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Country-by-Country Reporting: Form 8975 not required for most groups with foreign parents

As part of its objective to prevent multinational enterprises ("MNEs") from shifting profits to low-tax jurisdictions through transfer pricing (the Base Erosion and Profit Shifting initiative, or "BEPS) project, the Organization for Economic Development ("OECD") issued recommendations in 2015 regarding country-by-country ("CbC") reporting requirements. These requirements gained wide support from governments around the world; many countries have already implemented changes to their internal laws to align with those recommendations and most others are expected to do so.

In June of 2016, the Internal Revenue Service issued CbC reporting regulations that generally require certain U.S. persons that are the ultimate parent of a United States multinational enterprise (U.S. MNE) with annual revenue for the preceding reporting period of $850 million or more to file a report on Form 8975 (CbCR). The rules are first effective for tax years of the ultimate parent beginning on or after June 30, 2016. Regulation 1.6038-4(b) provides the following definition of the ultimate parent of a U.S. MNE group:

(1) ***Ultimate parent entity of a U.S. MNE group.*** An ultimate parent entity of a U.S. MNE group is a U.S. business entity that:

> **(i)** Owns directly or indirectly a sufficient interest in one or more other business entities, at least one of which is organized or tax resident in a tax jurisdiction other than the United States, such that the U.S. business entity is required to consolidate the accounts of the other business entities with its own accounts under U.S. generally accepted accounting principle, or would be so required if equity interests in the U.S. business entity were publicly traded on a U.S. securities exchange; and
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> **(ii)** Is not owned directly or indirectly by another business entity that consolidates the accounts of such U.S. business entity with its own accounts under generally accepted accounting principles in the other business entity's tax jurisdiction of residence, or would be so required if equity interests in the other business entity were traded on a public securities exchange in its tax jurisdiction of residence.

In a simple example, assume a U.S. parent corporation with U.S. subsidiaries and a Mexican subsidiary is also owned by a UK ultimate parent company. Although it is clear that a U.S. parent company with foreign subsidiaries (as under the first part of the definition above) would generally be required to file a CbCR as the "ultimate" parent of a U.S. MNE, what is less clear is how the rules work if the U.S. sub-group is owned by a foreign parent. Does the foreign parent have to file a CbCR with the IRS, or does the U.S. entity have to file on behalf of the group? Confusion has arisen over how the second prong of the two-part test should be interpreted. That section seems to exclude a foreign-owned business entity that consolidates the accounts of a subsidiary U.S. business entity with its own "under generally accepted

accounting principles in the other business entity's tax jurisdiction." But what if the foreign parent uses IFRS in its reporting? Does that mean the U.S. entity would then be required to file as the "ultimate" parent entity of a U.S. MNE group?

Although the wording in the regulation section cited above is not entirely clear, the preamble to the regulations provides a bit of clarity on the intent of the regulations and the scope to be applied: "The proposed regulations generally require a U.S. business entity that is an ultimate parent entity of a U.S. MNE group to file a CbCR with respect to business entities that are or would be consolidated with the ultimate parent entity. A CbCR is not required for an MNE group that does not have a U.S. business entity as its ultimate parent entity."

Upon further investigation, it appears the IRS was not intending for U.S. MNEs with a foreign parent to have to file Form 8975. Whether it is a UK or German entity using IFRS or a Canadian parent using Canadian GAAP to consolidate its accounts, the U.S. entity would not need to file. Instead, the foreign parent would be considered the ultimate parent of a foreign MNE and would be subject to that country's CbC rules, and the threshold for filing would be that country's specific requirement (for European countries this would most likely be €750,000 rather than the U.S. threshold of $850,000).

One exception to this would be where the foreign parent is not subject to CbC reporting because it is located in a tax haven (Cayman Islands, for example). There is also a limited exception where the U.S. MNE is owned by a U.S. territory ultimate parent, in which case the parent can designate the U.S. entity to file on its behalf. In general, however, most U.S entities with foreign parent companies should not need to file the new Form 8975. It would be appropriate, however, for a U.S. entity to confirm with that parent company if they are in compliance with their local country CbC reporting rules and those reports appropriately include the activity of the U.S. group.

Please contact your Elliott Davis Decosimo tax advisor if you would like additional information on the CbC reporting requirements or have any related questions.