

Final US country-by-country reporting regulations analyzed in-depth

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Executive summary

On 29 June 2016, the US Treasury Department (Treasury) and Internal Revenue Service (IRS) released much-anticipated final regulations ([TD 9773](#)) on country-by-country (CbC) reporting (the Final Regulations). The Final Regulations apply to reporting periods of ultimate parent entities of US multinational enterprise (MNE) groups that begin on or after the first day of the tax year of the ultimate parent entity that begins on or after 30 June 2016.

The Final Regulations adopt, with some changes (discussed below), Treasury regulations issued in proposed form ([REG-109822-15](#)) on 21 December 2015 (the Proposed Regulations). In general, the Final Regulations are modeled on the Organisation for Economic Co-operation and Development (OECD) recommendations for CbC reporting under Action 13 of the OECD and G20 Base Erosion and Profit Shifting (BEPS) project (2015 Final Report for Action 13). For a discussion of the Proposed Regulations, see EY Global Tax Alert, *US Treasury and IRS issue proposed regulations on country-by-country reporting*, dated 24 December 2015.

Under the Final Regulations, ultimate parent entities of a US MNE group with annual revenue of \$850 million or more for the immediately preceding accounting period must file Form 8975, "Country-by-Country Report," containing information, on a country-by-country basis, related to the US MNE group's income and taxes paid, together with certain indicators of economic activity within the US MNE group.

In the preamble to the Final Regulations (the Preamble), Treasury and the IRS announced their intention to allow voluntary CbC reporting, under guidance to be published separately, for reporting periods that begin on or after 1 January 2016, and before the applicable date of the Final Regulations.

Detailed discussion

Requirement to file CbC reporting form

General provisions

In general, every ultimate parent entity of a US MNE group with annual revenue of \$850 million or more for the immediately preceding accounting period must file a CbC report.¹ The Preamble notes that new Form 8975, "Country-by-Country Report" (Form 8975 or CbC Report), is currently under development but does not indicate when the form and instructions will be issued.

An ultimate parent entity of a US MNE group is 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 tax resident outside the United States, such that the US business entity:

- ▶ Must consolidate the accounts of the other business entities with its own accounts for financial reporting purposes under US generally accepted accounting principles (GAAP) or
- ▶ Would be required to consolidate accounts if equity interests in the US business entity were publicly traded on a US securities exchange²

A US business entity that is owned directly or indirectly by another business entity that consolidates the accounts of that US business entity within its own accounts under GAAP of 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 residence jurisdiction is not an ultimate parent entity of a US MNE group and is not required to file Form 8975.³

Under the Final Regulations, the term "business entity" is modified from the way that term was defined in the Proposed Regulations. In general, for purposes of the Final Regulations, "business entity" is any entity recognized for federal tax purposes, including any entity with a single owner that may be disregarded as an entity separate from its owner under Treas. Reg. Section 301.7701-3, that is not properly

classified as a trust under Treas. Reg. Section 301.7701-4.⁴ However, a grantor trust within the meaning of Section 671, all or a portion of which is owned by a person that is not an individual, is a business entity for purposes of the Final Regulations.⁵ A business entity does not include a decedent's estate or a bankruptcy estate described in Section 1398.

Additionally, a business entity includes a permanent establishment (PE) that prepares financial statements separate from those of its owner for financial reporting, regulatory, tax reporting or internal management control purposes. Under the Final Regulations, a "PE" includes a:

- ▶ Branch or business establishment of a constituent entity in a tax jurisdiction that is treated as a PE under an income tax convention to which that tax jurisdiction is a party
- ▶ Branch or business establishment of a constituent entity that is liable to tax under the domestic tax law of the tax jurisdiction in which the entity is located or
- ▶ 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 residence⁶

According to the Preamble, Treasury and the IRS modified the definition of PE in the Final Regulations to provide greater clarity and consistency with the intended meaning of the 2015 Final Report for Action 13.

A "US business entity" is a business entity that is organized or has its tax jurisdiction of residence in the United States.⁷ For purposes of the Final Regulations, foreign insurance companies that elect to be treated as domestic corporations under Section 953(d) are treated as US business entities.

Tax residence

A business entity generally is considered resident in a tax jurisdiction if the business entity is liable to tax under the laws of that tax jurisdiction based on place of management, place of organization or another similar criterion.⁸ A business entity will not be considered a resident in a tax jurisdiction if the business entity is subject to tax in that jurisdiction based solely on gross income, without any reduction for expenses, from sources in that tax jurisdiction (e.g., gross-based withholding tax), or to a tax that is levied on capital situated in that jurisdiction.⁹ If a business entity does not have a tax jurisdiction of residence, then solely for purposes of determining the ultimate parent entity of a US MNE group, the tax jurisdiction of residence is the business entity's country of organization.¹⁰

The Final Regulations provide special rules for determining the tax jurisdiction of residence of a business entity that is resident in more than one tax jurisdiction.¹¹

A corporation that is organized or managed in a tax jurisdiction that does not impose an income tax on corporations is treated as resident in that tax jurisdiction, unless that corporation is treated as a tax resident in another tax jurisdiction under a different provision of the Final Regulations.¹² A PE's tax jurisdiction of residence is the jurisdiction in which the PE is located.¹³

Under the Final Regulations, as in the Proposed Regulations, a business entity that does not have a tax jurisdiction of residence, such as a partnership, and that does not own or create a PE in the jurisdiction in which it is organized or another tax jurisdiction, is considered a "stateless entity" for CbC reporting purposes, except for determining the ultimate parent entity of a US MNE group. In response to requests for clarification of the reporting requirements for stateless entities such as partnerships, the Final Regulations provide that the tax jurisdiction of residence information for stateless entities is provided on an aggregate basis for all stateless entities in a US MNE group.¹⁴ In addition, each stateless entity-owner's share of the revenue and profit is also included in the information for the tax jurisdiction of residence of the stateless entity-owner.¹⁵ The Preamble clarifies that this rule applies irrespective of whether the stateless entity-owner is subject to tax on its share of the stateless entity's income in the owner's tax jurisdiction of residence.

US MNE group

A "US MNE group" is a group of business entities, including the US business entity that is the ultimate parent entity, that is required to consolidate its accounts under US GAAP, or would be required to consolidate its accounts if equity interests in the ultimate parent entity were publicly traded on a US securities exchange.¹⁶ The ultimate parent entity of a US MNE group must report income and tax information, together with certain indicia of the location of the economic activity within the US MNE group for each constituent entity.

A "constituent entity" is any separate business entity of a US MNE group, with the exception of a foreign corporation or foreign partnership whose ultimate parent entity is not required to report under Section 6038(a), determined without regard to Treas. Reg. Section 1.6038-2(j) and 1.6038-3(c) (exceptions to information reporting for certain constructive owners and when more than one person otherwise would

be required to submit the same information), or any permanent establishment of such foreign corporation or foreign partnership.¹⁷ In general, Section 6038(a) requires a US person report certain information related to any foreign business entity that the US person controls.¹⁸

Information to be reported on Form 8975

The Final Regulations and Preamble describe the information that new Form 8975 will require for each constituent entity.¹⁹ 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) that ends with or within the ultimate parent entity's tax 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) that ends on the last day of the ultimate parent entity's tax year.²⁰

Based on Treas. Reg. Section 1.6038-4(d) of the Final Regulations, new Form 8975 will have three sections: (i) constituent entity information; (ii) financial and employee information by tax jurisdiction; and (iii) additional information. This is consistent with the Proposed Regulations and the 2015 Final Report for Action 13.

Constituent entity information

The Final Regulations require the ultimate parent entity to report the following for each constituent entity:

- ▶ Complete legal name of the constituent entity (added by the Final Regulations)
- ▶ Tax jurisdiction of residence, if any
- ▶ Tax jurisdiction in which the entity is organized or incorporated if different from the tax jurisdiction of residence
- ▶ Tax identification number, if any, used by the tax administration in the entity's jurisdiction of tax residence
- ▶ Main business activity or activities of the constituent entity²¹

Financial and employee information by tax jurisdiction

Similar to the Proposed Regulations (with some modifications noted below), the Final Regulations describe the financial and employee information that must be reported on Form 8975 for each tax jurisdiction in which one or more constituent entities are resident.²² The information is to be presented for each tax jurisdiction as an aggregate of the information for all constituent entities resident in that tax jurisdiction. As noted, information would be required to

be reported, in the aggregate, for any entity or entities in a US MNE group with no tax jurisdiction of residence.²³ The following information would be required to be reported on Form 8975:

- ▶ Revenues generated from transactions with other constituent entities
- ▶ Revenues not generated from transactions with other constituent entities
- ▶ Profit or loss before income tax
- ▶ Total income tax paid on a cash basis to all tax jurisdictions, and any taxes withheld on payments received by the constituent entities
- ▶ Total accrued tax expense recorded on taxable profits or losses, reflecting only operations in the relevant annual period and excluding deferred taxes or provisions for uncertain tax liabilities
- ▶ Stated capital, except that a PE's stated capital must be reported in the tax jurisdiction of residence of the legal entity of which it is a PE unless there is a defined capital requirement in the PE's tax jurisdiction for regulatory purposes
- ▶ Total accumulated earnings, except that a PE's accumulated earnings must be reported by the legal entity of which it is PE
- ▶ Total number of employees on a full-time equivalent basis
- ▶ Net book value of tangible assets, which for purposes of this section, does not include cash or cash equivalents, intangibles or financial assets

The Final Regulations modify the reporting requirements with respect to employees. Rather than the CbC report reflecting the employees in the jurisdiction where the employees perform work for the US MNE group as required by the Proposed Regulations, the Final Regulations require employees of a constituent entity to be reflected in the tax jurisdiction of residence of that constituent entity.²⁴ The Preamble notes that this change responds to comments highlighting the administrative burden associated with determining the work location of employees in certain circumstances, and makes the reporting consistent with the 2015 Final Report for Action 13. The Final Regulations declined, however, to provide additional guidance on the definition of full-time equivalent employee.

The Final Regulations revised the definition of tangible assets to be consistent with the OECD recommendation in the 2015 Final Report for Action 13. The Final Regulations specifically provide that tangible assets do not include intangibles or financial assets.

Further, the Final Regulations clarify the definition of "revenue." Revenue includes all revenue, including revenue from sales of inventory and property, services, royalties, interest and premiums. It excludes dividends from other constituent entities that are treated as dividends in the payor's tax jurisdiction of residence, as well certain imputed earnings and deemed dividends from other constituent entities. Additionally, the Final Regulations do not consider revenue of the recipient-owner to be distributions and remittances from partnerships and other fiscally transparent entities and PEs that are constituent entities.

There is a special definition of "revenue" for certain Section 501(a) tax-exempt organizations that are constituent entities. For such tax exempt organization, the term "revenue" includes only revenue that is reflected in unrelated business taxable income – UBTI – as defined in Section 512.

Additional Information

Consistent with the Proposed Regulations, the Final Regulations suggest that there would be an "Additional Information" section on Form 8975. The Preamble notes that it is expected that the Additional Information section of Form 8975 will be included in the information transmitted under competent authority arrangements.

Data sources

The Final Regulations provide guidance on the sources of information and do not limit the constituent entity information to applicable financial statement of the constituent entity. Rather, to provide flexibility, the source of the tax jurisdiction of residence information on the CbC report must be based on applicable financial statements, books and records maintained with respect to the constituent entity, regulatory financial statements, or records used for tax reporting or internal management control purposes.²⁵ Further, applicable financial statements are defined as audited financial statements for: (1) purposes of reporting to shareholders, partners, or similar persons; (2) purposes of reporting to creditors in connection with securing or

maintaining financing; or (3) any other substantial non-tax purpose.²⁶ Financial amounts must be reported in US dollars.²⁷ The Final Regulations provide that the ultimate parent entity is not required to create and maintain records to reconcile the CbC reporting information to consolidated financial statements or tax returns.

Filing and exchange of CbC reports

The new US tax return reporting form for CbC information is still under development but has been officially numbered as Form 8975.

Under the Final Regulations, the CbC Report for a reporting period must be filed with the ultimate parent entity's income tax return for the tax year in or with which the reporting period ends. That tax return, and accompanying CbC Report, must be filed on or before the due date (including extensions), for filing that return or as otherwise prescribed by Form 8975.²⁸ The OECD recommends filing CbC reports by the end of the year following the year covered by the report. In contrast, the Final Regulations require the CbC Report for the reporting period to be filed when the tax return is filed, though it would appear that the Final Regulations leave open the possibility for alternate guidance on filing obligations when Form 8975 and instructions are issued.

The Final Regulations do not provide for the possibility of a US entity acting as a surrogate entity for foreign-parented MNE groups. A business entity organized in a US territory or possession of the United States that is the ultimate parent entity may, however, designate a US constituent entity that it controls (within the meaning of Section 6038(e)) to file a CbC Report on its behalf.²⁹

The ultimate parent entity that files the CbC Report must maintain records to support the information provided on that form.³⁰ The Final Regulations do not create new penalties specific to the CbC Report, though the Preamble notes that general reporting-related penalties under Section 6038 apply, including reasonable cause relief for failure to file.

Confidentiality of the CbC reporting information is a major concern for taxpayers. The Preamble states that the information provided on the CbC Report is return information for purposes of Section 6103, which imposes confidentiality rules for all return information. The Preamble also indicates that the United States is committed to entering into bilateral competent authority arrangements regarding the automatic exchange of the CbC reports in a timely manner.

These agreements will require the information exchanged to be treated as confidential and generally prohibit the parties to the agreements from using any information received for any purpose other than for the administration of taxes. Importantly, the Preamble indicates that Treasury and IRS will provide information about the jurisdictions with which the US competent authority has reached agreement on exchange of information.

If the US Competent Authority determines that a foreign jurisdiction has violated the confidentiality, data safeguards and appropriate use restrictions in the CbC reporting information exchange agreement, the United States will pause information exchanges with that tax jurisdiction. The Preamble notes that, in those circumstances, if the US stops exchanging CbC Reports as a result of a breach, the jurisdiction will not be able to require any constituent entity of the US MNE group in the tax jurisdiction to file a CbC report. In addition, Treasury and the IRS intend to establish a procedure for taxpayers to report suspected violations of confidentiality and other misuses of CbC reporting information.

Applicability date

Under the Final Regulations, the CbC reporting requirement applies to reporting periods of ultimate parent entities of US MNE groups that begin on or after the first day of a tax year of the ultimate parent entity that begins on or after 30 June 2016.³¹ This differs from the OECD recommendation that CbC reporting apply to fiscal years beginning on or after 1 January 2016, and creates the potential for constituent entities of US MNE groups with fiscal years beginning 1 January 2016 through 30 June 2016, to be subject to secondary CbC reporting requirements in foreign jurisdictions. To address this transition-year issue, the Preamble states that Treasury and the IRS intend to allow voluntary filing of the CbC Report with the IRS and subsequent exchange with foreign jurisdictions based on a procedure to be defined in forthcoming guidance.

On the same day that the Final Regulations were released, the OECD released Guidance on the Implementation of Country-by-Country Reporting (OECD CbC Guidance),³² which includes transitional filing options for MNEs when a tax jurisdiction has an effective date later than 1 January 2016. The OECD guidance refers to voluntary filing by the ultimate parent entity that some countries are contemplating, including the US, for

periods commencing after 1 January 2016, and refers to this voluntary filing as “parent surrogate filing.” The OECD guidance recommends against requiring a local filing obligation where surrogate filing (including parent surrogate filing) is available, and certain conditions are met. (For additional details on the OECD’s guidance, see EY Global Tax Alert, [OECD releases additional guidance on implementation of country-by-country reporting](#), dated 29 June 2016.)

Implications

The confirmation by Treasury and IRS in the Final Regulations that they intend to address the transition year issue created by the differences between the applicability date of the US regulations and that of other countries that have implemented CbC reporting beginning on or after 1 January 2016, is helpful given the concerns expressed by many about the potential cost and administrative burden associated with possibly having to file in multiple jurisdictions for the 2016 reporting period. Such confirmation, together with the guidance released by the OECD regarding voluntary filing, is welcome.

As discussed, the Final Regulations contain a number of clarifications and modifications, including with respect to reporting requirements for partnerships. The Final Regulations require information on all “stateless” entities in a US MNE group to be provided on an aggregate basis, and each stateless entity-owner’s share of the revenue and profit to be included in the information for the tax jurisdiction of residence of the stateless entity-owner. Thus, in these circumstances, the revenue and profit of the stateless entity would be reported on two different lines on the CbC report.

The Final Regulations modify the Proposed Regulations in a number of ways to take account of comments received, including providing that a US territory ultimate parent entity may designate a US business entity that it controls to file a CbC report on its behalf in certain cases. The Final Regulations do not, however, adopt a comment that requested a national security exception for CbC reporting in certain cases. The Preamble notes, however, that the Department of Defense continues to consider the national security implications of the CbC reporting in particular fact patterns.

Taxpayers should be mindful of the importance of coordinating the preparation of the CbC Report as required under the Final Regulations, with the preparation of the Master file and local file transfer pricing documentation (also required under Action 13). In general, the Master file provides a global overview of a taxpayer’s business and strategy, including transfer pricing policies. In contrast, the local file contains specific transfer pricing data for each relevant country of operation. While Treasury and the IRS have not indicated any intention to change the current Section 6662 approach to transfer pricing documentation, many other jurisdictions in which US MNE groups operate are adopting the full three-part framework of the Final Report for Action 13 (i.e., CbC reporting, Master file and local file). As such, US MNE groups with operations in those jurisdictions should be coordinating their approach to the three-part reporting framework.

Endnotes

1. Treas. Reg. Section 1.6038-4(a) and -4(h).
2. Treas. Reg. Section 1.6038-4(b)(1)(i) and (ii).
3. Treas. Reg. Section 1.6038-4(b)(1)(ii).
4. Treas. Reg. Section 1.6038-4(b)(2).
5. *Id.* A business entity does not include a decedent's estate or a bankruptcy estate. *Id.*
6. Treas. Reg. Section 1.6038-4(b)(3).
7. Treas. Reg. Section 1.6038-4(b)(4).
8. Treas. Reg. Section 1.6038-4(b)(8).
9. Treas. Reg. Section 1.6038-4(b)(8).
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. Treas. Reg. Section 1.6038-4(d)(3)(i).
15. *Id.*
16. Treas. Reg. Section 1.6038-4(b)(5).
17. Treas. Reg. Section 1.6038-4(b)(6).
18. A person is in "control" of a corporation for purposes of Section 6038(a) if that person owns stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote, or more than 50% of the total value of shares of all classes of stock, of a corporation. (Section 6038(e)(2)). A person is in control of a partnership for purposes of Section 6038(a) if that person owns directly or indirectly more than a 50% interest in that partnership. (Section 6038(e)(3)(A)). Certain constructive ownership principles apply for purposes of determining whether a person is in "control" of a corporation or partnership. (Sections 6038(e)(2)(A) & (B) and 6038(e)(3)(A), (B) & (C)).
19. Treas. Reg. Section 1.6038-4(d).
20. Treas. Reg. Section 1.6038-4(c).
21. Treas. Reg. Section 1.6038-4(d).
22. Treas. Reg. Section 1.6038-4(d)(2).
23. Treas. Reg. Section 1.6038-4(d)(3)(i).
24. Treas. Reg. Section 1.6038-4(d)(2)(viii).
25. Treas. Reg. Section 1.6038-4(e)(2).
26. Treas. Reg. Section 1.6038-4(b)(9).
27. Treas. Reg. Section 1.6038-4(e)(1).
28. Treas. Reg. Section 1.6038-4(f).
29. Treas. Reg. Section 1.6038-4(j). US territories or US possessions are American Samoa, Guam, the Northern Mariana Islands, Puerto Rico and the US Virgin Islands. (Treas. Reg. Section 1.6038-4(b)(10)).
30. Treas. Reg. Section 1.4068-4(g).
31. Treas. Reg. Section 1.6038-4(k).
32. See OECD (2016), [Guidance on the Implementation of Country-by-Country Reporting – BEPS Action 13](#), OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris.

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