

Frequently asked questions on country-by-country reporting

A guide for multinational corporations regarding country-by-country reporting questions and BEPS

The IRS has issued final regulations requiring annual country-by-country reporting (CbCR) by some U.S. taxpayers that are the ultimate parents of a multinational enterprise (MNE) group. These regulations are based on model legislation from the Organisation for Economic Co-operation and Development (OECD) and are part of the project addressing base erosion and profit shifting (BEPS).^{*} In this document, we've outlined some of the frequently asked questions around CbCR and how it can be managed by internationally active companies.

1. When is CbCR effective?

The U.S. regulations require CbCR for fiscal years beginning on or after June 30, 2016. Therefore, a calendar-year MNE must begin reporting in the United States for 2017. However, other countries passed CbCR legislation requiring reporting for 2016. Even though the United States requires filings to begin in 2017, taxpayers may file early under special guidance the U.S. Treasury issued. An early filing could eliminate the need to file in other jurisdictions. Taxpayers that have not taken advantage of the ability to file early may do so on an amended return.

2. When is the report due?

The OECD recommendations call for a due date not later than one year following the close of the MNE's fiscal year. This due date has been adopted by most countries with CbCR legislation. The U.S. Treasury regulations require the CbC report to be filed with the U.S. MNE's income tax return for the year; thus, filing is required no later than eight and a half months after year-end. The filing deadline is Oct. 15, 2018 for calendar-year taxpayers, while fiscal-year taxpayers are subject to earlier filing deadlines.

3. How is it filed?

The OECD has developed a model template to aid countries in collecting the required information. The IRS has also developed a form, Form 8975, based on the OECD model template, Country-by-Country Report.

4. Are there penalties associated with late filing or failure to file?

The OECD did not include penalty recommendations in its report. The U.S. Treasury regulations do not include any new penalties for failure to file a CbC report, though general reporting-related penalties may apply. Other countries may impose penalties based on specific or general penalty provisions. Penalties may be civil or criminal, depending on a country's law.

5. Will this information be shared with other countries?

Yes. The CbC report is filed with the ultimate parent entity and shared between jurisdictions through automatic exchange of information, pursuant to government-to-government mechanisms such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, bilateral tax treaties or Tax Information Exchange Agreements

^{*} Based on OECD model legislation and U.S. Treas. Reg. section 1.6038-4.

(TIEAs). As of June 30, 2016, 44 countries have signed the Multilateral Competent Authority Agreement for the automatic exchange of CbC reports. In March 2016, an agreement was reached enabling automatic exchange of CbC reports between European Union member states.

6. Will this information be made available to the public?

The OECD is supportive of confidentiality and has proposed confidentiality protections. The United States remains committed to confidentiality, stating that all automatic information sharing by the United States would be suspended should confidentiality be breached.

The European Commission has indicated it is considering whether public reporting of some of the information contained within the reports should be mandatory.

7. What measures are in place to maintain the confidentiality of this information once it is provided and shared among jurisdictions?

The OECD's proposed confidentiality protections include a framework for government exchanges of information contained within the CbC reports. The framework recommends enforceable legal protections similar to information exchange provisions within tax treaties, TIEAs, the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, or the Global Forum on Transparency and Exchange of Information for Tax Purposes.

8. How will tax authorities use this information?

The information provided in the CbC reports is intended to give governments a better understanding of whether companies may be engaged in practices designed to artificially shift substantial amounts of profits to low-tax jurisdictions where there is little or no substance to support such profits. It is intended as a high-level transfer pricing risk assessment tool, but is not meant to replace a detailed transfer pricing analysis or provide conclusive evidence that a company's transfer pricing policies are appropriate or inappropriate.

9. What are the risks to MNEs associated with CbCR?

The OECD guidelines and the U.S. regulations leave a number of aspects of the report to the reporting MNE's discretion, such as the source of the data and the basis on which to report employees. Further, some of the definitions are ambiguous and some of the requirements are inconsistent, particularly with respect to permanent establishments. These issues make it likely that countries will interpret the reporting requirements and the information contained within the report differently. If an assessment is made solely based on this information, the taxpayer may be faced with double taxation or engaged in a lengthy and costly competent authority process.

10. Which entity or entities within the group must file?

Under the U.S. regulations, a U.S. business entity that is the ultimate parent entity of a U.S. MNE group with revenues of \$850 million or more of consolidated group revenue, for the preceding annual accounting period, are required to file the U.S. CbC report. Other countries that have adopted CbCR legislation generally follow the OECD's recommendations requiring reporting when group revenues exceed 750 million euros.

11. What is a constituent entity?

A constituent entity is a separate business unit of the MNE group that is included in the consolidated group for financial reporting purposes. This includes a permanent establishment if a separate income statement is prepared for regulatory, financial, internal management or tax purposes. Under the U.S. regulations, a constituent entity includes a disregarded entity but does not include foreign corporations or partnerships of the U.S. MNE for which informational reporting is not required due to lack of control or any permanent establishment of such foreign corporation or foreign partnership.

12. What local notifications must be made by each constituent entity regarding CbCR and when are these due?

Each constituent entity must notify its jurisdiction of tax residence if it will file as the ultimate parent or surrogate parent and, if not, which entity of the MNE will file as the ultimate or surrogate parent. If there is more than one entity in a jurisdiction, notice must be given as to which entity is the filing entity in that jurisdiction. Notice must be received in each constituent entity's jurisdiction by the end of the year for which the report is being filed.

13. Is reporting required if the ultimate parent country does not require CbCR?

Yes, if an MNE has operations in a country or countries that have implemented CbCR and group revenue exceeds the applicable revenue thresholds.

14. How is a surrogate parent entity defined and what requirements must be met?

Designating a surrogate parent allows MNEs to avoid multiple local filings when the ultimate parent country doesn't require CbCR. The surrogate parent must be a tax resident in a country that requires CbCR and exchanges information.

15. What factors should we consider when selecting a surrogate parent entity?

It is important to understand (1) the reporting MNE's global footprint, (2) which countries will require CbCR, (3) which countries allow surrogate parent filing, and (4) the specific local country requirements for surrogate parent filing. Companies should consider where the proposed surrogate parent lies in the organization, the reputation of the foreign jurisdiction and whether there are appropriate information exchange procedures in place.

16. Does every country's CbCR legislation allow for surrogate filing?

No, not every country allows surrogate parent filing. Local legislation should be reviewed to determine if surrogate filing is acceptable or if local filing must be done.

17. If surrogate filing is not allowed and a constituent entity must file a local report, do the local rules for CbCR govern?

Yes, local rules regarding timing, currency, reporting standards, content and definitions for CbCR must be adopted.

18. How is the transition managed when reporting in the ultimate parent country is eventually required?

Careful consideration will need to be given to the transition from surrogate filing to ultimate parent company filing given there could be country-specific differences between the two filing requirements. Planning for the ultimate parent company filing should be considered during any transitional period in order to enhance efficiency.

19. Is there a mechanism to deal with the gap year caused by the OECD recommending start dates of fiscal years beginning on or after Jan. 1, 2016 (some countries have met this recommendation) versus the U.S. regulations requiring CbCR for fiscal years beginning on or after June 30, 2016?

Yes. The United States issued special guidance allowing ultimate parent entities resident in the United States to file early. By voluntarily doing ultimate parent surrogate filing, taxpayers will not need to do local parent surrogate filing in another jurisdiction. Taxpayers that have failed to complete this early filing in the United States may still do so by filing amended returns for the 2016 tax year and attaching a completed IRS Form 8975.

20. What period does the CbC report cover? How are constituent entities within the group with different year-ends reported?

- a. The CbC report covers the fiscal period of the reporting MNE. The OECD guidelines state that constituent entities should be reported based on (i) the fiscal period that ends on the same day as the reporting MNE or that ends within the 12-month period preceding such date, or (ii) based on the fiscal year-end of the reporting MNE. For example, assume a reporting MNE with a Sept. 30 year-end and a constituent entity with a Dec. 31 year-end. The 2017 CbC report is based on the reporting MNE's year-end of Sept. 30, 2017. Constituent entity information must be included for its year-end of Dec. 31, 2016, or based on the reporting MNE's year-end of Sept. 30, 2017.
- b. The U.S. regulations require information to be furnished for the 12-month period with respect to which the ultimate parent entity prepares its applicable financial statements ending with or within the ultimate parent entity's taxable year for which the CbC report is filed. However, if the ultimate parent entity does not prepare applicable financial statements, the reporting period is the 12-month period that ends on the last day of the ultimate parent entity's taxable year.

21. How are branches or permanent establishments reported?

Branches and permanent establishments should be reported under the tax jurisdiction where they are located with a note indicating the associated legal entity of which they are a part.

22. How are hybrid entities treated?

The U.S. regulations disregard the U.S. tax classification generated by U.S. check-the-box regulations in a reverse hybrid situation, requiring reporting by the partners of a reverse hybrid in the partner's tax jurisdiction. Based on the definition in the U.S. regulations of tax jurisdiction of residence, traditional hybrid entities are reported in the jurisdiction in which they are organized and subject to income tax.

23. What sources may be used to obtain information?

Data may be obtained from consolidated reporting packages, statutory financial statements, regulatory financial statements or internal management accounts.

24. What accounting principles must be used (local GAAP, IFRS)?

Companies have flexibility in determining the source of the information and reporting standards used as long as they remain consistent from year to year.

25. Does the information need to reconcile with consolidated financial statements or statutory reporting? Do you recommend reconciliation with consolidated financial statements or statutory reporting as a best practice?

Reconciliations are generally not required under current guidance; however, reconciliations are recommended to ensure accuracy of information reported and to provide a trail for future audits. A best practice would be to reconcile audited financial statements, statutory reporting and local tax returns to the CbC report.

26. Does the information need to come from the same source every year and across jurisdictions (e.g., statutory financials, consolidation packages, internal management accounts)?

Yes, the reporting MNE has discretion as to the source of the data, but the OECD guidelines require consistency from year to year and across jurisdictions. The U.S. regulations do not contain a consistency requirement.

27. Do I need a transfer pricing analysis in order to complete CbCR? Do I need to update my current transfer pricing documentation?

A transfer pricing analysis is not required in order to complete the CbC report. However, some countries may independently require a master file and local file be prepared. Any MNE with significant or high-risk intercompany cross-border transactions should consider completing or updating transfer pricing documentation.

28. What currency must be used (functional, local)?

Amounts should be reported in the functional currency of the reporting MNE. The U.S. regulations state U.S. reporting must occur in U.S. dollars, and an exchange rate not in accordance with U.S. GAAP must be disclosed.

29. Is the reporting required on an entity basis or a tax jurisdiction basis?

Reporting is required on a tax jurisdiction basis.

30. What is included in revenues?

The OECD guidelines and the U.S. regulations include in revenue sales of inventory and properties, services, royalties, interest, premiums, and other amounts derived from transactions with related or unrelated parties. This does not include dividends in certain situations.

31. Does income tax paid include withholding taxes?

Yes, the OECD guidelines and U.S. regulations require reporting of withholding taxes paid.

32. Does income tax accrued include deferred taxes and provisions for uncertain tax liabilities?

No, the OECD and U.S. regulations include only current amounts.

33. How is stated capital of permanent establishments reported?

Generally, under the OECD guidelines and U.S. regulations, the stated capital of a permanent establishment should be reported by the legal entity that owns the permanent establishment.

34. How are the accumulated earnings of permanent establishments reported?

Generally, under the OECD guidance and U.S. regulations, the accumulated earnings of a permanent establishment should be reported by the legal entity that owns the permanent establishment.

35. How is employee defined?

The OECD guidelines and U.S. regulations state that employees on a full-time equivalent basis should be reported. Independent contractors that participate in the operating activities of an entity may also be included. Reasonable rounding or estimates are permissible as long as it does not materially affect the number of employees reported across jurisdictions.

36. As of what date is the number of employees reported?

Under the OECD guidelines and U.S. regulations, the number of employees may be reported as of year-end, on an average yearly employment level basis, or any other reasonable basis. Reporting must be consistent across tax jurisdictions and from year to year.

37. Are tangible assets reported on a net or gross basis?

Tangible assets are reported based on the net book values under the OECD guidelines and U.S. regulations.

38. What is included in the definition of tangible assets?

The OECD guidance and U.S. regulations require reporting of all tangible assets other than cash and cash equivalents, intangible assets and financial assets.

39. How are tangible assets of permanent establishments reported?

Generally, under the OECD guidelines, the assets of a permanent establishment should be reported by reference to the tax jurisdiction where the permanent establishment is located.

40. What type of additional information is required in Table III?

This space allows companies to include any information that may assist in the understanding of information provided elsewhere in the CbC report. For example, a brief note indicating the data sources used should be included in Table III.

41. What best practices do you suggest for collection and aggregation of data?

When determining the source of information to be reported, consideration should be given to the timing of when the data sources are available relative to the due dates of the CbC report. MNEs should also assess practices adopted by their industry or competitors to avoid unfair comparisons. Existing data sources should be leveraged, if possible. For example, much of the information may be available from sources supporting IRS Forms 5471, 8858 and 8865; the tax account roll forward; and human resources.

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