

Country-by-Country Reporting – Questions and answers for Asset Managers (Part II)

Now that the United States and foreign countries have implemented CbCR rules, asset managers should assess whether they have reporting obligations.

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1. Introduction

On June 29, 2016, the IRS issued final Regulations¹ (TD 9773) (“U.S. Regulations”) requiring annual country-by-country reporting (CbCR) for certain U.S.-parented multinational enterprise (MNE) groups. The U.S. Regulations broadly follow the rules that the OECD recommended as part of its BEPS project in the context of Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting). Similarly, other countries have also adopted CbCR rules in the last several months, in line with the OECD recommendations.

As stated in Part 1 of this two-part article, the CbCR rules that the OECD recommended (and that the United States and other countries have consequently adopted) are designed mainly for typical MNEs, applying the rules to asset management structures may be difficult. Nevertheless, since the rules do not provide an exemption for the asset management industry, asset managers need to apply the rules and may face reporting obligations.

This article includes some frequently asked questions by asset managers on CbCR and the authors’ answers, when the answers appear clear. The article focuses on the application of the rules in the U.S. Regulations, although when appropriate, it touches on the application of CbCR rules as adopted by foreign countries. Part 1 of the article addressed general questions on what CbCR is; how it could apply to asset managers; how to identify MNE groups in asset management structures; and how asset managers should assess the USD 850 million revenue threshold. Part 2 below looks at the information that asset managers that have a CbCR obligation under the U.S. rules will have to report, and the manner and timing of the filings and impact of rules implemented by other countries.

¹ 81 Fed. Reg. 126 (June 30, 2016). See PwC, “IRS Issues CbC Final Regs.,” 27 JOIT 52 (September 2016). 0916

2. What to report?

2.1. What information would have to be reported on the CbC report?

U.S. Form 8975 (Country-by-Country Report) (“CbC report”) will include three parts.³ Part I will require, in brief, aggregate tax jurisdiction-wide information relating to the global allocation of income, taxes paid, and certain indicators of the location of economic activity among tax jurisdictions where the MNE group operates. Part II will require, generally, a listing of each business entity in the MNE group (the constituent entities—see the following section), including the tax jurisdiction of organization or incorporation when different from the tax jurisdiction of residence, local tax i.d. number, and nature of the main business activities of each constituent entity. Part III will permit the MNE to provide explanations of data and definitions used for and results of the CbC report.

In more detail, Part I of Form 8975 will require the following information on a CbC basis— presented as an *aggregate* of the information for the constituent entities resident in each tax jurisdiction— with respect to each tax jurisdiction in which one or more constituent entities of an MNE group is resident:⁴

- Revenues generated from transactions with other constituent entities.
- Revenues not generated from transactions with other constituent entities.
- Total revenues.
- Profit or loss before income tax.
- Total income tax paid on a cash basis to all jurisdictions, and any withholding taxes on payments to the constituent entities.
- Total accrued current tax expense recorded on taxable profits or losses.
- Stated capital.
- Total accumulated earnings.
- Total number of employees on a full-time equivalent basis.
- Net book value of tangible assets.

Part II of Form 8975 will require the following information to be reported entity by entity with respect to each constituent entity in the MNE group:⁵

- Complete legal name of the constituent entity.
- Tax jurisdiction where the constituent entity is resident for tax purposes (if any).
- Tax jurisdiction where the constituent entity is organized or incorporated (if different from the tax jurisdiction of residence)
- Tax i.d. number used for the constituent entity by the tax administration of the constituent entity’s tax jurisdiction of residence (if any).
- Main business activity or activities of the constituent entity.

³ The U.S has issued a draft of Form 8975, www.irs.gov/pub/irs-dft/f8975-dft.pdf.

⁴ See Reg. 1.6038-4(d)(2) (2016).

⁵ See Reg. 1.6038-4(d)(1) (2016).

2.2. Which entities are considered constituent entities?

In general, each business entity required to consolidate its accounts with the ultimate parent entity's accounts under U.S. GAAP (or that would be so required if the ultimate parent entity were publicly traded on a U.S. securities exchange) is considered a separate constituent entity of the MNE group. A constituent entity may include an entity treated as a partnership or an entity that is disregarded for U.S. federal tax purposes, 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 However, "constituent entity" does not include (for U.S. purposes) a foreign corporation or foreign partnership for which the ultimate parent entity is not required to provide information under Section 6038(a).

2.3. Which income items should be reported as revenue on the CbC report?

As also outlined in Part 1 of this article, in the context of how asset managers should assess the revenue threshold, the U.S. Regulations define "revenue" very broadly to include revenues from sales of inventory and properties, services, royalties, interest, and premiums.⁷ The OECD's CbCR guidance goes further by adding "and any other amounts."⁸ Without any further guidance from the OECD and U.S. Treasury, however, questions arise regarding what income is to be reported as revenue for CbCR purposes.

2.4. How to report on partnerships and stateless entities.

The U.S. Regulations say that tax jurisdiction information with respect to constituent entities that do not have a tax jurisdiction or residence ("stateless entities") is to be aggregated and reported on a separate row in Part I of the CbC report. A business entity that is treated as a partnership in the tax jurisdiction where it is organized and that does not create a permanent establishment in a tax jurisdiction generally will have no tax jurisdiction of residence. Consequently, the tax jurisdiction for these entities is to be reported in the "stateless" row of the CbC report. Alternatively, to the extent that the partnership creates a permanent establishment for it or its partners, the Part I data would be reported in the jurisdiction of the permanent establishment.

Further, each partner in a partnership must report its share of revenue and profit aggregated with the information reported for the tax jurisdiction of its residence, whether or not the partner is liable to tax on its share of income in its tax jurisdiction of residence. This "double counting" of some items—i.e., including the data in both the stateless line of the CbC report and in the partners' jurisdictions—is intended.⁹ Taxpayers may include notes in Part III of Form 8975 to clarify that income of certain partnerships that is reported on the stateless line of the CbC report is taxed at the partner level.

There are additional considerations for LLCs and other non-corporate entities. It is necessary to examine the local law to determine if these entities are transparent or subject to tax in local jurisdictions to map the entities to the proper line in Part I of the CbC report. See Exhibit 1.

⁶ See Reg. 1.6038-4(b)(6) (2016).

⁷ In the U.S. Regulations, "revenue" is further defined to not include payments received from entities that are part of the MNE group that are treated as dividends in the payor's tax jurisdiction of residence. Also, distributions and remittances from partnerships and other fiscally transparent entities and permanent establishments that are part of the MNE group are not considered revenue of the recipient-owner. "Revenue" also does not include imputed earnings or deemed dividends received from other constituent entities that are taken into account solely for tax purposes and that otherwise would be included as revenue by an entity that is part of the MNE group.

See Reg. 1.6038-4(d)(3)(ii) (2016).

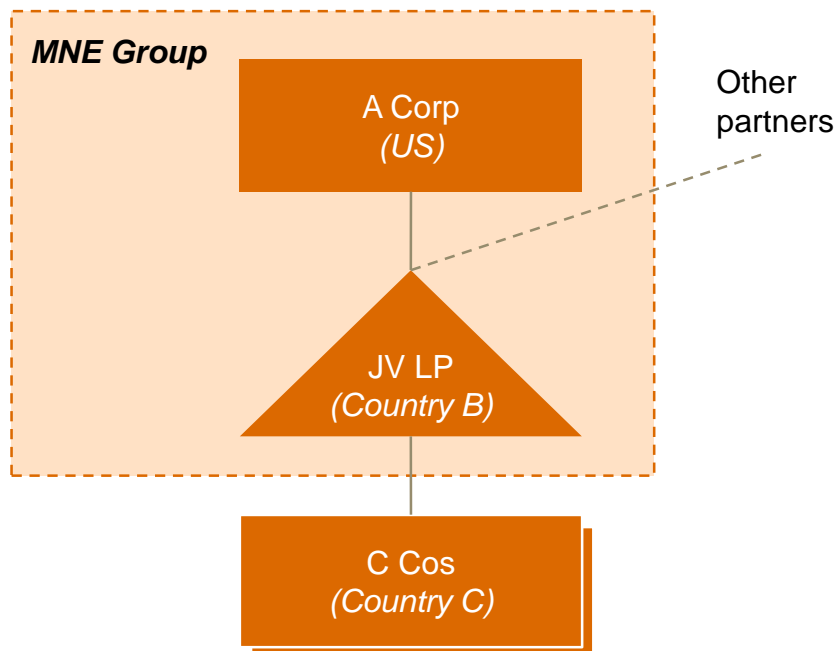
⁸ "Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report," www.oecd.org/tax/transferpricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm.

⁹ The U.S. has announced that it will issue additional guidance regarding the reporting of revenue and profits when the MNE group has tiered transparent entities.

Exhibit 1) CbC Report—“Stateless” reporting

Facts

A Corp is based in the United States and is treated as a corporation for U.S. federal income tax purposes. A Corp holds, with certain partners, an interest in JV LP, which is based in Country B. JV LP is treated as a partnership for U.S. federal income tax purposes and under country’s B domestic law. JV LP holds shares in various C Cos based in Country C and treated as corporations for local income tax purpose. JV LP does not have a permanent establishment in any jurisdiction. A Corp is required under U.S. GAAP to consolidate the accounts of JV LP. A Corp reports group revenues in the consolidated financial statement in excess of the USD 850 million revenue threshold.



CbCR Considerations

Since JV LP does not have a tax jurisdiction of residence, its Part I data is to be reported in the “stateless” row of the CbC report. Further, A Corp (as partner of JV LP) must report its share of revenue and profit from JV LP (i.e., the income from the C Cos) in the U.S. row of the CbC report.

2.5. How should part-time employees and independent contractors be reported?

The total number of employees is to be reported on a full-time equivalent basis. Taxpayers may use any reasonable, consistently applied approach to determine the number of employees. MNE groups can include or exclude independent contractors (that participate in the ordinary operating activities of a constituent entity) from employee headcount as long as their methodology is consistent across entities and from year to year.

2.6. Should net book value of any financial assets be included in the CbC report?

No. The only assets that must be reported in Form 8975 are tangible assets. Tangible assets do not include financial assets (or intangible assets, cash, or cash equivalents).

3. Manner & Timing of Filings

3.1. Who is required to file the CbC report?

The CbC report must be filed by the U.S. parent entity of a group that meets the U.S. MNE group definition (see Part 1 of this article for the U.S. MNE group definition) and that reports consolidated group revenue of at least the USD 850 million revenue threshold.¹⁰

3.2. How should the CbC report be filed?

A U.S. MNE that is subject to CbCR, under the U.S. Regulations, must file Form 8975 with the IRS as part of its tax return. When a partnership is the ultimate parent entity, the partnership would have the reporting obligation for the U.S. MNE group.

3.3. When must the first annual CbC report be filed?

The U.S. Regulations apply to reporting periods of U.S. MNE groups that begin on or after the first day of the tax year of the U.S. parent that begins on or after June 30, 2016.¹¹ Thus, calendar-year taxpayers, must file their first CbC report with their 2017 tax return in 2018 (with regard to 2017 data).

U.S.-parented MNE groups may be required to file a CbC report in 2017 (on their 2016 data) in foreign jurisdictions that have implemented CbCR with an effective date on or after of January 1, 2016, but before June 30, 2016 (when the U.S. MNE group has a taxable presence in the foreign jurisdiction). This requirement arises when the foreign jurisdiction has adopted the “secondary filing mechanism” discussed below.

To avoid the burden of filing locally or choosing a surrogate parent jurisdiction to share the CbC report with the foreign jurisdictions that have adopted the secondary filing mechanism (subjecting the MNE group to local laws and penalty regimes), the United States permits U.S. MNE groups to file voluntarily with the IRS for reporting periods beginning on or after January 1, 2016, through June 29, 2016.

¹⁰ See Reg. 1.6038-4(a) (2016).

¹¹ See Reg. 1.6038-4(k) (2016).

3.4. Will the United States share CbC reports with other countries?

Each CbC report that a U.S. reporting entity files with the IRS for the MNE group will be exchanged automatically with the foreign jurisdictions (1) where that MNE group is doing business, and (2) that have entered into an income tax treaty or tax information exchange agreement (TIEA) and a competent authority agreement for the automatic exchange of CbC reports with the United States.

3.5. Which confidentially protections apply to filed CbC reports?

The IRS has determined that CbC reports constitute tax return information and, thus, are entitled to the confidentiality protections of Section 6103 (Confidentiality and disclosure of returns and return information). The U.S. Regulations say that filing CbC reports with the IRS on Form 8975 aids confidentiality, since treaty partners will exchange such forms under competent authority agreements intended to safeguard data and information. The IRS can cease to exchange reports with any government that fails to protect taxpayer confidentiality. Further, the IRS plans to establish a procedure to report suspected violations of confidentiality and other misuses of the CbC report information.

U.S.-parented MNE groups that, as a result of the “secondary filing mechanism,” are required to file CbCR information locally in foreign jurisdictions where they are doing business will not have the confidentiality protections of Section 6103. Such local filings could occur, for example, if a calendar-year U.S.-parented MNE group elects to file the CbC report locally rather than U.S. voluntary filing for 2016.

Despite the lengths undertaken to ensure confidentiality of the CbC report, similar, additional requirements ultimately may result in the information becoming available publicly. For example, the European Commission has developed a proposal for a Directive¹² that (if European Parliament and the Council of Ministers approve it) will require public disclosure of CbCR information by large companies operating in the EU. This information is not the same as that required under the OECD’s CbCR but is substantially similar.

3.6. What are the penalties for not complying with the CbCR rules?

The U.S. Regulations are issued under the authority of Section 6038. As a result, failure-to-file penalties or penalties for filing an incomplete report as provided for by the Regulations could apply. Criminal penalties could apply for willful failure to file a CbC report in some jurisdictions. Also, a taxpayer’s statute of limitations for a particular tax return may be affected by a failure to file.¹³

¹² Proposal for a Directive of the European Parliament and of the Council of 12 April 2016 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches.

¹³ Information returns submitted to the IRS that are not complete and accurate are treated as not having been filed.

4. Foreign implementation of new transfer pricing documentation requirements, including CbCR

4.1. What is the ‘secondary filing mechanism’?

Under the OECD-recommended CbCR rules,¹⁴ the CbC report should, in principle, be filed by the ultimate parent entity of an MNE group in its jurisdiction of tax residence (“primary filing mechanism”). However, the rules that the OECD recommended require that, in certain circumstances, other constituent entities in an MNE group are to file the CbC report in their jurisdiction of tax residence (“secondary filing mechanism”). For example, this may apply when the ultimate parent entity of an MNE group is based in a jurisdiction that has not implemented CbCR rules.

In detail, under the secondary filing mechanism, any constituent entity in an MNE group could be required to file a CbC report in its jurisdiction of residence if any of the following apply:

- The ultimate parent entity of an MNE group has not made available a CbC report conforming to the CbCR requirements as recommended by the OECD to the tax authority of its jurisdiction of tax residence by the filing deadline (i.e., 12 months after the last day of the fiscal year of the ultimate parent entity).
- By the first filing deadline of the CbC report, the jurisdiction of tax residence of the ultimate parent entity of the MNE group does not have laws in place to require CbC reporting.
- By the first filing deadline of the CbC report, there is no exchange-of-information agreement for CbC reports in effect between the jurisdiction of tax residence of the ultimate parent entity and the local jurisdictions involved.
- The jurisdiction of tax residence of the ultimate parent entity has been notified by a relevant tax administration that there has been a systemic failure to automatically exchange CbC reports in its possession of MNE groups.
- One or more constituent entities in the MNE group have failed to meet the requirements (to the extent that they exist) to notify the tax authorities of its jurisdiction of residence before the end of the fiscal year¹⁵ of which entity will fulfill the CbCR obligation on behalf of the MNE group.

The second bullet above also could apply if there are differences between the effective dates of the CbCR rules in the jurisdiction of residence of the ultimate parent entity and the jurisdiction of residence of one (or more) of the constituent entities’ jurisdiction of residence (see Exhibit 2).

Countries that have already adopted the secondary filing mechanism include Luxembourg, the Netherlands, Spain, and the U.K. The secondary filing mechanism is not in the U.S. Regulations. To avoid the mechanism, U.S. MNE groups may elect to file voluntarily with the United States for 2016.

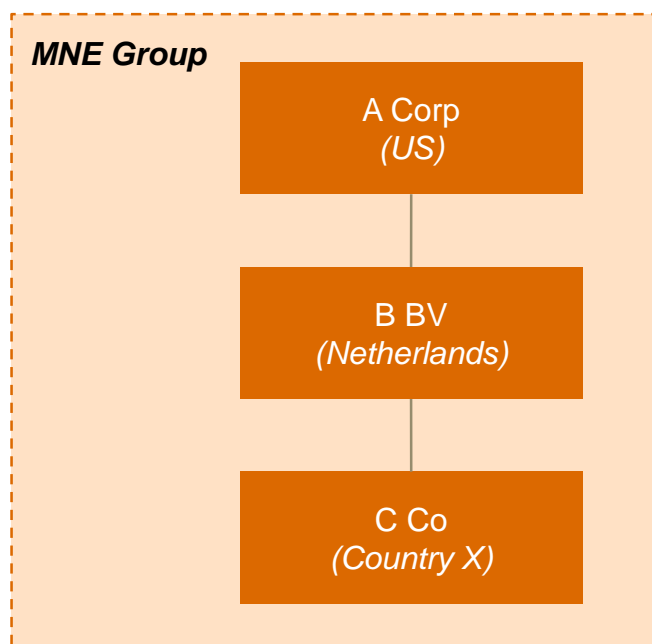
¹⁴ Action 13 final report, supra note 8.

¹⁵ On December 5, 2016, the OECD released “Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13,” suggesting that jurisdictions “may provide some flexibility regarding the date for the notification requirement if applicable, as neither the Action 13 standard nor the model legislation requires the notification to be at the end of the reporting fiscal year.” It further said that “[t]ransitional relief in these circumstances would not be frustrating the policy intention of the Action 13 minimum standard.” Following the guidance, certain jurisdictions (e.g., the Netherlands) have extended the deadline for submission of the CbC reporting notification, while other jurisdictions (e.g., Ireland) confirmed a year-end deadline, but indicated that as a transitional arrangement, domestic constituent entities should provide a notification by year-end based on a preliminary assessment of the identity and tax residence of the reporting entity. See www.oecd.org/tax/guidance-on-the-implementation-of-country-by-country-reporting-bepsaction-13.pdf.

Exhibit 2) Secondary Filing Mechanism Example

Facts

U.S.-based A Corp holds all of the shares in B BV, a company based in the Netherlands. B BV holds all of the shares in C Co, based in Country X. A Corp is required under U.S. GAAP to consolidate the accounts of B BV and C Co. A Corp reports group revenues in the consolidated financial statement in excess of the USD 850 million revenue threshold. A Corp, B BV, and C Co have calendar-year financial statements. Country X has not implemented CbCR rules.



CbCR considerations

While A Corp is a U.S. ultimate parent entity, it would not be subject to CbCR, under the U.S. rules, until calendar year 2017. However, B BV is a constituent entity that has its jurisdiction of tax residence in the Netherlands and would be subject to the “secondary filing mechanism” of the Netherlands, as the Netherlands has implemented the mechanism in its domestic law beginning January 1, 2016. To avoid application of the mechanism, A Corp may elect to file voluntarily with the United States for 2016, or to file the CbC report as a local filing in the Netherlands. The latter will subject A Corp to the Netherlands’ rules and penalties applicable to CbCR.

4.2. Should a U.S.-parented MNE group be concerned about foreign CbC reporting rules?

Yes. First, the U.S. Regulations apply to reporting periods of ultimate parent entities of MNE groups that begin on or after June 30, 2016. This effective date creates a “gap year” during which U.S.-parented MNE groups could be required to file the CbC report in foreign countries if the MNE group includes constituent entities that have their tax residence in a jurisdiction that has (1) implemented CbCR effective for fiscal years beginning on or after January 1, 2016; and (2) adopted the secondary filing mechanism. In that case, the constituent entity would be required to file the CbC report for the gap year. The IRS indicated in the Preamble to U.S. Regulations that it is in the process of developing guidance that will allow U.S.-parented MNE groups in this situation to file a U.S. CbC report voluntarily for the gap year. (See more on gap year in the following section.)

Second, a local filing obligation also may arise in a foreign country if, in brief, the United States will not exchange with the foreign country the CbC reports filed with the IRS by U.S. MNEs (see discussion above on when a filing obligation could arise under the secondary filing mechanism in foreign countries for a U.S.-parented MNE group).

At the time of writing, the United States is in the process of negotiating agreements with existing treaty and TIEA partners to effect CbC report exchange. If such agreements do not enter into force timely (which OECD defines as by the first deadline of the CbC report¹⁶), filing obligations could arise under the secondary filing mechanism in foreign countries for a U.S.-parented MNE group.

Several countries, including the U.K., have implemented annual notification requirements as part of their CbCR rules. These countries require each constituent entity of the MNE group that has its tax residence there to file a notification with the tax authorities of that country declaring which entity will file the CbC report. The OECD recommended that the first notification requirement for calendar-year taxpayers be filed by December 31, 2016. Some tax authorities have implemented this due date, while others are requiring the notifications as part of the tax return.¹⁷ It is unclear which penalties may apply for failure to file the notifications.

4.3. What should a U.S.-parented MNE group do that is required, under the U.S. Regulations, to file for the first time in FY 2018 a CbC report over FY 2017 data, but that operates in a foreign country that requires a CbC report be filed for the first time in FY 2017 over FY 2016 data?

As noted above, the U.S. Regulations apply to reporting periods of U.S. ultimate parent entities of MNE groups that begin on or after June 30, 2016, which creates a gap year during which U.S.-parented MNE groups could be required to file the CbC report under the secondary filing mechanism in foreign jurisdictions. That result could occur because other countries have adopted CbCR rules for annual accounting periods beginning on or after January 1, 2016, but before June 30, 2016, requiring reporting by constituent entities of MNE groups operating in their countries.

The U.S. Regulations address the gap year problem by allowing U.S. ultimate parent entities to file voluntarily Form 8975 for reporting periods that begin on or after January 1, 2016 (up to June 29, 2016) in accordance with a procedure to be provided in separate, forthcoming guidance. On the same day that the U.S. Regulations were released, the OECD issued "Guidance on the Implementation of Country-by-Country Reporting,"¹⁸ recommending that other countries accept reports filed voluntarily in the United States and in certain other countries for years beginning on or after January 1, 2016.

We understand that the tax administrations of countries participating in the BEPS process have agreed that constituent entities of U.S.-parented MNE groups will not have to file a CbC report in such foreign jurisdictions if the U.S. ultimate parent entity files a Form 8975 with the IRS in accordance with the forthcoming U.S. procedure and the CbC report is exchanged with the foreign jurisdictions subject to a competent authority agreement. Considerable work remains to implement this procedure. The United States must have in place with each jurisdiction that has implemented CbCR with effect on or after January 1, 2016, and that has adopted the secondary filing mechanism, an income tax treaty or tax information agreement, a competent authority agreement for the automatic exchange of CbC reports, and agreement to accept the voluntarily filed Forms 8975.

¹⁶ Id.

¹⁷ See note 12, supra.

¹⁸ See "Guidance on the Implementation of Country-by-Country Reporting" (June 2016), www.oecd.org/tax/beps/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.htm.

4.4. Should an MNE group that includes U.S. constituent entities and has an ultimate parent entity with its tax residence in a jurisdiction that does not exchange CbC reports with the United States be concerned about any local filing obligation in the United States?

No. Under the U.S. final Regulations, only U.S.-parented MNE groups are required to file a CbC report in the United States. The United States has not adopted the secondary filing mechanism. If an MNE group has an ultimate parent entity that has its tax residence in another jurisdiction, there should be no local filing obligation in the United States. The United States would, however, receive the CbC report via the automatic exchange of CbC reports, to the extent that one exists between the ultimate parent entity's jurisdiction of tax residence and the United States.

4.5. Should an MNE group that reports group revenues that do not meet the revenue threshold be concerned about filing a master or local file, as defined in the OECD Action 13 final report?

Yes. Numerous countries also have adopted the new master and local file requirements in the Action 13 final report. No (or much lower) revenue thresholds may apply in determining if an MNE is subject to the master or local file requirements. For example, in the Netherlands, an MNE group is required to prepare a master and local file if its consolidated group revenue exceeds EUR 50 million.

5. Conclusion

Under the U.S. Regulations, calendar- year taxpayers will have to file their first CbC report with their 2017 tax return in 2018 (with regard to 2017 data). However, asset managers should be aware that under CbCR rules implemented by foreign countries, they may be required to file their first CbC report in 2017 in those foreign jurisdictions (with regard to 2016 data).