



March 22, 2016

VIA EMAIL

Mr. Steven Musher
Associate Chief Counsel, International
Internal Revenue Service
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Washington, DC 20224-0002
(steven.a.musher@irscounsel.treas.gov)

**Re: USCIB Comment Letter on the Proposed Regulations on Country-by-Country Reporting
(IRS REG-109822-15)**

Dear Mr. Musher,

USCIB¹ is pleased to have the opportunity to provide comments on proposed regulations concerning country-by-country reporting (“CBCR”).

USCIB supports the IRS’ decision to follow the OECD guidance as closely as possible and wishes to reemphasize some important aspects of that guidance. The information in the CBC report is sensitive and confidential. The confidential status of the information must be preserved. The information should only be used as intended: for high-level risk assessment. The CBC report provides only one part of a more complex picture and cannot be relied on by itself to present a true picture of value creation in each country. The information provided by the CBC report need not be reconciled. All of these points are part of the OECD guidance and are made in the preamble to the proposed regulations, but none are reflected in the language of the regulations themselves. Preambles do not have the same status as regulations and over time the guidance provided in the preamble may be lost. We therefore recommend that these concepts be incorporated into the regulations themselves.²

¹ USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

² Some possible suggestions on this are as follows: §1.6038-4(a) could be amended to include a statement concerning the purpose for which the information may be used and

This letter focuses on a few high-level issues. That focus reflects two underlying factors. First, CBCR is supposed to provide a high-level overview to be used for risk assessment; as such the details of the report are less important than broad accuracy. Because this is the case, flexibility is an important principle. Companies will take different approaches to completing the CBC report and as long as the information is broadly accurate and the rules concerning consistency are followed, companies should have flexibility in completing the report. Too many detailed requirements will reduce flexibility and increase costs without commensurate benefits.³ Second, although companies are beginning to plan to implement CBCR, they are in the initial stages of this planning so that questions concerning the more detailed application of the regulations have not yet been identified. More questions will arise as implementation moves forward. USCIB therefore supports the IRS' decision to permit guidance to be provided by the instructions to the form, although with the caveat that the IRS should not be prescriptive in that additional guidance. That is, the IRS could clarify that a method of reporting is permissible without necessarily prohibiting other approaches and by offering alternatives. This approach to providing guidance would provide clarity and preserve flexibility.

1. Effective Date

USCIB believes the effective date of the proposed regulations is inconsistent with the timeframe agreed at the OECD and with emerging international practice by implementing jurisdictions. This will result in increased administrative difficulties in the first year, legal uncertainty, corporate governance issues, and potential for tax authority challenge in other countries, possibly disrupting local operations of U.S. businesses and placing them at a significant competitive disadvantage to their international competitors.

The *OECD/G20 Transfer Pricing Documentation and Country-by-Country Reporting: ACTION 13: 2015 Final Report*, ("The OECD Report") as agreed by all G20 and OECD Member Countries in October 2015, recommends (paragraph 50) that:

"...the first Country-by-Country Reports be required to be filed for MNE fiscal years beginning on or after 1 January 2016."

Additionally, the OECD Report recommends a Framework for exchanging CBC Reports and secondary mechanisms such that (paragraph 60):

"...In case a jurisdiction fails to provide information to a jurisdiction...because (a) it has not required Country-by-Country Reporting from the ultimate parent entity of such MNE groups, (b) no competent authority agreement has been agreed in a

could also include a cross-reference to 6103 on confidentiality of return information; and §1.6038-4(e)(2) could be amended to include the language from the preamble concerning reconciliation of the CBC report to financial statement or other information.

³ This is why USCIB has not generally responded to particular requests for comments.

timely manner under the current international agreements of the jurisdiction for the exchange of the Country-by-Country Reports or (c) it has been established that there is a failure to exchange the information in practice with a jurisdiction after agreeing with that jurisdiction to do so, a secondary mechanism would be accepted as appropriate, through local filing or through filing of the Country-by-Country Report by a designated member of the MNE group acting in place of the ultimate parent entity and automatic exchange of these reports by its country of tax residence.”

Consequently, where other countries in which U.S. MNEs have taxable operations implement the rules in line with the recommendations of the OECD Report (i.e. filing in relation to years commencing on or after January 1 2016), U.S. MNEs are not, on the face of it, protected from the obligation to file CBC reports; rather they could face the more onerous obligations to file locally or through secondary mechanisms.

We understand that efforts could be made to encourage other countries to amend their own legislation / practices such that filing is not required for periods commencing before 1 January 2017. However, this was not what was agreed and recommended in the OECD Report and many countries are already passing legislation to enact rules to apply for periods commencing on or after 1 January 2016 without this proviso. Consequently, if any single country does not agree to amend its legislation to contradict the OECD Report recommendations, then U.S. MNEs will likely face additional uncertainty and compliance burden relative to their international competitors:

- These countries may either insist on local filing in line with their own CBC template or on designation of a surrogate filing country (or multiple surrogate filing countries) by the U.S. parented constituent group.
- Once local or surrogate filing has been established in a different country, the surrogate filing obligation could remain beyond 2016.
- There may also be a greater risk of losing confidentiality, and more limited recourse available if confidentiality standards are not upheld by the surrogate country or the country requiring local filing, as it will not have been exchanged with other countries under U.S. exchange agreements.

Additionally, we note that secondary filing mechanisms may differ from country to country and may result in a significant number of filings, each of which could theoretically have subtle differences from the reports that will need to be filed in the U.S. in future years. The administrative burden of complying with such a scenario cannot be overstated. Thus, it is essential that the U.S. government continue to advocate strongly with other governments for multiple solutions that will enable U.S. based MNEs to comply with the new rules in a way that addresses both the cost and confidentiality concerns.

USCIB has identified six potential solutions for the U.S. Government to investigate to prevent this potentially harmful outcome:

- i) Work with the governments of all other countries globally that are seeking to adopt the OECD Reports recommendations to ensure that their rules provide that their secondary/local filing mechanisms will not apply for periods commencing before 1 January 2017⁴;
- ii) Work with the OECD to supplement their recommendations to encourage other countries to clearly provide that their secondary/local filing mechanisms will not apply for periods commencing before 1 January 2017;
- iii) Amend the U.S. proposed regulations to provide a mechanism for U.S. taxpayers to elect to file a CBC report with the U.S. Government for periods commencing on or after 1 January 2016 (and simultaneously attempt to achieve options (i) and (ii) where possible); or
- iv) Amend the proposed regulations to be effective for periods commencing on or after 1 January 2016.⁵
- v) If none of the above prove possible, then work with the OECD and relevant national governments to ensure that a “surrogate” filing in one country is accepted by all other countries to which the information is distributed as a valid filing by the U.S. group, and that switching to the U.S. will be accepted once U.S. filing is available.
- vi) Allow U.S. parented groups to file with the IRS for 2016 and work with the OECD and other countries to defer the exchange of the 2016 report.

USCIB expresses no preference for any one of these options. However, if no solution can be found then we reiterate that U.S. MNEs may be compelled to follow the local filing / secondary filing mechanisms operating in each of the countries in which they operate, which will increase uncertainty, costs, and risk of disclosure for U.S. MNEs. USCIB notes that recent reports indicate that Treasury intends to finalize the regulations during June of this year. If that schedule is followed, then the first CBC reports will be required for taxpayers with taxable years beginning July 1, 2016. Under section 6071(b), the unextended due date for taxpayers with tax years ending June 30, 2017 is September 15, 2017. The IRS will, therefore, need to provide the electronic form and be ready to accept the CBC report prior to September 2017 and be ready to exchange these forms in 2018. The last day for filing

⁴ The EU has recently released guidance that would make secondary filing optional for 2016 and mandatory for 2017.

⁵ USCIB recognizes that IRS processes may prevent an electronic filing of the calendar 2016 CBC report. To that end, USCIB supports alternative methods of filing, including a paper filing that would allow a U.S. group to satisfy its CBC report filing requirement for other jurisdictions. The election could also include a requirement that an electing group will provide an electronic version after the IRS publishes the final form.

calendar year 2016 returns pursuant to an extension under section 6081 is September 15, 2017. If the IRS will need to have forms ready and be ready to accept returns as of September 2017 and exchange them in 2018, it is unclear why an election to file the CBC report cannot be made available to calendar year taxpayers. USCIB understands that the IRS does not expect to be ready to handle the volumn of CBC reports that would be required from calendar year taxpayers in 2016⁶. It seems, however, inappropriate to cause taxpayers to bear the significant burden associated with using the secondary mechanisms because the IRS is unready, especially when, in fact, they will have to be ready for some filings by fiscal year taxpayers.

2. Filing Date

The filing date provided by the proposed regulations could be construed as inconsistent with the timeframe agreed at the OECD and is inconsistent with emerging international practice, which could result in increased administrative difficulty and likelihood of tax authority challenge in other countries, thus placing U.S. businesses at a significant competitive disadvantage to their international competitors.

The OECD Report, as agreed by all G20 and OECD Member Countries in October 2015, recommends (Annex III):

“...The Reporting MNE may choose to use data from its consolidation reporting packages, from separate entity statutory financial statements, regulatory financial statements, or internal management accounts...”

Among other reasons, this flexibility was provided so that groups could use other sources if statutory accounts were not available.

The proposed regulations would require the CBC report to be made with a corporation’s annual tax return. Thus corporations with December year ends must file their U.S. tax return by September of the following year. However, given the statutory accounts and tax return filing deadlines in other OECD/G20 countries (which are, in some cases, up to 12 months after the end of the accounting period), it is clear that in order to file with the U.S. tax return statutory account information will not be available, thus, effectively, forcing all U.S. groups – whether they wish to or not – to use consolidated financial or other suboptimal statements. This timeframe was acknowledged in the OECD Report in its recommendation that the CBC report be filed within one year of the end of the accounting period to which it relates (para 50):

“...it is recognised that in some instances final statutory financial statements and other financial information that may be relevant...may not be finalised until after the due date for tax returns in some countries for a given fiscal year. Under the

⁶ Most corporations have calendar years.

given circumstances, the date for completion...may be extended to one year following the last day of the fiscal year of the ultimate parent of the MNE group.”

Businesses wish to prepare CBC reports that are useful to tax authorities with a minimum associated administrative burden. For many groups this will involve using consolidated financials but for many others it will involve using local data (i.e. local GAAP statutory accounts and tax returns). In addition to the administrative burden of preparing the report itself, many U.S. MNEs are concerned that if they are not afforded the flexibility to use the data that best reflects their local activities (i.e. local statutory filings) then this will invite additional questions from tax authorities seeking to reconcile the CBC report. These reconciliations could result in an additional administrative burden because differences will always exist due to (for example) currency, GAAP and management account data vs taxable presence.

This particular scenario is worse still for U.S. corporations who wish to file their U.S. tax returns in advance of the statutory deadline.

We believe that the most appropriate date for filing the CBCR report would be one year after the accounting year end, which is in line with the minimum standard agreed at the OECD and currently being legislated in other countries. However, if the report must be filed in advance of this OECD agreed deadline, we would request that U.S. MNEs at least have the option to make their initial CBC report filing with currently available statutory account information and the option to complete the CBC report by a final one year deadline, before which the CBC report would not be shared with other countries.

3. “Constituent entities” and “MNE Group”

As stated above, USCIB believes that adherence to the OECD guidelines and flexibility are key to implementing CBCR in the least burdensome manner. Thus, we believe additional guidance on the definition of constituent entities is unnecessary. If, however, additional guidance is to be provided USCIB believes that an exception to CBCR should be available for situations in which U.S. GAAP requires consolidated financial accounting for reasons other than majority ownership.

The proposed regulations provide that: “A U.S. MNE group comprises the ultimate parent entity of a U.S. MNE group as defined in paragraph (b)(1) of this section and all of the business entities required to consolidate their accounts with the ultimate parent entity’s accounts under U.S. generally accepted accounting principles, or that would be so required if equity interests in the ultimate parent entity were publicly traded on a U.S. securities exchange, regardless of whether any such business entities could be excluded from consolidation solely on size or materiality grounds.”

This definition appears to include entities that companies are required to consolidate under U.S. GAAP in which they do not have a controlling equity interest (or potentially any equity

interest). These Variable Interest Entities (VIEs) are companies that a U.S. MNE has the power to direct/influence through a means other than the equity interest (i.e. through a contractual or financing arrangement) such that the company is the “primary beneficiary”.

Under U.S. GAAP, a company may be deemed to have a controlling financial interest in the variable interest entity, even though it holds less than 50% of its voting equity. In such a case the company would be required to consolidate the variable interest entity. Obtaining information from variable interest entities may not be possible, particularly in cases where the company does not prepare the entity's financial statements or lacks contractual or legal rights to certain information.

The need to break out this information *by country* clearly goes beyond the disclosure requirements required under U.S. GAAP and the primary beneficiary won't necessarily be able to obtain timely and accurate CBC detail from an entity in which it does not have a majority ownership interest.

Thus, USCIB believes that an exception to CBCR should be available for situations in which U.S. GAAP requires consolidated financial accounting for reasons other than majority ownership. For variable interest entities in particular, it may not be possible for the primary beneficiary to obtain accurate and timely country-level information. Equity method investments are not considered part of the U.S. MNE group under the proposed regulations, and we believe that similar treatment may be appropriate for consolidated variable interest entities. At a minimum, the rules should provide a practical exception for instances in which information cannot be reasonably obtained from the majority owners or management of the variable interest entity. Further, the GAAP rules should not be used to expand the definition of constituent entity when the U.S. MNE Group does not use U.S. GAAP as the basis for its CBC report.

4. Transmitting Accurate Information

The CBC report provides the opportunity for companies to footnote information provided in the report. This footnoted information is likely to be important to understanding the information provided (otherwise the company would not footnote it) and should be included in the CBC report transmitted to other tax jurisdictions. For example, a U.S. MNE Group may have income that appears to be low or no-taxed in one entity but that income is subject to tax in the U.S. under subpart F or as branch income of a U.S. corporation. Thus, the effective rate of tax on that income will be 35%. In the CBC report, however, the income may be shown in one jurisdiction, while the taxes will be in another (the U.S.). In the event of a mismatch, a footnote will clarify that the income is in fact subject to a high rate of tax and therefore, from the perspective of BEPS risk assessment, this income would not present a BEPS risk and should be of little concern to the country receiving the CBC report. If, however, the information in the footnote is not transmitted as part of the

schema (because it does not “fit” in the schema) then this valuable information would be lost.

5. Notification of Transmission

The IRS should put in place an automatic procedure to notify U.S. MNEs of the transmission of the CBCR report to another country. This is related to misuse of the information. If the U.S. MNE is unaware of whether the information has been provided to a country, then it cannot accurately assess whether the information is being misused.

6. National Security

We believe it is appropriate for the IRS and Treasury Department to allow an exemption from CBCR for national security purposes. For companies that conduct business as contractors for the U.S. Department of Defense or U.S. government intelligence or security agencies, we are concerned that military sensitive information would be contained in or extractable from CBCR reports envisioned by the proposed regulations, particularly with respect to reporting on personnel, sales, and tangible assets in each country in which they operate.

Though the OECD has established confidentiality standards, they were intended to protect business sensitive matters, not military sensitive information, and are not adequate to do so. Furthermore, as the CBCR reports are adopted by more countries, it is becoming evident that certain information contained in the reports will not be kept confidential (as evidenced by the recent agreement of the EU Finance Ministers to publicly release certain data). More fundamentally, the objectives of the entire project have little or nothing to do with the tax practices of defense contractors, whose operations are primarily domestic, whose effective tax rates are high, and whose tax practices are, as a consequence, transparent. We believe an appropriate exemption from CBCR for national security should be crafted so that sensitive data does not fall into the wrong hands.

7. Penalties

The goal of the U.S. Treasury, other countries, and the OECD in implementing CBCR should be to facilitate companies and countries adoption of the requirements and administration of the new rules so that the process is running smoothly as soon as practicable. This is unlikely to be achieved for the 2016 year and application of penalties to companies during this time is not likely to further that ultimate goal. USCIB believes that penalties should be waived for the 2016 year and that the U.S. Treasury, should advocate that other countries also waive penalties for the 2016 year.

Conclusion

Proper implementation of country-by-country reporting is critically important to U.S. based multinationals. USCIB is willing to work with the IRS and tax authorities of other countries

to ensure that the required information is provided as efficiently as possible and countries continue to protect the confidential information that companies are providing through this mechanism.

Sincerely,



William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

cc:

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