

Client Alert

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Final US Regulations on Country-by-Country Reporting Implement OECD BEPS Action 13 for US Multinationals

On June 29, 2016, Treasury and the IRS released final regulations (the “Final Regulations”) requiring large US multinational companies to prepare and file an annual country-by-country report stating their worldwide profits, taxes, capital, employees, assets and other information, by jurisdiction. This Alert describes the final regulations and issues taxpayers may face as they prepare their first country-by-country reports. It also discusses the current international environment surrounding CbC reporting, and challenges ahead for the US Treasury, the IRS and taxpayers.

BEPS in Brief

The Organisation for Economic Co-operation and Development (“OECD”) began in July 2013 a joint project with the G20 intended to prevent multinational enterprises (“MNEs”) from shifting profit to low-tax jurisdictions (the Base Erosion and Profit Shifting (“BEPS”) project). The BEPS initiative undertook 15 “Action Items” toward this goal, and in October 2015, Final Reports were issued on each of these Actions, including guidance on taxation of the digital economy, hybrid instruments, preferential ruling regimes, treaty abuse, permanent establishments and transfer pricing.

Of all of the BEPS Action Items, the recommendations included in the October 2015 Final Report on Action 13, “Transfer Pricing Documentation and Country-by-Country Reporting” (“Final Report on Action 13”), have gained the most support from governments worldwide. The country-by-country reporting part of these requirements was among the “Minimum Standard” measures that all participating countries in the BEPS Project committed to implement. A number of countries around the world, including Australia, France, Japan, Mexico, the Netherlands and the United Kingdom, already have implemented changes to their laws requiring the filing by MNEs of country-by-country reports using the framework established in the Final Report on Action 13, and many others are expected to follow. The Final Regulations implement country-by-country reporting for the United States.

BEPS Project Final Report on Action 13

BEPS Action 13 called for the development of “rules regarding transfer pricing documentation to enhance transparency for tax administrations.” The Final Report on Action 13 recommends that MNEs prepare transfer pricing documentation comprised of three documents: a master file, jurisdiction-specific local files and a country-by-country report (“CbCR”). As noted above, countries are required to implement CbCR requirements as one of the BEPS minimum standards.

The master file is a high-level overview of the MNE group’s business operations and transfer pricing policies. The local files include more detailed information on specific intercompany transactions of the entities in each jurisdiction.

The CbCR provides aggregate, jurisdiction-wide information on an MNE group’s global allocation of income, taxes paid and economic activity in each jurisdiction where the MNE group operates, presented on a common template. The CbCR consists of two main tables, the Action 13 Report templates for which are attached as Appendix 1. The first table requires, in aggregate for each tax jurisdiction, the following information:

- Revenues (required to be broken down by unrelated party, related party, and total)
- Profit (loss) before income tax
- Income tax paid (on cash basis)
- Income tax accrued – current year
- Stated capital and accumulated earnings
- Number of employees
- Tangible assets other than cash and cash equivalents

The second table requires a list by tax jurisdiction of all constituent business entities in the MNE group whose information is included in Table One, along with identification of the main activities conducted by each entity (e.g., purchasing and procurement, research and development). There also is an optional third table, on which the MNE may at its option provide additional information in narrative form to facilitate understanding of the compulsory information in Tables One and Two.

The Final Report on Action 13 recommended that the CbC reporting requirement apply to MNE groups with annual consolidated group revenue of €750 million, and that the first CbCRs be filed for MNE fiscal years beginning on or after January 1, 2016. The Final Report urged that all governments adopt the Final Report CbCR template, without addition or subtraction of data items from that template. The CbCR is explicitly intended only for high-level transfer pricing risk assessment and certain other specified limited purposes, and not as a basis for adjustments based on formulary apportionment or otherwise.

The Final Report on Action 13 indicates that CbCRs are to be filed by the parent of an MNE group, with the tax authority in its jurisdiction of residence. They may be shared by that tax authority with other relevant tax authorities through automatic exchange of information, pursuant to competent authority agreements under bilateral tax treaties, tax information exchange agreements (“TIEAs”) or the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

Simultaneously with the issuance of the Final Regulations, on June 29, 2016, the OECD released “Guidance on the Implementation of Country-by-Country Reporting,” under BEPS Action 13 (“OECD Implementation Guidance”), providing answers to four implementation questions that have arisen since the Final Report on Action 13 was published in October 2015. This implementation guidance provides a recommended approach for OECD and G20 member countries to deal with jurisdictions (like the United States) that have implementing regulations effective for reporting periods beginning only after January 1, 2016. It also contains guidance for reporting on investment funds, partnerships and reverse hybrids, and on the impact of currency fluctuations on filing thresholds.

As of July 10, 2016, at least 17 countries had implemented CbC reporting requirements: Australia, Belgium, Bermuda, China, Denmark, France, India, Ireland, Italy, Japan, Mexico, the Netherlands, Poland, Portugal, Spain, the United Kingdom and the United States. At least 15 additional countries, including Canada, Germany, Switzerland and Singapore, had proposed or publicly announced their intention to propose legislation to do so.

Survey of the Final Regulations

The Final Regulations, published in the Federal Register on June 30, 2016, (T.D. 9773, 81 Fed. Reg. 42482), largely follow the approach contained in the Final Report on Action 13 and the proposed regulations (“Proposed Regulations”), with the clarifications noted below. The CbC reporting form, which has not yet been released, will be Form 8975, and it is expected to closely track the OECD templates attached as Appendix 1.

Effective Date and Filing Deadlines

The Final Regulations are applicable to taxable years of MNEs with an ultimate US parent (“US MNE groups”) beginning on or after June 30, 2016. As explained below, this effective date creates potential issues for calendar year taxpayers with affiliates in foreign jurisdictions requiring CbCRs for tax years beginning between January 1 and June 29, 2016 (consistent with the Final Report on Action 13). To mitigate this issue, the IRS intends to allow ultimate parent entities of US MNE groups to voluntarily file CbCRs for tax years beginning between January 1 and June 29, 2016, under a procedure to be provided in separate, upcoming guidance. This plan is discussed in more detail below.

Under the Final Regulations, a CbCR must be filed with the ultimate US parent’s federal income tax return for the taxable period in question. Multiple comments on the Proposed Regulations urged that CbCRs be due one year after the last day of the end of the taxable year in question, consistent with the Final Report on Action 13. This recommendation was not adopted because the IRS currently does not have the information technology resources to process a form filed apart

from the tax return. However, the Final Regulations provide that Form 8975, when published, may prescribe a different time or manner of filing.

Confidentiality of CbC Reports

The Final Regulations confirm that information provided on Form 8975 is tax return information subject to the confidentiality protections of Internal Revenue Code (“Code”) Section 6103. Section 6103(k)(4) allows the US competent authority to exchange tax return information with the competent authority of another country only to the extent provided in, and subject to the terms and conditions of, an information exchange agreement. Under the terms of the United States’ existing competent authority and information exchange agreements, neither country is allowed to disclose the information received under the agreement or use the information for any non-tax purpose. The Preamble to the Final Regulations (“Preamble”) indicates that the United States intends to enter into competent authority agreements for the automatic exchange of CbCRs with jurisdictions with which the United States has an income tax treaty or TIEA that protects the confidentiality of the CbCR information. The US competent authority intends to further limit the permissible uses of CbCRs to high-level assessment of transfer pricing and other tax risks and, where appropriate, for economic and statistical analysis.

Before entering into a competent authority or information exchange agreement with another country, the US Government closely examines the jurisdiction’s legal framework for maintaining confidentiality of taxpayer information and its track record of complying with that legal framework. Even where the US Government is satisfied that the country has the necessary legal safeguards in place, it will not agree to an automatic exchange of information, or will pause automatic exchange, where it determines that the country is not in compliance with confidentiality requirements, data safeguards, or the appropriate use standards provided for under the competent authority or information exchange agreement. The interaction between these US policies and objectives and the Final Action 13 Report recommendations on information exchange procedures and deadlines are discussed later in this Alert.

US Persons Required to File Form 8975

The revenue threshold for reporting is unchanged from the proposed regulations at US\$850 million. The Preamble indicates that the IRS anticipates that other countries will not require local filing by constituent entities of US MNE groups with annual revenue less than \$850 million. This is consistent with the simultaneously issued OECD Implementation Guidance stating that no secondary filing obligation should be triggered where the ultimate parent entity’s jurisdiction has implemented a reporting threshold based on a near equivalent to €750 million in its local currency as measured in January 2015.

The Final Regulations require filing only by MNE groups with a US ultimate parent entity. A US ultimate parent entity is defined as a US business entity that:

- Owns directly or indirectly a sufficient interest in one or more other business entities, at least one of which is organized or resident in a tax jurisdiction outside the United States, such that the US business entity is required to consolidate the accounts of the other business entities with its own accounts under US generally accepted accounting principles (“US GAAP”), or would be required to do so if the ultimate parent were a public company; and
- Is not owned directly or indirectly by another business entity that consolidates the accounts of such US business entity with its own accounts under generally accepted accounting principles in the other business entity’s tax jurisdiction of residence, or would be so required if equity interests in the other business entity were traded on a public securities exchange in its tax jurisdiction of residence.

Generally No Surrogate Filing

The Regulations do not require any filings by US constituent entities of foreign-parented MNE groups, regardless of whether the foreign jurisdiction requires CbC reporting. Moreover, citing resource constraints, the Final Regulations generally do not permit foreign-parented MNE groups to make voluntary surrogate filings in the United States by a US subsidiary on behalf of a foreign parent. An exception to this general rule is provided for parent entities resident in US territories or possessions that have a US subsidiary in their MNE groups, which have the option to have the US subsidiary file in the United States as a surrogate for the territory parent.

Entities That Must be Included on Form 8975

Constituent Entities

Under the Final Regulations, Form 8975 must include all of the filer’s “constituent entities,” which are defined as all separate business entities in the filer’s US MNE group, other than foreign corporations or partnerships (or permanent establishments thereof) for which the US MNE parent is not required to provide information under section 6038(a) (determined without regard to Treas. Reg. §§ 1.6038-2(j) and 1.6038-3(c), which are intended to eliminate duplicative filing obligations). Section 6038(a) only permits the Treasury to require US persons to furnish information regarding foreign business entities that the US person “controls” (including through attribution), with control being measured as more than 50% ownership. Thus, foreign business entities which are not controlled by the US MNE parent will not be constituent entities for purposes of Form 8975.

A US MNE group is defined as comprising the ultimate US parent entity and all of the business entities required to consolidate their accounts with the parent under US GAAP, or that would be so required if the ultimate parent were a public company, regardless of whether any of the entities may be excluded from consolidation solely on size or materiality grounds. Under US GAAP, the standards for consolidation largely overlap with the control standard of section

6038(a), but there may be differences (e.g., US GAAP may require consolidation without majority ownership in some circumstances and may preclude consolidation in some circumstances notwithstanding majority ownership). Some comments on the Proposed Regulations suggested that Treasury require reporting on “variable interest entities” that are consolidated with the US MNE group for financial accounting purposes, but not controlled within the meaning of section 6038. However, the Final Regulations do not adopt this or related suggested changes to the constituent entity definition, in part owing to the lack of authority under section 6038 to require information reporting on non-controlled foreign entities. Thus, the entities included as constituent entities in the Form 8975 may not be identical with the entities that are included in the US MNE group’s consolidated financial statements.

Constituent Entity Must be a Business Entity

Further, as noted above, an entity will not be a constituent entity for Form 8975 purposes unless it also falls within the definition of a business entity. The Regulations generally define a “business entity” as an entity that is recognized as such for US federal tax purposes and that is not classified as a trust. However, the following are also included in the definition of business entity: (i) a grantor trust owned by person(s) other than individuals; (ii) a single owner entity that may be disregarded as an entity separate from its owner for federal income tax purposes; and (iii) a permanent establishment (“PE”), if the PE prepares financial statements separate from its owner for financial reporting, regulatory, tax reporting, or internal management control purposes.

PE Definition

The Final Regulations modify the Proposed Regulations’ definition of permanent establishment to remove references to the OECD Model Tax Convention on Income and on Capital (the “OECD Model Treaty”) definition of PE, and instead provide that a branch or business establishment of a constituent entity located in another tax jurisdiction will be a PE if it is: (i) a PE under a tax treaty to which that jurisdiction is a party; (ii) liable to tax under the domestic law of the jurisdiction where it is located; or (iii) treated in the same manner for tax purposes as an entity separate from its owner by the owner’s jurisdiction of residence. In all cases, however, the PE will not be a business entity (and thus a constituent entity) unless it prepares financial statements separate from its owner, as described above.

Tax Jurisdiction of Residence

The Final Regulations provide that a tax jurisdiction is a country or a jurisdiction that is not a country but that has fiscal autonomy. They clarify, in response to comments, that a US territory or possession (i.e., American Samoa, Guam, the Northern Mariana Islands, Puerto Rico or the US Virgin Islands) is viewed as having fiscal autonomy.

“Liable to tax” Criterion

Under the Final Regulations, a business entity is considered a resident in a tax jurisdiction if, under the laws of that jurisdiction, the business entity is liable to tax therein based on place of management, place of organization, or another similar criterion. The Proposed Regulations provided that a business entity would not be considered resident in a tax jurisdiction if it were liable to tax solely with respect to income from sources within that jurisdiction or capital situated in that jurisdiction. This provision raised questions as to whether entities organized in jurisdictions like Hong Kong or Panama, which have pure territorial tax systems, might not be considered to have a tax jurisdiction of residence. The Final Regulations have been revised to clarify that a business entity will not be treated as a tax resident in a jurisdiction where it is liable to tax only by reason of a tax imposed by reference to gross amounts of income without any reduction for expenses, provided that such tax applies only with respect to income from sources in that tax jurisdiction or capital situated in such tax jurisdiction (e.g., income subject to a withholding tax). Thus a jurisdiction with a purely territorial tax system can be a tax jurisdiction of residence. This will reduce the amount of income and other items that must be reported as “stateless.”

Tie Breaker Rule

If an entity is resident in more than one tax jurisdiction, the residence rules of the applicable income tax treaty (if any) will apply to determine the entity’s jurisdiction of residence. If an income tax treaty does not apply or does not answer the residence question (e.g., because it would require a competent authority determination), the entity’s tax jurisdiction of residence is determined in accordance with Article 4 of the 2014 OECD Model Treaty (i.e., by reference to the entity’s place of effective management). In response to comments that the OECD Model Treaty Article 4 test may not provide a definite answer to the residency question, the Preamble and the Final Regulations note that that Form 8975 may provide further guidance on determination of tax jurisdiction of residence. For PEs, the tax jurisdiction of residence is the jurisdiction in which the PE is located.

The Final Regulations also clarify that foreign insurance companies that elect domestic status under Code Section 953(d) will be treated as US corporations, and therefore US business entities, for CbC reporting purposes.

Stateless Entities

A business entity that is fiscally transparent in the jurisdiction where it is organized (e.g., a partnership) and that does not have a PE in that or another tax jurisdiction generally will have no tax jurisdiction of residence. The Preamble explains that such entities will be treated as “stateless” entities for purposes of the CbCR, and the income and other items of all stateless entities must be aggregated and reported on a separate row of Form 8975. Additionally (as discussed further below), the owner(s) of a transparent, “stateless” entity must include their share of the revenues and profits of the stateless entity in the row for the tax jurisdiction of residence of the stateless entity’s owner(s), except to the extent that the revenues and profits belong to a PE of that stateless entity. This treatment applies regardless of whether the stateless entity is transparent from

the perspective of its owner(s)' tax jurisdiction of residence. Thus, for example, a China business trust, which is fiscally transparent in China but which may elect to be treated as a corporation for US tax purposes, will be treated as a stateless entity for purposes of Form 8975, except to the extent it has a PE subject to tax in China or another tax jurisdiction.

The Final Regulations also provide that an entity treated as a corporation in its jurisdiction of residence (i.e., not a fiscally transparent entity) will not be treated as stateless for purposes of Form 8975, even if such entity is resident in a jurisdiction that does not have a corporate income tax (e.g., Bermuda), and thus the entity does not technically have a tax jurisdiction of residence under the regulatory definition. Instead, that entity's reportable items will be reported on a separate line for that tax jurisdiction, rather than combined with the items of other stateless entities. This is a change from the Proposed Regulations.

Information Reported on Form 8975

As noted above, Form 8975 is expected to be in the same format and require the same information as the model templates included in the Final Report on Action 13. The Final Regulations provide definitions for various items required to be included, e.g., revenue and income tax paid and accrued.

Source of Data for Form 8975

The Final Regulations broaden the scope of source data for Form 8975. The Proposed Regulations provided that the data reported could be pulled from "applicable financial statements," books and records of the constituent entity, or records used for tax reporting purposes. "Applicable financial statements" are defined as certified audited financial statements including an independent auditor's report. The Final Regulations also allow constituent entity data to be pulled from "regulatory financial statements" and records used for "internal management control purposes." Whatever data sources are selected, they should be from sources prepared for the annual period of each constituent entity ending with or within the reporting period discussed below. The data sources listed vary somewhat from those listed in the Final Report on Action 13 (i.e., consolidation reporting packages, separate entity financial statements, regulatory financial statements, and internal management accounts); however, the Preamble notes that the intention is for the Final Regulations to be read broadly to include all information sources allowed by the Final Report on Action 13. The Final Report on Action 13 allows an MNE Group to populate its CbCR using either a "top down" approach (based on group-wide consolidated financial reporting records) or a "bottom up" approach (based on a compilation of data from constituent entity local financial records), provided that the same data sources are used consistently from year to year.

Neither the Preamble nor the Final Regulations address whether Form 8975 must be prepared using consistent data sources from year to year, other than in the context of the methodology used for reporting employees (discussed below). However, according to discussion in the preamble to the Proposed Regulations, Form 8975 likely will include a section requiring a "brief description of sources of data used in preparing the form" and an explanation of the reasons for any change to data sources used in the prior year and the consequences of the change.

Consistent with the Proposed Regulations, the Final Regulations do not require taxpayers to reconcile the amounts reported on Form 8975 to consolidated financial statements of the US MNE group or the tax returns filed in any jurisdiction, or to make adjustments for differences in local accounting principles. Despite this stated flexibility, the regulations make clear that taxpayers are required to maintain records to support the data provided in the CbCR.

Reporting Period

Pursuant to the Final Regulations, the reporting period covered by Form 8975 is:

the period of the ultimate parent entity's applicable financial statement prepared for the 12-month period (or a 52-53 week period described in Code Section 441(f)) 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 (or a 52-53 week period described in section 441(f)) that ends on the last day of the ultimate parent entity's taxable year.

Data for constituent entities should be provided for an annual period of each constituent entity ending with or within the ultimate parent entity's reporting period. These provisions modify the text of the Proposed Regulations, and the Preamble indicates that they are intended to give US MNE groups the flexibility to use either consolidated financial records to populate the CbCR (a top down approach), or separate financial records prepared for the constituent entities (a bottom up approach). The reporting period and data source provisions in the Final Regulation are not drafted as clearly as they could be but, read together, allow the MNE Group to draw from any of the constituent entity data sources discussed above for periods that end on or within the reporting period.

Stateless Entity Items

As noted above, each owner of an entity that is fiscally transparent in its jurisdiction of residence will be required to include its proportionate share of the revenues and profits of the stateless entity in the information for the owner's tax jurisdiction of residence, except to the extent that the revenues and profits belong to a permanent establishment of such stateless entity. These revenues and profits (along with other items of the stateless entity) must also be included on the separate row of Form 8975 that reports information for all of the "stateless" entities in the US MNE group. This requirement applies regardless of whether the owner's tax jurisdiction taxes the owner on the stateless entity's income or whether the owner's jurisdiction treats the stateless entity as a separate entity for tax purposes. The Final Regulations are consistent with the OECD Implementation Guidance regarding reporting of stateless entity items. It should be noted that these rules could result in double reporting of revenue and income. If the double-reported amounts are significant, the US MNE parent may wish to consider explaining the circumstances in an optional notes section or schedule to the Form 8975. The OECD Implementation Guidance suggests, for example, noting in the notes section of the CbCR when a partnership's "stateless" income is includible and taxable in the partner's jurisdiction of residence.

Revenues

The Proposed Regulations provided that “revenues” reported on the CbC Report in a tax jurisdiction row would not include amounts received as dividends from other constituent entities. In response to comments, the Final Regulations further provide that imputed earnings and deemed dividends taken into account solely for tax purposes (e.g., Subpart F inclusions) should be treated similarly to actual dividends and should not be included in revenues of the recipient of the deemed income. Similarly, the Final Regulations clarify that actual distributions from a partnership or other fiscally transparent entity or from a PE to its partner/owner are not included in the owner’s revenue. The Final Regulations also provide that, for constituent entities that are tax-exempt for US purposes (e.g., under Code Section 501(c) or tax exempt retirement plans or education accounts), “revenues” include only revenues that are unrelated business taxable income, as defined in Code Section 512.

Taxes Paid/Accrued

The Preamble clarifies that the “income taxes paid” reporting category includes all income taxes imposed on constituent entities resident in a particular tax jurisdiction, regardless of whether the tax is imposed by the recipient’s tax jurisdiction of residence (e.g., net basis income tax) or the payor’s jurisdiction (e.g., gross basis withholding tax). All such taxes should be reported on the row corresponding to the income recipient’s tax jurisdiction. For example, if a payment to a French entity from a Belgian affiliate is subject to Belgian withholding tax and French income tax, both tax amounts should be included in the row for France (along with taxes imposed on any other French entities in the US MNE group).

Definition of Tangible Assets

In response to comments, the Final Regulations clarify that when reporting the fair market value of tangible assets for each tax jurisdiction on Form 8975, intangible assets and financial assets are excluded from the definition of tangible assets. This definition applies regardless of whether the entity is required for local regulatory purposes to maintain financial reserves (as might be required for a bank or insurance company).

Employees

Like the Proposed Regulations, the Final Regulations provide that Form 8975 must include the number of employees in each tax jurisdiction of residence of the MNE group, and that taxpayers may use any reasonable basis to determine and allocate the total number of employees in each tax jurisdiction. Independent contractors participating in the ordinary operating activities of a constituent entity may (but are not required to) be reported as employees of that entity. Several commentators asked for further clarification on how to determine the number of full time equivalent employees or how to account for independent contractors. Treasury and the IRS declined to provide further rules in this area, noting in the Preamble that the Final Regulations give the taxpayer the flexibility to use any reasonable approach for counting and allocating employees, provided the method is consistently applied.

The Final Regulations do, however, modify the rule in the Proposed Regulations regarding the tax jurisdiction in which an employee should be reported. The Proposed Regulations indicated that an employee should be counted in the tax jurisdiction in which the employee performs his/her work. However commentators noted that this approach was inconsistent with the OECD recommendations and that determining work locations for all employees could be very burdensome, particularly where employees travel. Therefore the Final Regulations provide that employees of a constituent entity should be included in the row corresponding to the tax jurisdiction of residence of that entity. For employees of a partnership (or other entity) treated as a stateless entity, employees of the partnership should be reported on the “stateless” jurisdiction row, unless the employees work for a PE of the stateless partnership. In that case, they should be reported on the row corresponding to the PE’s tax jurisdiction of residence.

Additional Items

Some commentators suggested requiring reporting on additional items, such as deferred taxes and provisions for uncertain tax positions, or requiring additional information regarding constituent entities (e.g., identification as passthrough entities). None of these recommendations were adopted, in order to keep the information required on Form 8975 consistent with the Final Report on Action 13 recommendations.

Penalties

The penalty rules under section 6038 apply to CbCRs, including reasonable cause relief for failure to file.

No National Security Exception

Comments had been requested when the Proposed Regulations were issued on whether a national security exception to CbC reporting should be available, so that some taxpayers could be exempted from filing certain information on the ground that providing the information would compromise national security. As discussed in the Preamble, Treasury and the IRS considered various comments received in this area and also consulted with the Department of Defense. The Department of Defense determined that the information requested by Form 8975 generally would not pose a national security concern, so the Final Regulations do not provide any national security exceptions. However, the Department of Defense will further consider whether CbC reporting may raise concerns under particular fact patterns, and future guidance may be provided allowing taxpayers to consult with the Department of Defense regarding presentation of CbC data in such cases.

Practical Concerns and Next Steps

Treatment of “Gap Year” and Information Exchange Issues

Gap Year Solution

The Final Regulations, as expected, apply from the first taxable year of an ultimate parent entity of a US MNE group that begins on or after June 30, 2016 (the date of publication in the Federal Register). As noted above, the Final Report on Action 13 allows countries to require CbC reporting for taxable years that begin on or after January 1, 2016. These different dates create a “gap year,” where a US filing is not required, but a constituent entity of a US MNE might have a filing requirement in its jurisdiction of residence. This potential issue arises because the Final Report on Action 13 implementation package indicates that for MNE groups where the ultimate parent does not have a CbC report filing requirement, a local constituent entity could be required to file the CbCR, and several countries, including France and Australia, have implemented such rules.¹

To address the practical concerns raised by this possibility, including potential penalties being imposed on constituent entities that cannot obtain the information necessary to prepare the CbCR from their parents, the Preamble indicates that the Treasury Department and the IRS intend to allow the voluntary filing of CbCRs for reporting periods that begin on or after January 1, 2016, but before the effective date of the US Regulations, “under a procedure to be provided in separate, forthcoming guidance.” The promised guidance presumably will address questions such as the filing deadline and procedure for voluntary CbCRs. This statement is welcome news for US MNE groups, in that it would address one element of the concern regarding potential constituent entity filing.

The Preamble also notes that the Treasury Department is working to ensure that foreign jurisdictions implementing CbC reporting requirements will not require constituent entities of MNE groups to file a CbCR with the foreign jurisdiction if the US MNE group files a voluntary CbC report with the IRS. The simultaneously released OECD Implementation Guidance addresses this second issue by taking the position that secondary filing by constituent entities in other countries is not required if a group’s ultimate parent entity files a CbCR voluntarily in countries (such as the United States) that do not require CbCRs for years beginning on

¹ The United States, by way of contrast, does not require any CbC report from US constituent entities of foreign-parented MNEs, and the Preamble states explicitly that because the Regulations are promulgated under the authority of section 6038, the definition of control in section 6038(e) limits the foreign business entities for which US persons (such as the US subsidiary of a foreign parent) can be required to furnish information. Although not referenced in the Preamble, it should be noted that the information required to be provided in the CbCR also goes well beyond that which is required to be filed by US subsidiaries of foreign-parented groups under section 6038A.

January 1, 2016, provided that certain conditions are met.² These conditions, which also apply to surrogate filing more generally, include that: (i) the contents of the filings must be consistent with the Final Report on Action 13; (ii) the filing country must have CbC reporting rules in place by the filing deadline of the first CbCRs (December 31, 2017, for calendar year taxpayers in jurisdictions adopting the OECD recommended filing deadline; potentially earlier in countries, like the United States, that do not adopt the OECD recommended filing deadline); (iii) the filing country must have a competent authority agreement in place with the relevant counterparty country by the CbCR filing deadline providing for the exchange of CbCRs; (iv) the filing country must not have notified the relevant counterparty country of a “Systemic Failure” (i.e., that automatic exchange has been suspended for certain reasons); and (v) the ultimate parent entity must have notified its tax jurisdiction of its intent to file voluntarily, and a resident constituent entity must have notified the relevant counterparty jurisdiction that it is not the ultimate parent entity nor the surrogate parent entity and provided the identity and tax residence of the reporting entity (unless those jurisdictions do not require such notifications). The notifications must be given by the last day of the reporting fiscal year of the MNE group, unless the relevant jurisdictions prescribe a different date. The OECD Implementation Guidance specifically mentions the United States as a country that likely will satisfy the OECD conditions, although US MNE groups relying on this accommodation will obviously need to be attentive in particular to the requirements regarding timely notifications and the timely existence of a competent authority agreement.

Treasury’s announced efforts regarding the gap year issue and the OECD’s endorsement of voluntary gap year filing are encouraging. If the OECD Implementation Guidance reflects the agreed interpretation of all countries with domestic law secondary filing obligations, satisfaction of the requirements in that guidance should render those obligations inoperative. In this regard, Achim Pross, head of the OECD’s International Co-operation and Tax Administration Division, stated in a July 12, 2016 OECD webcast that “everybody agrees” that voluntary filing in the parent jurisdiction will deactivate local surrogate filing requirements in other jurisdictions, provided that the requirements in the OECD Implementation Guidance are met. It is to be hoped that the OECD or Treasury’s efforts will produce greater clarity in the near future on which countries are committed to that interpretation.

² The OECD Implementation Guidance is silent on whether it represents an interpretation of the Final Report on Action 13 by the OECD Secretariat or an agreed interpretation by countries participating in the OECD/G20 BEPS Project (and, if so, which ones). Given the speed with which many jurisdictions have amended their laws to adopt CbC reporting, there might be a reluctance on the part of some jurisdictions to forego direct access to CbC reports involving US MNE groups, so it will be important to know which countries are committed to following the OECD Implementation Guidance.

Information Exchange

More challenging than the gap year issue is the issue of the timing of concluding information exchange agreements between countries. The Preamble reiterates the position set forth in the Proposed Regulations that the United States will exchange CbC reports with foreign jurisdictions only through a specific competent authority arrangement entered into with each jurisdiction with which the United States has an income tax treaty or TIEA.³ Such agreements, according to the Preamble, will include limitations on the use of information by foreign jurisdictions, and will allow the United States to immediately pause exchanges of all reports with a jurisdiction that fails to meet the confidentiality requirements, data safeguards, or appropriate use restrictions that will be included in such competent authority arrangement. The Preamble states that the Treasury Department “is committed to entering into bilateral competent authority agreements with respect to CbC reports in a timely manner, taking into consideration the need for appropriate review of systems and confidentiality safeguards in the other jurisdictions.”

Until such agreements are in place, however, the Final Report on Action 13 provides that a constituent entity (i.e., an entity other than the ultimate parent) “shall file a Country-by-Country Report” if, among other criteria, the jurisdiction of the ultimate parent entity has a current international agreement (such as a bilateral tax treaty) “but does not have a Qualifying Competent Authority Agreement in effect to which [Country] is a party” by the filing deadline for the CbCR for the reporting fiscal year. Thus, while the Treasury Department is committed to entering into such agreements, there is no guarantee that they will succeed in obtaining agreements with all of the significant treaty partners before the earliest deadline for filing CbC reports (December 31, 2017 under the Final Report on Action 13 framework; potentially earlier in the United States and elsewhere).

To the extent that, for example, the Treasury Department does not have in effect a competent authority agreement with the French tax authority before the filing deadline for the first CbCR, and the French tax authority does not agree to forego its right to request constituent entity filing, the French constituent entities of US MNE groups could be required to submit the CbC Report directly to France, and the report would not be covered by the confidentiality requirements that would apply if the report were exchanged through the treaty mechanism. Further, while Treasury has made it clear that the misuse of a CbC Report by any country (for example, by basing a transfer pricing adjustment on the CbC information without any substantive audit) will result in the suspension of the exchange of CbC

³ The Treasury Department has not published the text of any proposed competent authority agreement, but the Final Report on Action 13 includes model competent authority agreements, both for double tax treaties and for TIEAs. The language in the model agreements addresses the items identified by Treasury and presumably could be used by Treasury in its negotiations.

Reports with that country, a constituent entity would have no similar recourse if such an adjustment were levelled against it after providing the CbC Report directly.

The Preamble notes that where a competent authority agreement is in effect, if a tax jurisdiction has adopted CbC reporting rules that are consistent with the Final Report on Action 13, that tax jurisdiction “will not be able to require any constituent entity of the US MNE group to file a CbC report” during any period when the automatic exchange is “paused.” Yet the Preamble does not explicitly address the situation described above, where the competent authority agreement has not yet been established with a particular treaty partner, and the Final Report on Action 13 clearly requires such constituent filing. As noted above, the earliest filing deadline for CbC reports under the Final Report on Action 13 is December 31, 2017, and thus the Treasury Department has at most 18 months to obtain the necessary competent authority agreements.⁴ The Treasury Department has indicated that it will make information about the existence of competent authority agreements for CbC reports publicly available, but the manner in which such information would be published has not yet been determined.

Public Disclosure of CbC Reports?

Although the Treasury Department’s efforts to maintain confidentiality of CbCRs filed with the IRS are admirable, the information that companies report may ultimately be publicly available through other means. The Preamble notes that some comments requested treating the CbCR as a Treasury report that would not be subject to the confidentiality protections of section 6103, but that request was rejected. Among those seeking public release of the CbCRs by the IRS were four Democratic US Senators (Al Franken, Edward Markey, Bernie Sanders and Sheldon Whitehouse), who wrote to Treasury Secretary Lew on June 7, 2016. Nevertheless, calls for the public disclosure of CbC-type information are continuing and seem to be encountering greater receptivity elsewhere, particularly in the EU.

In April 2016, the European Commission proposed a Directive that would “require [] that MNEs disclose publicly in a specific report the income tax they pay together with other relevant tax-related information. MNE groups, whether headquartered in the EU or outside, with turnover of more than €750 million will need to comply with these additional transparency requirements.” Rather than requiring *tax authorities* to make CbCRs public, the proposed EU Directive would require *companies* that meet the €750 million threshold and have subsidiaries in the EU above a certain size (e.g., €40 million net turnover and 250 employees) to

⁴ That target date could be sooner if the earliest filing deadline was understood to mean the non-extended September 15, 2017, deadline for US MNE Groups with taxable years beginning on July 1, 2016, or even a different “voluntary filing” deadline that might be prescribed for US MNE Groups with taxable years beginning between January 1 and June 29, 2016.

publish *on their website* the following items: (1) nature of activities; (2) number of persons employed; (3) net turnover made (including with related parties); (4) profits before taxes; (5) amount of income tax due in the country as a result of the profits made in the current year; (6) the actual payments made to the country's treasury during that year; and (7) the amount of accumulated earnings. The information would be provided separately for each EU Member State and for yet-to-be-specified "tax haven" jurisdictions. The same information on activities in tax jurisdictions outside the EU would be provided on an aggregate basis. The report would be required to remain accessible for at least five consecutive years on the company's website. The proposed EU Directive has been submitted to the European Parliament and Council for their consideration and final adoption by a qualified majority of the Council.⁵ If the proposed EU Directive is adopted, EU member countries would be required to adopt the Directive within one year after it enters into force.

A similar proposal to require public CbC reporting in the UK was narrowly defeated (by a 22-vote margin) in the UK House of Commons on June 28, 2016. Representatives of NGOs, who have lobbied extensively for public CbC reporting in the UK, the EU, and the United States, were undeterred by their defeat in the UK and vowed to continue to seek to require public reporting.

Companies should closely monitor the developments in the EU because it does not appear that the push for public CbC reporting will diminish anytime soon.

Impact of Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports ("the MCAA")

As discussed above, the United States is pursuing separate competent authority agreements with each of the countries with which it has bilateral tax treaties and TIEAs, and will exchange CbC Reports only through those mechanisms. Many other countries, however, have chosen to become signatories of the MCAA, which was drafted by the OECD under the auspices of the Convention on Mutual Administrative Assistance in Tax Matters or the Convention on Mutual Administrative Assistance in Tax Matters, as amended by the Protocol (the "Convention").

⁵ In a July 5, 2016 "Communication on further measures to enhance transparency and the fight against tax evasion and avoidance" sent by the European Commission to the EU Parliament and the Council of the EU, the EC invited the Parliament and Council "to consider this proposal swiftly."

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The MCAA, which as of this writing has been signed by 44 countries,⁶ includes a section (Section 5) regarding confidentiality, data safeguards and appropriate use that is based on the considerations outlined in the Final Report on Action 13, and that is consistent with the Preambles of both the Proposed and Final US Regulations. For example, Section 5 of the MCAA states that all information exchanged under it is subject to the confidentiality rules of the Convention, and further provides that the use of the information will be “for assessing high-level transfer pricing, base erosion and profit shifting related risks,” and where appropriate for economic and statistical analysis. The section also provides that transfer pricing adjustments will not be based on the CbCR, and that “inappropriate adjustments [not consistent with the section] made by local tax administrations will be conceded in any competent authority proceedings.” Any cases of non-compliance with the MCAA should be reported by a Competent Authority to the Coordinating Body Secretariat at the OECD, including any remedial actions taken by the non-compliant Competent Authority or any measures taken by the reporting Competent Authority in respect of the non-compliance. The MCAA provides that a Competent Authority may temporarily suspend the exchange of information under the agreement where there is or has been substantial non-compliance by another Competent Authority, but requires that before imposing such a suspension the two Competent Authorities shall engage in a consultation.

The United States, which is a signatory of the Convention,⁷ has chosen not to become a signatory of the MCAA, although a number of its significant treaty partners, e.g., Canada, France, Germany, Japan, Mexico and the United Kingdom, have signed the MCAA. Whether the decision not to join the MCAA will have an impact on the willingness of treaty partners to enter into individual agreements with the United States remains to be seen. There would not seem to be any significant substantive differences between the stated goal of the MCAA and the United States’ goal as explained in the Preamble, and there appear to be no significant substantive differences between the model competent authority agreements included in the implementation package of the Final Report on Action 13 and the MCAA, so it is hoped that the Treasury Department will base its competent authority agreements on the models from the Final Report, which might enhance treaty partner cooperation.

⁶ 1. Argentina, 2. Australia, 3. Austria, 4. Belgium, 5. Bermuda, 6. Canada, 7. Chile, 8. Costa Rica, 9. Curaçao, 10. Czech Republic, 11. Denmark, 12. Estonia, 13. Finland, 14. France, 15. Georgia, 16. Germany, 17. Greece, 18. Iceland, 19. India, 20. Ireland, 21. Israel, 22. Italy, 23. Japan, 24. Korea, 25. Liechtenstein, 26. Luxembourg, 27. Malaysia, 28. Mexico, 29. Netherlands, 30. New Zealand, 31. Nigeria, 32. Norway, 33. People’s Republic of China, 34. Poland, 35. Portugal, 36. Senegal, 37. Slovak Republic, 38. Slovenia, 39. South Africa, 40. Spain, 41. Sweden, 42. Switzerland, 43. United Kingdom, 44. Uruguay

⁷ The United States has signed but not completed its ratification of the Protocol to the Convention, which opened up participation to countries beyond the OECD and Council of Europe membership. As of July 7, 2016, a total of 65 jurisdictions had completed their ratification of the amended Convention.

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Conclusion

While the Final Regulations answer many, but not all, of the questions raised by the Proposed Regulations regarding CbC reporting and confidentiality in the United States, significant questions remain regarding reporting requirements and confidentiality outside the United States. In particular, how other countries will address the "gap year" (i.e., whether they will follow the OECD Implementation Guidance) and whether public reporting of CbC information will be required through other means in other jurisdictions continues to develop. US MNE groups should monitor developments in their foreign jurisdictions of operation in order to decide how best to comply with those foreign requirements.

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Appendix 1

Model Template for the Country-by-Country Report

Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on Cash Basis)	Income Tax Accrued - Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other Than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Table 2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group: Fiscal year concerned:														
Tax Jurisdiction	Constituent Entities Resident in the Tax Jurisdiction	Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence	Main Business Activity(ies)											
			Research and Development	Holding or Managing Intellectual Property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management of Support Services	Provision of Services to Unrelated Parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding Shares or Other Equity Investments	Dormant
	1.													
	2.													
	3.													
	1.													
	2.													
	3.													

1. Please specify the nature of the activity of the Constituent Entity in the "Additional Information" Section.

Table 3. Additional Information

Name of the MNE group: Fiscal year concerned:
<i>Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the Country-by-Country Report.</i>