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U.S. Multinationals Need to BEPS-Proof Country-by-Country Reports




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The U.S. is front and center in implementing the final report Action 13 of the international project to combat base erosion and profit shifting (BEPS). The crux of the post-BEPS reporting process is country-by-country reporting, implemented through the October 2015 BEPS Action 13 final report. Each member country's tax administration and business taxpayers have essential roles to play in implementing the BEPS country-by-country report. Failure to comply with the reporting rules involves penalties ranging from thousands to hundreds of thousands of U.S. dollars in member countries that have implemented country-by-country reporting.

Under the U.S. final country-by-country reporting regulations, 1.6038-4, 81 F.R. 42482, every ultimate parent entity of a U.S.-based multinational enterprise with an annual revenue of $850 million—equivalent to 750 million euros threshold in BEPS Action 13—or more in the immediately preceding reporting period is required to provide tax authorities with a breakdown of their allocation of profits by jurisdiction on a global basis, the amount of taxes paid on those profits, and certain other economic indicators.

Applicable IRS Form 8975 and the associated schedule largely conform to the Organization for Economic Cooperation and Development's country-by-country reporting templates in the BEPS Action 13 final report.

The U.S. regulations apply to fiscal years beginning on or after June 30, 2016, and the reporting deadline is the tax return due date for the given fiscal year, including extensions. The penalty rules under section 6038 generally apply with reasonable cause relief for failure to file. The IRS provides additional guidance on Form 8975 via Frequently Asked Questions on CbCR.

When to File In the U.S., the first applicable date for filing the country-by-country report is the fiscal year starting on or after June 30, 2016.

In many other countries the first applicable year is the fiscal year starting on or after Jan. 1, 2016, creating a potential one-year gap among multiple required jurisdictions.

Moreover, the U.S. final regulations only apply to U.S.-parented multinational groups. Some countries target the country-by-country reporting rules at both domestic parent and subsidiary entities, for example Australia and the Netherlands. As such, a U.S.-parented multinational with Australian or Dutch subsidiaries with a December year end needs to file the country-by-country report for the fiscal year ended Dec. 31, 2016 to comply with the reporting rules in Australia and the Netherlands.

To address this issue, the U.S. final regulations allow voluntary filing for the gap year—that is the fiscal year starting between Jan. 1, 2016 and June 30, 2016. Alternatively, the U.S. multinational group has the option to designate a foreign entity to do surrogate filing for the fiscal year ended Dec. 31, 2016.

On the same day that U.S. final country-by-country reporting regulations were released, the OECD issued ''Guidance on the Implementation of Country-by-Country Reporting,'' recommending that other countries accept reports filed voluntarily in the U.S. and other countries for the fiscal year beginning on or after Jan. 1, 2016.

Who Files? While surrogate filing is commonly accepted in many member countries implementing country-by-country reporting, the U.S. final regulations do not permit a foreign parent to designate a U.S. entity to file a country-by-country report with the IRS to meet reporting obligations elsewhere.

However, the U.S. ultimate parent company is allowed to designate a U.S. business unit that it controls, to file on the former's behalf.

Who Has the Rights to the Company's Filing? As part of the IRS's implementation of country-by-country reporting, the U.S. intends to automatically exchange reports, prepared by multinational groups with a reporting entity in the U.S., with partner jurisdictions where the multinational group operates, provided that:

- a legal instrument allowing for the automatic exchange of information is in force, for example, a double taxation convention or tax information exchange agreement (TIEA); and
- a competent authority arrangement (CAA) for the exchange of country-by-country reporting is operative in the jurisdiction.

At the time of the writing of this article, the U.S. signed CAAs with 30 countries and is in negotiation with 12 countries for the automatic exchange of the country-by-country report. Updates by the IRS are posted on the IRS website.

Confidentiality of country-by-country reporting information is a major concern for taxpayers. The U.S. Treasury warns trading partners about the potential negative responses to applicable foreign tax jurisdictions if they act inappropriately toward the U.S. If a counterparty's jurisdiction fails to meet confidentiality requirements, data safeguards, and appropriate use restrictions in the competent authority context, Treasury will suspend the exchange of information that would otherwise take place with the counterparty's jurisdiction.

Audit Risk Concerns The preamble to the proposed U.S. regulations—but NOT in the final regulations—indicates that the IRS will use country-by-country reporting information for high-level transfer pricing risk identification and assessment. The IRS indicated that they will not undertake transfer pricing adjustments ''solely on the basis of a CbCR.'' However, the IRS can use the country-by-country report as the ''basis for further inquiries'' into transfer pricing practices or other tax matters which might lead to transfer pricing adjustments.

Under the U.S. final regulations, the IRS promised companies not to use the taxpayer's country-by-country report as means of triggering transfer pricing tax adjustments, in accordance with the 2015 final report under BEPS Action 13, at section 5, paragraph 2, page 49.

However, exigent circumstances—for example, a sharp curtailment of the IRS budget by Congress, might prompt the IRS to revisit its own audit limitations. The Treasury's response could cause the IRS to activate the taxpayer's Form 8975 responses for audit response purposes.

Furthermore, some countries appear to be taking a more aggressive posture by treating the country-by-country report as a basis for a transfer pricing audit. Competitive pressures on the part of these nation-states might encourage the U.S. government to follow suit.

Tax administrations in countries other than the U.S. are unlikely to follow BEPS 13 audit limitations and are likely to trigger Action 13 responses, especially country-by-country information, to demand income adjustments. Tax adjustments in one country are then likely to lead to countervailing U.S. tax adjustments. Multinational enterprises need to prepare now for potentially extensive and often conflicting transfer pricing adjustments.

Making Transfer Pricing BEPS Proof One way to avoid a potential audit triggered by a country-by-country reporting disclosure is to perform diagnostic assessments on the global profit split by jurisdiction prior to filing the report.

This assessment can help ensure the alignment of economic outcomes and the functions, assets, and risks by jurisdiction as conveyed in the country-by-country reporting data. The diagnostic assessment will also proactively identify potential audit concerns and help plan tax structure realignment with BEPS concepts.

This self-diagnostic exercise enables multinational enterprises to document and defend the company's results to tax authorities around the globe.

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