

US Treasury and IRS issue proposed regulations on country-by-country reporting

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Executive summary

On 21 December 2015, the Internal Revenue Service (IRS) and the Treasury Department (Treasury) released much-anticipated proposed regulations ([REG-109822-15](#)) on country-by-country (CbC) reporting (the Proposed Regulations), which include a template for the form that will be required for reporting purposes (CbC Reporting Form). In general, the Proposed Regulations are modeled on the Organisation for Economic Co-operation and Development (OECD) recommendations for country-by-country reporting, including the OECD model template, under Action 13 of the OECD and G20 Base Erosion and Profit Shifting (BEPS) project.¹ There are some differences, however, discussed in more detail below.

Under the Proposed Regulations, US persons that are the ultimate parent entity of a multinational enterprise (MNE) group with annual revenue of \$850 million or more for the immediately preceding annual accounting period would be required to file a CbC Reporting Form containing information, on a country-by-country basis, related to the MNE group's income and taxes paid, together with certain indicators of the location of economic activity within the MNE group.

The Proposed Regulations are proposed to apply to tax years of ultimate parent entities of US MNE groups that begin on or after the date the Proposed Regulations are finalized and that include annual accounting periods of all

foreign constituent entities and tax years of all domestic constituent entities beginning on or after that date. The CbC Reporting Form must be filed with the ultimate parent entity's timely filed income tax return, including any extensions for filing such returns. For example, for calendar-year taxpayers, if the Proposed Regulations are finalized in 2016, such taxpayers generally would be required to file a CbC Reporting Form as part of their timely filed 2017 tax return.

The Preamble states that the information reported under the Proposed Regulations will be treated as return information under Internal Revenue Code (IRC) Section 6103, with the attendant confidentiality provisions and exchange-of-information conditions associated with tax return information.

Detailed discussion

Requirement to file CbC Reporting Form

Under the Proposed Regulations, in general, a US business entity that is the ultimate parent entity of a US MNE group would be required to file a CbC Reporting Form.² The regulations provide an exception to this filing requirement for a US MNE group with revenues of less than \$850 million for the preceding annual accounting period.³

In general, "the ultimate parent entity of a US MNE group would be defined as a US business entity controlling a group of business entities, at least one of which is organized or tax resident outside of the United States,

- i. That are required to consolidate their accounts for financial reporting purposes under US generally accepted accounting principles (GAAP), or
- ii. That would be required to consolidate their accounts if equity interests in the US business entity were publicly traded on a US securities exchange."⁴

The ultimate parent entity of a US MNE group would not, however, include a US business entity that is owned directly or indirectly by another business entity that consolidates the accounts of such US business entity with its own accounts under the 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.⁵

The term "business entity" would mean a person as defined in IRC Section 7701(a) that is not an individual, as well as a permanent establishment that prepares financial statements separate from those of its owner for financial reporting,

regulatory, tax reporting or internal management control purposes.⁶ A US business entity would be a business entity that is organized or has its tax jurisdiction of residence in the United States.⁷

A business entity generally would be considered 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 another similar criterion.⁸ 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 would be the business entity's country of organization. The Preamble states that a business entity that is treated as a partnership in the tax jurisdiction in which it is organized and that does not own or create a permanent establishment in another tax jurisdiction generally would have no tax jurisdiction of residence (other than for purposes of determining the ultimate parent entity of a US MNE group). Further, the Preamble states that it is expected the partners would report their share of the partnership's items in the partners' respective tax jurisdictions of residence.

A business entity would not be considered resident in a tax jurisdiction if it is only subject to source-based taxation with respect to that jurisdiction or to a tax that is levied on capital situated in that jurisdiction. The Proposed Regulations provide special rules for determining the tax jurisdiction of residence of a business entity that is resident in more than one tax jurisdiction or that is a permanent establishment. The tax jurisdiction of residence of a permanent establishment would be the jurisdiction in which the permanent establishment is located.⁹

A US MNE group would be a group of business entities, including the US business entity that is the ultimate parent entity, that are required to consolidate their accounts under US GAAP, or would be required to consolidate their accounts if equity interests in the ultimate parent entity were publicly traded on a US securities exchange.¹⁰ The Preamble states that a US MNE group would not include business entities that are accounted for under the equity method, notwithstanding that the equity owner's proportionate share of the business income of such entities is included in the equity owner's consolidated financial statements.

Any US ultimate parent entity of an MNE group would be required to 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 would be any separate business entity of a US MNE group, with the exception of a foreign corporation or partnership whose ultimate parent entity is not required to report under Section 6038(a), determined without regard to Treas. Reg. Sections 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.¹¹

In general, information reporting is required under Section 6038(a) by a US person with respect to any foreign business entity that the US person controls. In this regard, the Preamble indicates that, if none of the constituent entities owned by the ultimate parent entity directly, indirectly or constructively owns enough stock in a foreign corporation to be considered a United States shareholder of a controlled foreign corporation, the foreign corporation would not be a constituent entity. If, however, the ultimate parent entity of a US MNE group constructively owns more than 50% of the voting stock of a foreign corporation because a wholly owned domestic subsidiary directly owns such stock and the domestic subsidiary reports information with respect to the foreign corporation under Section 6038(a), the foreign corporation would be a constituent entity of the US MNE group notwithstanding that, under Treas. Reg. Section 1.6038-2(j)(2), the ultimate parent entity itself is not required to report information under Section 6038(a).

The Proposed Regulations do not include any provisions for CbC reporting by constituent entities that are US persons that are part of an MNE group that has a non-US ultimate parent entity.

Information to be reported on CbC Reporting Form

The Proposed Regulations describe the information that would be required by the CbC Reporting Form for each constituent entity.¹² Based on the template provided in the Proposed Regulations, there would be three sections to the CbC Reporting Form: (i) constituent entity information; (ii) financial and employee information by tax jurisdiction; and (iii) additional information.

Constituent entity information

Under the Proposed Regulations, for each constituent entity, the ultimate parent entity must report the:

- ▶ Tax jurisdiction of residence, if any
- ▶ Tax jurisdiction in which the entity is organized or incorporated if different from the tax jurisdiction of residence
- ▶ Main business activity or activities, based on the specified categories, which includes a category for “other”
- ▶ Tax identification number, if any, used by the tax administration in the entity’s jurisdiction of tax residence¹³

Financial and employee information by tax jurisdiction

The Proposed Regulations describe the financial and employee information that would be reported on the CbC Reporting Form for each tax jurisdiction in which one or more constituent entities are resident.¹⁴ The information for the constituent entities would be aggregated by tax jurisdiction of residence. Further, the information would be required to be reported, in the aggregate, for any entity or entities in a US MNE group that have no tax jurisdiction of residence. The information that would be required to be reported is the following:

- ▶ Revenues generated from transactions with other constituent entities
- ▶ Revenues not generated from transactions with other constituent entities
- ▶ Profit (or loss) before income tax
- ▶ Income tax paid on a cash basis to all tax jurisdictions, including 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 positions
- ▶ Stated capital¹⁵
- ▶ Accumulated earnings¹⁶
- ▶ Number of employees on a full-time equivalent basis in the relevant tax jurisdiction¹⁷
- ▶ Net book value of tangible assets other than cash or cash equivalents

The number of employees may be reported as of the end of the accounting period, on the basis of average employment levels for that period, or any other reasonable basis, as long as the definition is applied consistently from year to year and across tax jurisdictions.¹⁸ Further, according to the Preamble, the number of full-time equivalent employees in

a tax jurisdiction of residence would be determined by the number of employees that perform activities for the US MNE group within such residence.

Additional information

The Preamble states that the CbC Reporting Form is expected to have a section for additional information. This section would include a brief description of the data sources used in preparing the form, and, if a change is made in such sources, an explanation of the reasons for the change and its consequences. The Preamble indicates, however, that permission to change the source of data would not be required.

Data sources

The Proposed Regulations provide guidance on the sources of financial information. Financial amounts would be required to be reported in US dollars.¹⁹ The source of financial amounts would be “applicable financial statements, books and records maintained with respect to the constituent entity, or records used for tax reporting purposes.”²⁰ Further, applicable financial statements are defined as audited financial statements for purposes of reporting to shareholders, partners, or similar persons; for purposes of reporting to creditors in connection with securing or maintaining financing; or for any other substantial non-tax purpose.²¹

Filing and exchange of CbC reports

Under the Proposed Regulations, the CbC Reporting Form for a tax year would be required to be filed with the ultimate parent entity's income tax return for such year on or before the due date, taking into account extensions, for filing such return.²² In contrast, the OECD recommends filing CbC reports by the end of the year following the year covered by the report, which, in the case of a calendar-year filer, would be the following 31 December.

The ultimate parent entity that files the CbC Reporting Form would be required to maintain records to support the information provided on such form.²³ The ultimate parent entity would not, however, be required to have or maintain records that reconcile the information on the CbC Reporting Form with the tax returns for any jurisdiction or with applicable financial statements.

The Proposed Regulations do not provide for any new penalties specific to the CbC Reporting Form. General reporting-related penalties are provided in the statutory provisions under whose authority the Proposed Regulations requiring the CbC Reporting Form are issued.

The Preamble states that the information provided on the CbC Reporting Form is return information for purposes of Section 6103, which imposes confidentiality rules for all return information. The Preamble indicates that the US competent authority is expected to enter into competent authority arrangements providing for the automatic exchange of the CbC reporting under the authority of information exchange agreements to which the United States is a party. Such agreements 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. The Preamble further indicates that the competent authorities of the United States and other jurisdictions “intend to further limit the permissible uses of exchanged CbC reports to assessing high-level transfer pricing and other tax risks and, where appropriate, for economic and statistical analysis.”

Applicability date

Under the Proposed Regulations, the CbC reporting requirement would apply to tax years of ultimate parent entities that begin on or after the date of publication of final regulations and that include annual accounting periods determined under Section 6038(e)(4) of all foreign constituent entities and tax years of all domestic constituent entities that also begin on or after such date.²⁴ Before the regulations are finalized, there is a 90-day period for submitting comments, followed by a public hearing, if requested by a person who has submitted comments. Thus, for example, assuming that the Proposed Regulations were to be finalized during 2016, the regulations would generally apply to calendar-year taxpayers for the 2017 tax year. This differs from the OECD recommendation that CbC reporting apply to fiscal years beginning on or after 1 January 2016.

Requests for comments

Comments are invited on all aspects of the Proposed Regulations. As noted in the Preamble, Treasury and the IRS specifically request comments on the following:

- ▶ Whether additional guidance is needed for determining which US persons must file a CbC Reporting Form or which entities are considered constituent entities of the filer, specifically relating to whether additional guidance on the definition of US MNE group is needed to address when US GAAP or US securities regulations permit or require

consolidated financial accounting for reasons other than majority ownership and any situations in which US GAAP or US securities regulations permit separate financial accounting of majority-owned enterprises

- ▶ The treatment of entities that are not treated as fiscally transparent in the owner or owners' tax jurisdiction of residence but are treated as fiscally transparent in the entity's country of organization
- ▶ Whether an exception to filing some of the information should be granted for national security reasons and the procedures to be followed to demonstrate a national security reason
- ▶ Whether additional guidance is needed on which business entities of a US MNE group are considered constituent entities, specifically on the exclusion of foreign corporations and partnerships or a permanent establishment of such foreign corporation or partnership for which an ultimate parent entity is not required to submit information under Section 6038(a)
- ▶ Whether any of the other items of information requested in the proposed regulations should be refined or whether additional guidance is needed on how to determine any of the items of information proposed to be submitted (e.g., the manner in which information on taxes paid or accrued by MNE groups and their constituent entities on taxable income earned in the relevant account period is gathered)
- ▶ Whether guidance is needed regarding the treatment of particular employment situations

Implications

The issuance of the Proposed Regulations confirms Treasury's stated intention to implement CbC reporting for US-based multinational groups. As noted in the Preamble, the guidance closely follows the OECD recommendations for CbC reporting, which were developed with significant input from Treasury. The most significant deviations from the standards reflected in the OECD Action 13 Report involve the potential implementation date and the potential filing date. Under the applicability date specified in the

Proposed Regulations, if final regulations are issued in 2016, US multinationals filing their tax returns on a calendar-year basis would generally be required to prepare the CbC Reporting Form for 2017 and file it with their US income tax return by the return due date in 2018. The OECD recommendation contemplates preparation of the CbC reports for the 2016 year and filing of such reports by the end of the following year. Moreover, the countries that have implemented CbC reporting requirements to date typically require such reports for 2016. Therefore, given the possibility that other countries could seek direct filing of CbC reports for 2016 from US-based companies with subsidiaries or permanent establishments in such countries, it is important for companies to continue to move forward with their preparations for CbC reporting.

In addition, given the proposal to require the CbC Reporting Form to be filed with the US tax return, which, even with extensions is due earlier than the OECD recommendation of up to one year after the end of the year, US companies should evaluate whether the sources of data they are considering using would be available in a timely manner or whether consideration should be given to the potential use of other sources of data that would be available earlier. The implications of the proposed filing date also may be a matter on which companies may wish to submit comments to Treasury and the IRS.

In most other respects, the Proposed Regulations mirror the OECD recommendations on CbC reporting. US multinationals should, however, review the details carefully because, in some key areas, the Proposed Regulations contain additional guidance not reflected in the OECD Action 13 Report, including, for example, specifying that information regarding employees is to be reported based on where the employees perform their activities and providing specific guidance on the treatment of constituent entities that are treated as partnerships. In addition, companies should consider taking the opportunity to submit comments on the Proposed Regulations, addressing any of the areas on which Treasury and the IRS specifically requested input or other areas where additions or revisions to the guidance would be useful.

Endnotes

1. See OECD/G20 Base Erosion and Profit Shifting Project: Transfer Pricing Documentation and Country-by-Country Reporting (the Action 13 Report).
2. Prop. Treas. Reg. Section 1.6038-4(a).
3. Prop. Treas. Reg. Section 1.6038-4(h).
4. Prop. Treas. Reg. Section 1.6038-4(b)(1)(i).
5. Prop. Treas. Reg. Section 1.6038-4(b)(1)(ii).
6. Prop. Treas. Reg. Section 1.6038-4(b)(2).
7. Prop. Treas. Reg. Section 1.6038-4(b)(3).
8. Prop. Treas. Reg. Section 1.6038-4(b)(6).
9. Prop. Treas. Reg. Section 1.6038-4(b)(6).
10. Prop. Treas. Reg. Section 1.6048-4(b)(4).
11. Prop. Treas. Reg. Section 1.6048-4(b)(5).
12. Prop. Treas. Reg. Section 1.6038-4(d).
13. Prop. Treas. Reg. Section 1.6038-4(d)(1).
14. Prop. Treas. Reg. Section 1.6038-4(d)(2).
15. Stated capital of a permanent establishment would 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.
16. Accumulated earnings of a permanent establishment would be reported by the legal entity of which it is a permanent establishment.
17. Under Proposed Treas. Reg. Section 1.6038-4(d)(3)(iii), independent contractors that participate in ordinary operating activities of a constituent entity may be considered employees of that constituent entity.
18. Prop. Treas. Reg. Section 1.6038-4(d)(3)(ii).
19. Prop. Treas. Reg. Section 1.6038-4(e)(1).
20. Prop. Treas. Reg. Section 1.6038-4(e)(2).
21. Prop. Treas. Reg. Section 1.6038-4(d)(7).
22. Prop. Treas. Reg. Section 1.6038-4(f).
23. Prop. Treas. Reg. Section 1.4068-4(g).
24. Prop. Treas. Reg. Section 1.6038-4(j).

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