

Resources

Resources / Alerts / IRS Issues Final Country-by-Country Reporting Regulations for Large Multinationals



IRS ISSUES FINAL COUNTRY-BY-COUNTRY REPORTING REGULATIONS FOR LARGE MULTINATIONALS

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AT A GLANCE

The Treasury and the IRS have finalized regulations requiring country-by-country (CbC) reporting for U.S. companies that are “ultimate parent entities” of multinational enterprises (MNEs). The final regulations apply to U.S. MNEs that have \$850 million or more in annual revenue for the preceding annual accounting period. The required CbC information must be filed on Form 8975, which the IRS has yet to release, and included with the ultimate parent’s federal income tax return. The final rules are generally effective for reporting periods that begin on or after June 30, 2016.

BACKGROUND

The new regulations were issued to further the Base Erosion and Profit Shifting (BEPS) agenda developed by the Organisation for Economic Co-operation and Development (OECD) and the G20, which seeks to curtail the artificial shifting of profits to low- or no-tax jurisdictions. Multinational corporations have long exploited international tax laws to reduce their worldwide tax bills; however, it was not until recently that the OECD sought to put some teeth into the prevention of these practices.

CbC reporting, which requires MNEs to provide information relating to their revenue and activities in the countries in which they do business, is aimed at establishing a mechanism to gain more visibility into multinationals’ worldwide operations and tax footprints and to facilitate the exchange of information among jurisdictions. As of May 2016, 39 countries have signed CbC agreements. The final regulations generally follow the international standard outlined by the OECD.

THE FINAL REGULATIONS

The regulations (Treasury Reg. §1.6038-4) impose the obligation to file a Form 8975 on the ultimate parent entity of a U.S. MNE group. An ultimate parent is defined as a U.S. 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 a tax resident in a tax jurisdiction other than the U.S., such that the U.S. business entity is required to consolidate the accounts of the other business entities with its own accounts under U.S. generally accepted accounting principles, or would be so required if equity interests in the U.S. business entity were publicly traded on a U.S. securities exchange and
- Is not owned directly or indirectly by another business entity that consolidates the accounts of such U.S. 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.

NEW FORM 8975

The to-be-released Form 8975 that must be filed with the ultimate parent's tax return will require a multitude of informational items for each "constituent entity" of the U.S. MNE, including:

- The tax jurisdiction in which the constituent entity is resident for tax purposes;
- The tax jurisdiction in which the constituent entity is organized or incorporated (if different from the tax jurisdiction of residence);
- The tax identification number, if any, used for the constituent entity by the tax administration of the constituent entity's tax jurisdiction of residence;
- The main business activity of the constituent entity;
- 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, including any taxes withheld on payments received by the constituent entities of the U.S. MNE group;
- Total 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 capital of all the constituent entities;
- Total accumulated earnings;
- Total number of employees on a full-time equivalent basis in the relevant tax jurisdiction; and
- Net book value of tangible assets, excluding cash or cash equivalents and intangibles or financial assets.

ADDITIONAL OECD GUIDANCE

On the same day the IRS issued the final regulations, the OECD released guidance regarding the implementation of CbC reporting under Action 13 of the BEPS initiative. Among other items, the new guidance addresses transition issues with respect to CbC reporting implementation. Since the OECD's CbC framework requires reporting for fiscal years beginning on or after January 1, 2016, concerns were raised by many multinationals that they would be subject to multiple sets of rules and differing effective dates. In these situations, the OECD has recommended that jurisdictions permit voluntary filing by resident ultimate parent entities (so-called "parent surrogate filing"). Where an MNE opts to submit a parent surrogate filing, the OECD recommends that local filing requirements should not apply in a jurisdiction that would otherwise require a local CbC report.

However, the parent surrogate filing rule is subject to several conditions, including:

- The ultimate parent must make available a CbC report to the tax authority of its tax residence by the filing deadline (12 months after the last day of the reporting fiscal year of the MNE group);
- The ultimate parent's tax residence must have a CbC mandate in place by the first filing deadline of the CbC report;
- By the first filing deadline of the CbC report, a Qualifying Competent Authority Agreement must be in effect between the ultimate parent's jurisdiction of tax residence and the local jurisdiction of the constituent entity;
- The tax residence of the ultimate parent must not have notified the local jurisdiction's tax administration of a systemic failure; and
- The following notifications must have been provided:
 - The jurisdiction of tax residence of the ultimate parent has been notified by the ultimate parent no later than the last day of the reporting fiscal year of the MNE group and

- The local jurisdiction's tax administration was notified by a constituent entity of the MNE group that is resident for tax purposes in the local jurisdiction that it is not the ultimate parent entity nor the surrogate parent entity, stating the identity and tax residence of the reporting entity no later than the last day of the reporting fiscal year of the MNE group.

Presently, Japan, Switzerland, and the U.S. have indicated that they would permit voluntary parent surrogate filing. U.S. guidance on voluntary filing is expected shortly.

WHAT THIS MEANS TO YOU

The final regulations represent a significant step by the U.S. in thwarting profit shifting by U.S. multinationals and in furthering the BEPS agenda. The new rules require unprecedented transparency for U.S. companies in terms of their transfer pricing practices and tax positions that will undoubtedly create a number of administrative and compliance burdens. Companies subject to the new rules are advised to reassess their transfer pricing policies and documentation and update these items accordingly to ensure compliance and assess risk. The new Form 8975 will likely be the IRS's first stop when considering a transfer pricing audit. Therefore, having recent, comprehensive, and supportable transfer pricing documentation on file will be critical should an audit occur.

EKS&H's International Advisory Group helps companies identify targeted tax benefits and navigate through complex tax issues in the areas of transfer pricing and international tax consulting. For more information, please contact Kari Thiessen at kritzthiessen@eksh.com or 303-740-9400.

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