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International Tax Newsletter

Transfer Pricing
Update Q2 2017



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COUNTRY-BY-COUNTRY REPORTING AND OTHER TRANSFER PRICING UPDATES

The Kreston International Tax (KIT) group comprises international tax specialists from throughout the Kreston network seeking to collaborate and offer Kreston International affiliates' clients global expertise related to their increasingly complex international tax needs. Within the KIT group, we have specialists who focus on the international taxation niche of transfer pricing. With the tremendous changes occurring in the transfer pricing environment globally, the KIT group will be publishing quarterly updates on priority events of interest effecting transfer pricing regulations around the world. The following is the first quarterly article covering the globally relevant topic of the Multilateral Instrument, country by country reporting topics affecting multinationals with operations in the United States or Brazil, and a globally significant tax case involving Amazon and the transfer of intangible assets.

Strong momentum carried through the second quarter of 2017 on the Organisation for Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting Project (BEPS). The aim of BEPS is to help local countries capture profits from multinational organizations that aggressively attempt to move profits to lower tax jurisdictions. The U.S. finalized its country-by-country reporting form, and more than 60 countries recently signed the OECD's multilateral instrument to enable quick implementation of various actions in the BEPS project. In other transfer pricing news, a recent decision from the U.S. Tax Court holds implications for arm's-length pricing strategies related to the transfer of intangible assets.

IRS Finalizes Country-by-Country Reporting Form

The IRS finalized forms used to report certain information for U.S. parent entities conducting a multinational enterprise (MNE) through at least one other business entity that is a tax resident of a foreign jurisdiction. This information includes a list of the MNE's subsidiaries (constituent entities), their filing jurisdictions, and main business activities.

Form 8975, Country-by-Country Report, must be filed by MNEs with annual revenue for the preceding reporting period of more than \$850 million. The first day of the first

tax year that begins on or after June 30, 2016 is used to determine the initial Form 8975 reporting period. For calendar-year tax years, this first day would be Jan. 1, 2017. The initial Form 8975 reporting period is generally the 12-month financial statement period that begins on or after this first day. In the previous example, the initial reporting period would begin on this same day if a calendar year is also used for preparing financial statements, whereas the first fiscal year beginning after Jan. 1, 2017 would otherwise be the initial reporting year. Reporting periods that end with or within a tax year are included with that tax year's filing. In the previous example, an initial reporting period that begins on Jan. 1 2017 would be included with the 2017 calendar-year tax filing, whereas initial reporting periods beginning after Jan. 1, 2017 would be included with the 2018 calendar-year tax filing.

Country-by-Country (CbC) reporting helps identify high risk transfer pricing and other base erosion and profit shifting risks. It is among the action items recommended for participants in the BEPS project. In April 2017, the OECD released guidance for implementing CbC reporting in the 2016 fiscal year.

Links to the IRS forms and OECD guidance are below:

- [Instructions for the Form 8975](#)
- [2016 Form 8975](#)



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- Schedule A, Form 8975
- OECD Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13

OECD Multilateral Tax Treaty Signed

On June 7, 2017, **67 countries** signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The MLI comes as part of the BEPS project, and outlines standards that countries may choose to adopt to reduce profit shifting. Notably, the U.S. did not sign the MLI, but it has already implemented many of the BEPS minimum standards and recommended treaty action items included in the MLI.

Countries that signed the MLI will begin the process of ratifying changes to meet the MLI recommendations. Ratification of these changes is expected to be piecemeal, with some countries making adjustments for 2018 and others adjusting treaties for 2019 or 2020.

Brazil Issues CbC Clarifications

Brazil's CbC reporting guidance requires Brazilian constituent entities of non-Brazilian MNEs to include CbC reports as part of their 2016 income tax filing, if the MNE does not have a competent authority agreement between the jurisdiction of its headquarters and Brazil by July 31, 2017. The competent authority agreement allows for the automatic exchange of CbC reports between the two countries.

This timing had been a concern for some Brazilian affiliates facing uncertainty about whether an agreement between the U.S. and Brazil would be finalized before the July 31 deadline. On May 23, the **Brazilian Federal Revenue Office** updated its CbC guidance to extend the competent authority agreement window.

The updated guidance exempts Brazilian constituent entities from a CbC filing requirement in Brazil, as long as the

competent authority agreement is in place by Dec. 31, 2017. If the competent authority agreement is not in place by that date, the Brazilian constituent entity will have 60 days to amend its 2016 income tax filing and submit the 2016 CbC report. Brazilian constituent entities may also designate a constituent entity of its MNE in another jurisdiction as a "surrogate entity" to the Brazilian constituent entity, where such other constituent entity has a competent authority agreement in place with Brazil. The Brazilian constituent entity would indicate in its 2016 income tax filing whether the surrogate entity is filing the CbC report.

Brazilian constituent entities with MNEs having fiscal years that do not coincide with a calendar year were also provided clarification guidance on compliance procedures.

Amazon.Com Case Carries Implications for Transfer Pricing

In May 2017, the U.S. Tax Court decided a case that could affect transfer pricing calculations for intangible assets transferred between related parties. **Amazon.com, Inc. v. Commissioner** involved an arrangement between the online retailer and a Luxembourg subsidiary. The subsidiary agreed to operate the European website and fulfillment centers and related businesses, which required Amazon.com to transfer trademarks, domain names and customer lists and information to the subsidiary.

Amazon.com calculated the up-front buy-in payment to receive the intangible assets using the comparable uncontrolled transaction methodology (CUT method). It determined the buy-in price would be \$254.5 million. The subsidiary would also make annual cost-sharing payments to Amazon.com, which Amazon.com calculated using a multistep allocation system.

The IRS took issue with the buy-in price and claimed Amazon.com's transaction did not meet an arm's-length standard under Section 482. The IRS countered with a

discounted cash-flow methodology and determined the buy-in payment should have been nearly \$3.5 billion, in part because it claimed the intangible assets had an indeterminate useful life and should be valued as integrated components of the same operating business.

The Tax Court sided with Amazon.com and ruled that the CUT method was the most reasonable for determining arm's-length buy-in prices for the transaction involved.

Time has yet to expire on the Government's decision whether to appeal the ruling. The case would go to the U.S. Court of Appeals for the Ninth Circuit if the Internal Revenue Service decides to appeal. The Ninth Circuit previously ruled for the taxpayer in **Xilinx Inc. v. Commissioner**, while **Altera Corp. v. Commissioner** is still pending there. The Tax Court ruled against the IRS in both of those cases, which, like Amazon's, involved cost-sharing arrangements with foreign affiliates.

For More Information

We will keep you informed of these and other developments related to transfer pricing. For specific comments, questions or concerns, please **contact us**.

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Related Reading

- **Framework Established for Multinational Tax Platform**
- **Rolling Out Section 385**
- **Multinational Enterprises Need to Reevaluate Transfer Pricing Documentation**