the reported information on Form 8975, but it is not required to maintain records that reconcile the reported information to tax returns or applicable financial statements.
- ***Tax jurisdiction of residence for jurisdictions with no income tax.*** Under the proposed regulations, an entity regarded as a corporation that is organized or managed in a jurisdiction with no corporate income tax (such as the Cayman Islands or Bermuda) would not have a tax jurisdiction of residence and would thus fall under the aggregated stateless income category. Under the final regulations, this is changed so that such an entity will be considered tax resident in the jurisdiction in which it is organized or managed, even if that jurisdiction does not impose any income tax on those entities. Thus, for example, information regarding Cayman Islands corporations will be listed on a "Cayman Islands" row instead of the aggregated stateless income row (and so forth, for other such jurisdictions). All other

establishment of such foreign corporation or foreign partnership. The definition of "business entity" is modified, as discussed in the "Significant changes" section below.

rules in the proposed regulations regarding the definition of tax jurisdiction of residence are retained.[3]

- ***Tax jurisdiction of residence concept clarified regarding territorial systems.*** The final regulations clarify that Treasury never intended for all territorial systems to be included in the stateless income category, which some commentators had suggested was unclear, given the sentence that stated that "a business entity will not be considered a resident in a tax jurisdiction solely with respect to income from sources in such jurisdiction, or capital situated in such jurisdiction." The final regulations modify this sentence to indicate that "[a] business entity will not be considered a resident in a tax jurisdiction if the business entity is only liable to tax in such tax jurisdiction by reason of a tax imposed by reference to gross amounts of income without any reduction for expenses, provided such tax applies only with respect to income from sources in such tax jurisdiction or capital situated in such tax jurisdiction."

- ***Partnerships.*** Under the proposed regulations, a business entity that was treated as a partnership in the tax jurisdiction in which it was organized and that did not own or create a permanent establishment in that or another tax jurisdiction generally would have no tax jurisdiction of residence. That rule has stayed the same. Nevertheless, a comment to the proposed regulations requested clarification as to whether the partnership or partners, or both, should report the partnership's CbC information. In response, the final regulations have clarified that the tax jurisdiction of residence information with respect to stateless entities is provided on an aggregate basis for all stateless entities in a US MNE group, and that each stateless entity-owner's share of the revenue and profit of its stateless entity is also included in the information for the tax jurisdiction of residence of the stateless entity-owner. So, for example, a *commanditaire vennootschap* (CV) treated as a partnership in the Netherlands and as a corporation by the United States (or other jurisdiction) in which the owner resides would report its income and other financial information on both the stateless income row (for the Netherlands income) and the US row (for the US partner's share of such income).[4] The final regulations also clarify that, when a partnership creates a permanent establishment for itself or its partners, the CbC information regarding the permanent establishment is not reported as stateless, but instead is reported as part of the information on the CbC report for the permanent establishment's tax jurisdiction of residence.

- ***Definition of "business entity" modified, excludes grantor trusts and decedents' estates***. The final regulations modify the definition of "business entity" by defining it as an entity recognized for federal tax purposes that is not classified as a trust under Treas. Reg. §301.7701-4, but excluding decedents' estates, individuals' bankruptcy estates, and grantor trusts within the meaning of IRC §671, when the owners of such entities are individuals. The definition of "business entity" specifically includes a permanent establishment, as defined below, and any entity with a single owner that may be disregarded as an entity separate from its owner under Treas. Reg. §301.7701-3.

- ***Permanent establishments***. The final regulations provide explicit guidance on what constitutes a permanent establishment. The term permanent establishment includes: (i) a branch or business establishment of a constituent entity in a tax jurisdiction that is treated as a permanent establishment under an income tax convention to which that tax jurisdiction is a party; (ii) a branch or business establishment of a constituent entity that is liable to tax in the tax jurisdiction in which it is located pursuant to the domestic law of such tax jurisdiction; or (iii) a branch or business establishment of a constituent entity that is treated in the same manner for tax purposes as an entity separate from its owner by the owner's tax jurisdiction of residence.

- ***Deemed domestic corporations.*** The final regulations expressly provide that foreign insurance companies that elect to be treated as domestic corporations under IRC §953(d) are US business entities that have their tax jurisdiction of residence in the United States.

- ***Surrogate filings for US territory ultimate parent entities***. A US territory ultimate parent entity may file the CbC report via a US surrogate business entity that it controls, as defined under IRC §6038(e).

- ***Employees***. Employees will be counted in the jurisdiction of the employer and not in the jurisdiction in which they work. The preamble to the final regulations notes that taxpayers have flexibility in reporting the number of employees so long as the method for reporting is reasonable and consistent.

- ***Clarification of the definition of revenues.*** The proposed regulations and the final regulations both state that the term "revenue" includes all amounts of revenue, including revenue from sales of inventory and property, services, royalties, interest,

[3] Under both the proposed and final regulations, 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.

[4] This raises the question as to what happens if a taxpayer has another partnership or fiscally transparent entity above the partnership or reverse hybrid. It would appear under the final regulations that in this situation, the taxpayer would need to report that owner's share as stateless too, and so on, until the taxpayer arrives at a stateless entity-owner in the chain that does not itself fall into the stateless income category.

and premiums, but excludes payments received from other constituent entities that are treated as dividends in the payor's tax jurisdiction of residence. The final regulations further clarify that the term "revenue" does not include: (1) distributions and remittances from partnerships and other fiscally transparent entities and permanent establishments that are constituent entities; and (2) imputed earnings or deemed dividends received from other constituent entities that are taken into account solely for tax purposes and that otherwise would be included as revenue by a constituent entity. These clarifications suggest that a US shareholder would not report subpart F income in the United States. The final regulations also clarify that, with respect to a constituent entity that is an organization covered under certain tax code sections,[5] the term "revenue" includes only revenue that is reflected in unrelated business taxable income as defined in IRC §512.

Changes that were requested but not made

Some of the changes requested by taxpayers but not made in the final regulations include the following:

- ***National security exception rejected***. Treasury notes that it consulted with the Department of Defense (DoD) as to whether the CbC report should include a national security exception, but that the DoD indicated that no such general exception was needed. However, Treasury indicated that it would continue to work with DoD to determine whether specific guidance on national security issues should be provided in the future.

- ***Surrogate filing with IRS limited to US territories***. Some commentators requested that the United States allow surrogate filing for ultimate parent entities located in other jurisdictions. Treasury rejected this request because of limited resources. The final regulations allow surrogate filing only for entities whose ultimate parent entity is located in a US territory.

- ***Additional protections for confidential information rejected***. Many commentators requested additional precautions apply to confidential information before the United States automatically exchanged it (or, alternatively, that the United States consider withdrawing the proposed regulations altogether due to this concern). Treasury rejected these requests. The preamble to the final regulations indicates that, moving forward, the US competent authority will negotiate bilateral competent authority arrangements that will provide for the exchange of the CbC reporting template with other tax administrations that have entered into an income tax convention or tax information exchange agreement (TIEA) with the United States. Treasury expects that such competent authority arrangements, in accordance with the OECD model agreements, will further limit the permissible uses of CbC reports to assessing high-level transfer pricing and other tax risks and, when appropriate, for economic and statistical analysis. Treasury states in the preamble to the final regulations 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 confidentiality requirements, data safeguards, and appropriate use standards.

Coordination with OECD guidance on CbC

The OECD released guidance on CbC reporting at the same time as the United States' release of its final CbC regulations. For more information on the OECD guidance, see the Deloitte alert on the same [Global TP Alert 16-023]. Several salient points of comparison should be noted between the new OECD CbC guidance and the final US CbC regulations:

- ***Partnerships.*** The OECD guidance clarifies that the general framework to determine whether partnerships are members of an MNE group is provided by the accounting consolidation rules. If under the accounting consolidation rules a partnership is an includable entity, then that partnership may be a constituent entity of an MNE group subject to the CbC reporting requirement. The OECD guidance provides specific guidance on how to report fiscally transparent partnerships. If the partnership is a permanent establishment in the tax jurisdiction of its country of organization or has a permanent establishment in another tax jurisdiction, then the operations attributable to the permanent establishment will be reported in accordance with the rules for permanent establishments. If the partnership earns income that is not attributable to a permeant establishment in a tax jurisdiction, the income will be reported as stateless or nowhere income. Partners that are constituent entities within the MNE group should include their share of the partnership's stateless income in their jurisdiction of tax residence. As with the final US CbC regulations, this will result in double reporting of stateless income. It may be advisable for the MNE to provide an explanation in the

[5]Specifically: an organization exempt from taxation under §501(a) because it is an organization described in §§ 501(c), 501(d), or 401(a), a state college or university described in §511(a)(2)(B), a plan described in §403(b) or 457(b), an individual retirement plan or annuity as defined in §7701(a)(37), a qualified tuition program described in §529, a qualified ABLE program described in §529A, or a Coverdell education savings account described in §530.

notes section of the CbC report on the partnership structure and the stateless entities.[6]

- ***Voluntary filing allowed***. The OECD guidance allows for voluntary filing for US MNE groups, calling it "parent surrogate filing."
- ***Surrogate filing.*** If surrogate filing (including parent surrogate filing) is available, then no local filing is required, provided the conditions laid out in the OECD report – for example that the CbC report is filed by the filing deadline -- are satisfied. This will help US MNEs that file voluntarily with the IRS or via surrogate in a country that has surrogate filing, such as the UK, to not have to file locally in another jurisdiction, such as France.
- ***Currency coordination rule.*** The OECD guidance provides a currency coordination rule to address the impact of currency fluctuations on the agreed EUR 750 million filing threshold. The Action 13 Final Report stated that the agreed filing threshold for the CbC report is EUR 750 million or a near equivalent amount in the domestic currency as of January 2015. Many countries have adopted a local currency threshold that met the "near equivalent" rule when adopted, but no longer meets that rule because of currency fluctuations. The additional guidance provides that if the jurisdiction of the ultimate parent entity has implemented a reporting threshold in accordance with the recommended threshold, such as the United States' $850 million threshold, then an MNE group that complies with that local currency threshold should not be exposed to a local filing requirement merely because the other jurisdiction is using a threshold denominated in a different currency.

Concluding remarks

The final regulations 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 some cases, this analysis will require a review of income associated with hybrid entities and hybrid transactions. The impact on tax examinations should be considered, particularly for business entities doing business in high-tax jurisdictions that engage, directly or indirectly, in transactions with related parties in lower-tax jurisdictions. Due to this and other complex interpretation issues associated with the final CbC regulations, US MNE groups should consult their local international tax and/or transfer pricing advisor to plan for compliance with the regulations.

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[6] It appears that the only way to read the OECD guidance and the US regulations consistently is to assume that the definition of constituent entity that talks about PEs does not require the PE to be separate from the business entity. In other words, under the OECD guidance, as under the US rule, a partnership has a PE in the jurisdiction it is organized because the separate business unit is considered a PE of its partners.

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