

# INTERNATIONAL INSIGHTS

## Country-by-Country Reporting Regulations Finalized

### Affecting

The Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) finalized Treasury Regulations under Internal Revenue Code (“IRC”) Section 6038 (the “Finalized Regulations”) that require large United States (“U.S.”) parent companies of multinational enterprise (“MNE”) groups to report certain information to the Service on a country-by-country (“CbC”) basis. The Finalized Regulations apply to taxable years beginning on or after June 30, 2016.

### Background

On December 23, 2015, Treasury and the Service released proposed regulations on CbC reporting, which were largely based off the Organization for Economic Co-operation and Development (“OECD”) recommendations for CbC reporting in Action Item 13 of the Base Erosion and Profit Shifting Action Plan (“BEPS”) Final Report.

The proposed regulations on CbC reporting provide that U.S. parent companies of MNE groups with annual revenue of \$850 million or more for the immediately preceding annual accounting period would be required to file a CbC return listing certain information such as revenue, profit, or loss before income tax, total income tax paid, total number of employees, total accumulated earnings, along with other items, on a CbC basis.

Essentially, these reporting requirements are supposed to provide transparency to tax authorities around the world to identify situations where companies may be improperly shifting profits to low or no tax jurisdictions, a possible sign of tax avoidance.



# Country-by-Country Reporting Regulations Finalized Cont.

## Details

The Finalized Regulations largely follow the proposed regulations on CbC reporting, but some changes were made to take into account comments received by Treasury and the Service relating to the proposed regulations. Certain key developments and clarifications in the Finalized Regulations and the preamble to the Finalized Regulations (“Preamble”) are discussed below.

### 1. Form 8975, Country-by-Country Report

The Finalized Regulations amend the proposed regulations to reflect the official number of the form, Form 8975, Country-by-Country Report, (“Form 8975” or “CbCR”). Form 8975 is still being developed.

### 2. Applicability Date and Voluntary Filings

Other countries have adopted CbC reporting requirements for annual accounting periods beginning on or after January 1, 2016, that would require reporting of CbC information by constituent entities of MNE groups with an ultimate parent entity resident in a tax jurisdiction that does not have a CbC reporting requirement for the same annual accounting period. The Finalized Regulations apply to reporting periods of ultimate parent entities of U.S. MNE groups that begin on or after the first day of a taxable year of the ultimate parent entity that begins on or after June 30, 2016. Thus, the Finalized Regulations are not applicable for tax years of ultimate parent entities before June 30, 2016.

However, the Preamble indicates that Treasury and the Service intend to allow ultimate parent entities of U.S. MNE groups and U.S. business entities designated by a U.S. territory ultimate parent entity to file CbCRs for reporting periods that begin on or after January 1, 2016 but before June 30, 2016, under a procedure to be provided in separate, forthcoming guidance.

Treasury and the Service also indicated that they are working to ensure that foreign jurisdictions implementing CbC reporting requirements will not require constituent entities of U.S. MNE groups to file a CbC report with the foreign jurisdiction if the U.S. MNE group files a CbCR with the Service pursuant to this voluntary procedure, and the CbCR is exchanged with such foreign jurisdiction pursuant to a competent authority arrangement.

Separately, the OECD released guidance on June 29, 2016, relating to the implementation of CbC reporting, which sanctions voluntary CbC reporting during this transitional period by providing that if specified requirements are met, foreign countries should not require additional local filings by constituent entities.



# Country-by-Country Reporting Regulations Finalized Cont.

## 3. Permanent Establishments

The Finalized Regulations modify the term permanent establishment included in the definition of business entity. The Finalized Regulations provide that the term permanent establishment includes (i) a branch or business establishment of a constituent entity in a tax jurisdiction that is treated as a permanent establishment under an income tax convention to which that tax jurisdiction is a party, (ii) a branch or business establishment of a constituent entity that is liable to tax in the tax jurisdiction in which it is located pursuant to the domestic laws of such tax jurisdiction, or (iii) a branch or business establishment of a constituent entity that is treated in the same manner for tax purposes as an entity separate from its owner by the owners' tax jurisdiction of residence.

The Finalized Regulations revise the term permanent establishment so that it is more in line with the definition of permanent establishment that will be incorporated in the OECD Model Tax Convention per the recommendations provided in Action Item 7 (Preventing the Artificial Avoidance of Permanent Establishment) of the BEPS Final Report.

## 4. Grantor Trusts and Decedent's Estates

The Finalized Regulations exclude decedents' estates, individuals' bankruptcy estates, and grantor trusts within the meaning of IRC Section 671, all the owners of which are individuals, from the definition of business entity.

## 5. National Security Exception

Treasury and the Service received comments requesting a national securities exception for reporting CbC information. The Preamble states that Treasury and the Service consulted with the Department of Defense regarding the information collected on the CbCR and that the Department of Defense concluded such information reporting generally does not pose a national security concern. Accordingly, the Finalized Regulations do not provide a general exception for information that may relate to national security. Nonetheless, the Department of Defense continues to consider the national security implications of the CbCR in particular fact patterns, and future guidance may be issued to provide procedures for taxpayers to consult with the Department of Defense regarding the appropriate presentation of CbC information in such fact patterns.

## 6. Source of Data and Reconciliation

The Finalized Regulations provide that the reporting period covered by Form 8975 is the period of the ultimate parent entity's annual applicable financial statement that ends with or within the ultimate parent entity's taxable year, or, if the ultimate parent entity does not prepare an annual applicable financial statement, then the ultimate parent entity's taxable year.

The Finalized Regulations do not limit the constituent entity information to applicable financial statements of the constituent entity but rather, provide that the source of the tax jurisdiction of residence information on the CbCR must be based on applicable financial statements, books and records, regulatory financial statements, or records used for tax reporting or internal management control purposes for an annual period of each constituent entity ending with or within the reporting period.



## Country-by-Country Reporting Regulations Finalized Cont.

The proposed regulations stated that the amounts provided in the CbCR should be based on applicable financial statements, books and records maintained with respect to the constituent entity, or records used for tax reporting purposes. The term “books and records” was intended to be broad enough to include all sources of information that the BEPS Final Report allows. In order to clarify this intent, the Finalized Regulations provide that the source of data may also include regulatory financial statements and records used for internal management control purposes.

### 7. Partnerships and Stateless Entities

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 that or another tax jurisdiction generally would have no tax jurisdiction of residence under the definition in the proposed regulations, other than for purposes of determining the ultimate parent entity of a U.S. MNE group. Under the proposed regulations, tax jurisdiction information with respect to constituent entities that do not have a tax jurisdiction or residence, or “stateless entities,” would be aggregated and reported in a separate row of the CbCR. The preamble to the proposed regulations indicated that partners of a partnership that is a stateless entity would report their respective shares of the partnership’s items in their respective tax jurisdiction(s) of residence.

A comment requested clarification as to whether the partnership or its partners, or both, should report the partnership’s CbC information. The Finalized Regulations provide that the tax jurisdiction of residence information with respect to stateless entities is provided on an aggregate basis for all stateless entities in a U.S. MNE group and that each stateless entity-owner’s share of the revenue and profit of its stateless entity is also included in the information for the tax jurisdiction of residence of the stateless entity-owner. In the case in which a partnership creates a permanent establishment for itself or its partners, the CbC information with respect to the permanent establishment is not reported as stateless, but instead is reported as part of the information on the CbCR for the permanent establishment’s tax jurisdiction of residence.

The Final Regulations also clarify that distributions from a partnership to a partner are not included in the partner’s revenue and that remittances from a permanent establishment to its constituent entity-owner are not included in the constituent entity-owner’s revenue.

### 8. Time and Manner of Filing

The Finalized Regulations provide that the CbCR for a taxable year must be filed with the ultimate parent entity’s income tax return for the taxable year on or before the due date, including extensions, for filing that person’s income tax return.

Treasury and the Service did not adopt the Finalized Regulations recommendations to permit taxpayers to file a CbCR up to one year from the end of the ultimate parent entity’s taxable year or annual accounting period to facilitate the taxpayer’s ability to use statutory accounts or tax records of constituent entities to complete the CbCR. The Finalized Regulations do provide, however, that Form 8975 may prescribe an alternative time and manner for filing, leaving open the possibility that the Form 8975 filing instructions may offer some flexibility for filing the CbCR after the tax return due date.



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## Country-by-Country Reporting Regulations Finalized Cont.

### 9. Other Items

Among other items, the Finalized Regulations clarify certain terms and definitions, address certain comments to the proposed regulations, and confirm the confidentiality protections of IRC Section 6103 to CbC reporting.

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