

AN ALERT FROM THE BDO TRANSFER PRICING PRACTICE

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TRANSFER PRICING



SUBJECT

THE TREASURY AND IRS INTRODUCED PROPOSED REGULATIONS SECTION 1.6038-4, ON COUNTRY-BY-COUNTRY (“CBC”) REPORTING (REG 109822-15) FOR CERTAIN UNITED STATES TAXPAYERS

SUMMARY

On December 21, 2015, the Treasury Department (the “Treasury”) and Internal Revenue Service (the “Service”) introduced Proposed Regulations Section 1.6038-4, on Country-by-Country (“CbC”) reporting (REG 109822-15) for certain United States taxpayers. The Treasury and Service officials maintain that collecting information mandated under the proposed regulations will provide the Service with greater transparency regarding the operations and tax positions taken by United States multinational groups, which, in turn, will enable the Service to better enforce United States tax laws.

DETAILS

Under the proposed regulations, the ultimate parent entity of a United States multinational group with at least \$850 million in annual revenue in the preceding annual accounting period must file a yet-to-be-named CbC reporting form with the Service. The United States CbC reporting form follows the model template developed by the Organisation for Economic Co-operation and Development (“OECD”) under Action Item 13: Transfer Pricing Documentation and Country-by-Country Reporting of its Base Erosion and Profit Shifting (“BEPS”) initiative. By following the model template, the Service aims to minimize compliance costs. The IRS recognizes that an agreed upon international standard of information reporting will: (1) promote consistency of reporting obligations across tax jurisdictions and (2) reduce the risk that other countries will depart from this standard by imposing inconsistent or overlapping

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reporting obligations on United States multinationals. The proposed regulations call for the CbC reporting form to be filed no later than eight and a half months after the ultimate parent entity's fiscal year end.

The filing of this reporting form is novel in that United States multinationals are now required to share extensive information when they file their tax return. On the reporting form, the United States parent entity must disclose extensive information about each constituent entity or country of operation, including:

- ▶ intercompany and third party revenue;
- ▶ profit (or loss) before income tax;
- ▶ stated capital; accumulated earnings;
- ▶ net book value of tangible assets other than cash or cash equivalents;
- ▶ cash taxes paid;
- ▶ income taxes accrued;
- ▶ number of employees on a full-time equivalent basis; and
- ▶ indicators of economic activity within the group.

The Treasury and Service have determined that this information will assist in better enforcement of the federal income tax laws by providing the Service with greater transparency regarding the operations and tax positions taken by United States multinationals. It must be noted that information collected under the CbC reporting form does not qualify as a substitute for a full transfer pricing analysis under the Section 482 regulations, or form the sole basis for taxable income adjustments. The CbC reporting form can, however, be used as a basis for further inquiry into a multinational group's transfer pricing practices, which may lead to adjustments.

Given the extensive new data reporting requirements, multinational groups have voiced concerns regarding the use and potential misuse of this information, either through the Service's audit mechanism or through exchange of information procedures with foreign governments. To address these concerns, the proposed regulations outline a number of confidentiality safeguards. First, the United States CbC reporting form is limited to information that is presented on a multinational group's tax return. Second, the Service is permitted to exchange this information with a competent authority in a tax jurisdiction only if an information exchange agreement is in place between the two countries. Prior to entering an information exchange agreement, the Treasury and Service are responsible for reviewing the relevant tax jurisdiction's legal framework for maintaining confidential taxpayer information. The review includes ensuring that necessary buffers are in place to protect exchange information, that protections are enforced, and that adequate penalties apply to any breach of confidentiality. If a tax jurisdiction fails to comply with the confidentiality requirements, the United States competent authority can pause automatic exchange of the CbC reporting form until confidentiality obligations are met.

The Treasury and the Service have requested comments on certain aspects of the proposal before March 22, 2016. If the proposed regulations are finalized this year, a United States multinational with a calendar year end must file its first CbC reporting form with its timely filed tax return, for the taxable year beginning on January 1, 2017.

BDO INSIGHTS

Since the OECD released Action Item 13 on October 5, 2015, a number of countries (e.g., Spain) have moved forward with implementing CbC reporting requirements, while several other countries, in addition to the United States, are in the implementation process. With CbC reporting already underway in several countries, many United States multinationals are potentially subject to filing local CbC reports in these foreign jurisdictions prior to the finalization of the United States Treasury Regulations. Thus, United States multinationals that fall under the scope of the proposed regulations should begin assessing their internal data gathering and retrieval processes, analyzing resources, and developing internal procedures in anticipation of the implementation of United States and foreign CbC reporting requirements.

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