TAX EXECUTIVES INSTITUTE, INC.

comments on

REG-109822-15

relating to

Proposed Regulations Requiring Country-by-Country Information Reporting by Certain Parent Entities of Multinational Enterprise Groups

submitted to

The Internal Revenue Service

March 21, 2016

The Internal Revenue Service (the Service) and Treasury Department (Treasury) released proposed regulations on December 23, 2015, requiring certain U.S. persons to report selected information about their operations and taxes paid on a country-by-country basis.[1] The Proposed Regulations generally reflect the recommendations regarding country-by-country reporting in the final report under Action 13 of the Organisation for Economic Co-Operation Development's (OECD) base erosion and profit shifting (BEPS) project. The final report under BEPS Action 13 provides guidance for countries participating in the BEPS project to implement improved transfer pricing documentation requirements, including country-by-country (CbC) reporting, with the goal of improving tax administration and risk assessment in transfer pricing matters.

[1] Prop. Treas. Reg. § 1.6038-4; REG-109822-15 (Proposed Regulations)

The Service and Treasury requested comments on the Proposed Regulations on or before March 22, 2016. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to this request for comments.

Tax Executives Institute

TEI is the preeminent association of in-house tax professionals worldwide. Our approximately 7,000 members represent more than 2,800 of the leading corporations in North and South America, Europe, and Asia. TEI represents a cross-section of the business community and is dedicated to developing and effectively implementing sound tax policy, promoting the uniform and equitable enforcement of the tax laws, and reducing the cost and burden of tax administration and compliance to the benefit of taxpayers and governments alike. TEI is firmly committed to maintaining a tax system that works — one that is administrable and with which taxpayers can comply in a cost-efficient and predictable manner.

TEI, as a professional association of in-house tax executives, offers a unique perspective. Members of TEI manage the tax affairs of their companies and must contend daily with provisions of the tax law impacting business enterprises, including information reporting and documentation requirements such as those set forth in the Proposed Regulations. Our members work for companies in a wide variety of industries and their collective perspectives are broad-based and not tied to any particular special interest group. The diversity, background, and professional training of TEI's members place the organization in a uniquely qualified position from which to comment on the Proposed Regulations.

General Comments

TEI commends the Service and Treasury for the overall approach of the Proposed Regulations in generally tracking the final report issued under BEPS Action 13. The flexibility

provided to multinational enterprises (MNEs) to use the financial information best suited to their operations to populate the CbC reporting template is particularly welcome. While the Proposed Regulations generally follow the OECD guidance for CbC reporting, there are significant differences between the Proposed Regulations and the final OECD report on BEPS Action 13.[2] This is regrettable because one of the objectives of the BEPS project was to develop a common approach to address the perceived problems of base erosion and profit shifting and prevent "global tax chaos"[3] from arising if countries took unilateral measures to address BEPS. TEI therefore urges the Service and Treasury to strive for consistency with the OECD's final Action 13 guidance regarding filing CbC reports when promulgating the final CbC regulations.

Effective Date of Final Regulations

The Proposed Regulations require certain taxpayers to report CbC data for taxable years beginning on or after the date regulations are finalized.[4] U.S. headquartered companies will generally not be required to file the CbC report with the Service until sometime in 2018 for their 2017 taxable year because the Proposed Regulations will be finalized in 2016. The final Action 13 report, in contrast, recommends data collection for CbC reporting purposes begin in 2016 for reporting in 2017. U.S. based multinationals may be required to file CbC reports directly with other countries in 2017 because of this one year gap between when the Proposed Regulations are finalized and the reporting requirements already in place in other countries for 2016. U.S. MNEs filing CbC reports directly with tax authorities in other jurisdictions would not enjoy the

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[2] The significant differences between the OECD report and Proposed Regulations are discussed in more detail below.

[3] OECD's *Action Plan on Base Erosion and Profit Shifting*, pages 10-11 ("Inaction in this area would likely result in some governments losing corporate tax revenue, the emergence of competing sets of international standards, and the replacement of the current consensus-based framework by unilateral measures, which could lead to global tax chaos marked by the massive re-emergence of double taxation.").

[4] Prop. Treas. Reg. § 1.6038-4(j).

confidentiality protections accompanying a filing accomplished through the Service and then shared with other jurisdictions via a tax treaty or other tax information exchange agreement.

The security and confidentiality of the data populating the CbC report is of paramount concern to MNEs, both those headquartered in the United States and elsewhere. Filing reports directly with countries adopting a requirement to report 2016 data will only increase the chances of unauthorized disclosure of an MNE's CbC report. Absent a requirement to file the CbC report with the Service for 2016, moreover, MNEs may be required to satisfy varying formats and filing deadlines in other jurisdictions, rather than filing a single report with a single deadline with the Service. This would substantially increase the compliance and administrative burden on U.S. MNEs and would only apply for the first year of reporting if the Proposed Regulations are finalized in 2016.

TEI recommends the Service and Treasury permit U.S. MNEs to apply the final regulations to filings in 2017 for 2016 taxable years (*i.e.*, those years beginning on or after January 1, 2016). This may relieve such MNEs of the requirement to file individual – and potentially different – CbC reports in those countries requiring MNEs to report 2016 information. Regrettably, even an elective mechanism may not satisfy the filing requirements in certain other countries because an "optional" filing may be insufficient under local legislation following the BEPS Action 13 report, which states such a filing must be "required." This may trigger the surrogate entity reporting mechanism discussed in the Action 13 report or some other method of local filing. Such filings as noted may be required to satisfy those countries' particular CbC format rather than the format required in the final U.S. regulations. Therefore it may be preferable from an administrative and compliance standpoint to *require* U.S. MNEs to file the CbC report with the Service in 2017 for

2016 taxable years, which would allow such MNEs to avoid individual local filings under potentially different reporting formats and standards.

We understand, however, that resource constraints may make even an optional CbC filing unmanageable for the Service for 2016 CbC data. Absent a required or optional 2017 filing of the CbC report for U.S. MNEs for 2016 years, TEI urges the Service and Treasury to consult with their counterparts in those countries requiring 2016 reporting and request U.S. MNEs be permitted to file the U.S. version of the CbC report, as required by the final CbC regulations. This would at least permit U.S. MNEs to file the CbC report in consistent formats from year to year and avoid unnecessary audit inquiries about differences between the 2016 and 2017 filings.

Filing Deadline

The Proposed Regulations require U.S. MNEs to file the CbC report along with their U.S. federal income tax return at the appropriate deadline (*e.g.*, September 15 for a calendar year taxpayer, with extensions).[5] This is inconsistent with the final Action 13 BEPS report, which recommends a filing deadline of one year from the end of the relevant taxable year (*e.g.*, December 31 for a calendar year taxpayer). Taxpayers preferring to use foreign statutory account or tax return data to populate the CbC report may find a September 15 (or similar) deadline difficult to meet because such information is unlikely to be available in time. The inability to use such information would remove one of the key components of the Proposed Regulations – their flexibility in permitting a taxpayer to use whatever financial information best suited to its operations to populate the CbC reporting template.[6] The flexibility of the substantive provisions of the Proposed Regulations, in other words, is taken away by the proposed filing deadline. Many

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5 Prop. Treas. Reg. § 1.6038-4(f).

6 *See* Prop. Treas. Reg. § 1.6038-4(e)(2).

U.S. MNEs will, therefore, be faced with a more burdensome task of populating the CbC report than the regulations imply, and thus be disadvantaged compared to non-U.S. based MNEs with a later filing deadline.

TEI recommends a filing deadline consistent with the OECD standard – one year after the end of the relevant taxable year – even if it necessitates a separate filing with the IRS. This would preserve the flexibility provided to taxpayers by the regulations when choosing the data to populate the CbC report.

Reporting the Number of Full-Time Equivalent Employees

The preamble to the proposed CbC regulations states the "number of full-time equivalent employees in a tax jurisdiction of residence should be determined by reference to the employees that perform their activities for the U.S. MNE group within such tax jurisdiction of residence."[7] This is in contrast to the final OECD report, which provides a MNE report employees of "all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction."[8] The Proposed Regulations, in other words, appear to require (according to the preamble) reporting employees in a tax jurisdiction based on where individual employees perform their duties, whereas the OECD recommendation requires employee reporting based on the tax residence of the constituent entity employer. The added physical/geographic condition in the preamble to the Proposed Regulations would materially increase the reporting burden for multinationals if this approach is required in the final CbC regulations (as opposed to being optional). Moreover, the additional U.S. requirement would lead to unwarranted permanent establishment assertions by local countries where MNEs have employees "in country" but whose activities do not rise to the level of a

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7 Prop. Treas. Reg. § 1.6038-4 (Preamble).

8 BEPS Action 13 Final Report at 34.

permanent establishment. Thus, a different U.S. standard for employee reporting will only increase potential assessments and presumptions by tax authorities based upon inconsistent reporting of employees in a jurisdiction by U.S. MNEs as compared to MNEs in other jurisdictions. This inconsistency will be highlighted around the world, leading to more complexity for a U.S. MNEs as compared to their foreign competitors.

TEI recommends the final CbC regulations be consistent with the OECD standard set forth in the final BEPS Action 13 report for purposes of determining the location of an employee. The regulations should permit taxpayers to report their employees based on the tax residence of their employer. Alternatively, TEI recommends the regulations provide taxpayers with the flexibility to report the location of their employees and taxpayers could then disclose, via the "additional information" box, the manner in which employee location is determined (*e.g.,* by tax residence of the employer, where the employee's duties are performed, or some other method).

Separately, the preamble and text of the Proposed Regulations provide great flexibility for determining where mobile employees should be reported as performing their duties and permitting independent contractors to be reported as employees. However, it is unclear whether the same flexibility extends to what constitutes a "full time equivalent" employee in the first instance. That is, what is meant by reporting "the number of employees on a full-time equivalent basis?"[9] Whether an employee is considered "full-time" varies among industries and companies. Some companies do not consider an employee "full-time" unless they work an average of 40 hours per week, whereas other companies consider an employee working as little as 20 hours per week full-time. An employer's internal systems and method of tracking employees as full or part-time are of course tailored to the employer's particular approach. Requiring taxpayers to report employees

[9] Prop. Reg. § 1.6038-4(d)(3)(iii).

as "full time" only if they work 40 or more hours per week would impose an additional compliance burden on employers who accord employees "full time" status for working less than 40 hours per week.

TEI recommends the final CbC regulations permit a taxpayer to report an employee as a "full time equivalent" based on the taxpayer's usual practice so as long as the company does so consistently from year-to-year and across entities and the method does not "materially distort the relative distribution of employees across the various tax jurisdictions."[10]

Sharing the CbC Report with U.S. States

Information reported under the Proposed Regulations constitutes confidential tax return information under section 6103 and, as such, will be exchanged with a competent authority of another tax jurisdiction only to the extent provided in, and subject to the terms and conditions of, an information exchange agreement. Section 6103(d) authorizes the Service to disclose federal tax information to state and local tax authorities, but only to the extent necessary for such jurisdictions to administer their tax laws. CbC reports are not relevant to state and local tax administration in TEI's view. Moreover, the wider CbC information is shared the greater the chances of improper disclosure. TEI recommends CbC reports not be included in information shared by the Service with state and local jurisdictions in the United States and the Service include a statement to that effect in public guidance.

Ending the Transmission of the CbC Report to Other Countries

The Proposed Regulations provide if another jurisdiction does not satisfy the confidentiality and data protection requirements under its agreement with the United States to

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[10] *See id*.

automatically exchange CbC information then the Service will "pause" such information sharing.[11] Information exchange will not resume, under the Proposed Regulations, "until such time as the United States is satisfied the tax jurisdiction is meeting its obligations under the applicable" agreement.[12]

TEI applauds this statement in the preamble as data security is a key concern of taxpayers with respect to the exchange of CbC reports between countries and suspending automatic exchange of such information is an appropriate measure to ensure compliance. TEI recommends the Service publicly announce such a suspension so U.S. MNEs are aware the data is no longer being shared with a country in which the multinational has operations should such a measure become necessary. The country in question in such cases may ask the MNE (or one of its local subsidiaries) directly for the CbC report and it would be helpful if the taxpayer knew in advance the information was no longer being shared by the Service. This would allow the taxpayer to take appropriate protective measures against potential penalties and other sanctions the jurisdiction might apply. More broadly, once the Service begins automatic exchange of CbC reports (whether in 2017 or later), TEI recommends the Service publish a list of countries with which it is exchanging the reports, whether on the Service's website or elsewhere. This would enable taxpayers to properly anticipate and react to direct requests for the CbC report in those and other jurisdictions.

Differing Definition of Tax Expense

The Proposed Regulations define accrued taxes as accrued tax expense recorded on taxable profits or losses, reflecting only operations in the relevant annual accounting period and excluding deferred taxes or provisions for uncertain tax liabilities. The BEPS guidance under Action 13

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11 Prop. Treas. Reg. § 1.6038-4 (preamble).

12 *Id.*

defines accrued taxes as accrued current tax expense recorded on taxable profits or losses of the year of reporting.[13] In general, for accounting purposes "current tax expense" should reflect only operations in the current year and should not include deferred taxes or provisions for tax liabilities, but the Proposed Regulations do not use this term. We recommend the final CbC regulations use the same term and definition of accrued taxes as used in the BEPS guidance to avoid confusion.

Conclusion

Tax Executives Institute appreciates this opportunity to present its views on the Proposed Regulations. Please contact Mark Pollard, chair of TEI's U.S. International Tax Committee, at (920) 721-4325 or Mark.Pollard@kcc.com or Ben Shreck, TEI Tax Counsel, at (202) 464-8353 or bshreck@tei.org if you have any questions about these comments.

Respectfully submitted,

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[13] BEPS Action 13 Final Report at 34.