BEPS Update: U.S. Voluntary Filing Unlikely to Offer Viable Alternative to Local CbC Filing

A technical analysis from Thomson Reuters

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The Organisation for Economic Cooperation and Development's (OECD's) complex BEPS initiative was a concept long before it was a concrete policy prescription. Now, it's a reality, and one common opinion of its current state is that the OECD is fast-tracking implementation.

This may or may not be the right way to characterize the current state of BEPS, but it's safe to say that the OECD does want progress to continue. It has good reasons for this objective.

The OECD sees the opportunity to oversee the reshuffle of the global tax scene before the momentum created by the financial and economic crisis – and highly publicized tax structuring cases – ebbs away. The deck has at times been stacked, and the OECD seeks to correct some of the market's structural flaws.

One natural consequence of this, however, is gaps and mismatches in implementation. Country-by-Country (CbC) reporting under Action 13 of the BEPS deliverables is a powerful case of this. The reality is that voluntary filing in the United States is not likely to offer multinational enterprises (MNEs) a viable alternative to the local CbC filing requirements.

Instead, U.S. MNEs will have to make a hard choice between voluntary filing and local filing, in many cases before the end of 2016.

Voluntary filing is a temporary solution to the gap issue U.S. MNEs will face because of the mismatch in timing between the U.S. and other countries. It is probably not, however, a viable alternative to local filing. This will come as a surprise to those who have a casual familiarity with BEPS but do not know the exact consequences of the regulation or its technical specifications.

This analysis explains why.

THE OBJECTIVE OF CbC REPORTING

The purpose of CbC reporting is quite straightforward: to align revenue allocation within MNEs with value creation. CbC reporting gives governments a high-level view of how MNEs go about respecting this premise in their dealings. The result is an obligation for countries to require CbC filing by their own MNEs, and subsequently to exchange these reports with those other countries in which the relevant MNE is active. By analyzing the CbC reports received from foreign MNEs through the exchange mechanism thus introduced, and, as importantly, those filed by their own MNEs, governments would be able to flag transfer pricing and other profit-shifting and base erosion risks, and, where warranted, subject those to further scrutiny or audit. The entire scheme is to start for fiscal years commencing on or after 1 January 2016.

Two prerequisites will allow this architecture to work globally:

1. Coherent legal provisions across the domestic laws of the many countries involved regarding such matters as perimeter, coverage, identity of filer, type and source of information, and timing and deadlines; and
2. A workable mechanism for the exchange of the reports between the countries involved.

U.S. multinational enterprises will have to make a hard choice between voluntary filing and local filing, in many cases before the end of 2016.

The OECD did substantial work on both prerequisites. With respect to the first, it proposed standard legislation, complete with model templates, that countries can adopt to limit the risk of mismatches. With respect to the second, it designed a primary exchange mechanism supplemented by a secondary fallback position, developed three sets of model Competent Authority Agreements (CAAs) to set out the practical modalities of the exchange, released an XML Schema to facilitate the exchange, and even floated the thought of itself acting in the future as a central repository and dispatcher of incoming and outgoing CbC reports.

Regardless, the exercise was bound to produce gaps and mismatches, and it did just that.

The gaps and mismatches resulting from either lack of clarity in the OECD proposals or their divergent implementation by the various countries introduced confusion. The subsequent adoption of an EU-wide CbC reporting regime, in some cases parallel to existing national CbC reporting regimes, added to it. Those gaps and mismatches relate to the timing of enforcement and the nature of the enforcement mechanism.

TIMING MISMATCHES

The following timing and deadlines are relevant to CbC reporting:

1. Filing of CbC report by the MNE.
2. Lodging of required notifications with the home country and/or the country of the Constituent Entity or of the surrogate parent.
3. Exchange of the CbC report between the relevant governments.

Filing of CbC report

Pursuant to the OECD guidance, CbC reporting is to become effective for FYs starting on or after 1 January 2016, and the deadline for filing CbC reports is the end of the 12-month period following the end of the relevant FY. Therefore, where the MNE's FY follows the calendar year, the first CbC report should be filed with the relevant national tax administration by 31 December 2017. If the FY starts after 1 January 2016, the first report should be filed by the end of the 12-month period following the close of the FY. Hence, for an MNE whose FY starts on 1 July 2016, the first report should be filed by 30 June 2018, being by the end of the 12-month period following the end of the FY.

This straightforward approach to the reference FY, which in turn determines the filing deadline, can be impacted by two factors.

First, the reference FY may be modified by a CAA. Indeed, where the CbC exchange is effected under a multilateral or bilateral CAA, the reference FY, and by extension the filing deadline, is the one indicated by the acceding country in its notification of access to the multilateral CAA, or the one agreed to between the two contracting countries in a bilateral CAA. This reference FY may or may not coincide with the reference FY foreseen in the OECD guidance.

Second, there are filing delay options foreseen by some national legislations as well as by the EU-wide CbC Directive. Indeed, in order to avail MNEs with a practical solution in view of the expected implementation delays, a (very limited) number of countries introduced a one-year delay option for MNEs headquartered in countries that did not introduce CbC reporting from 1 January 2016. Also, the EU-wide CbC reporting obligation introduced under the EU Directive on Administrative Cooperation on Tax Matters allows the Member States to implement a one-year delay option for third-country ultimate parents, should they so wish.

Regardless of the potential divergences from the reference FY, it is most likely safer for MNEs to assume that they have a filing obligation with respect to FY commencing on or after 1 January 2016.

Notification requirements

In addition to the requirement to file CbC reports, MNEs are also required to lodge notifications with their tax authorities and/or the tax authorities of the countries where they have a Constituent Entity or a surrogate parent. These notification requirements are separate from the CbC filing requirement itself and follow a separate deadline. In most cases, the notifications are due by the last day of the relevant MNE's reporting FY.

Thus, assuming the standard requirement for reporting to start with FYs commencing on or after 1 January 2016, and assuming an FY corresponding to the calendar year, these notifications are due by 31 December 2016. Even in cases where an MNE may avail itself of a one-year delay option, the option is most often restricted to the filing of the CbC report itself, and it does not extend to the filing of the required notifications.

Exchange of CbC reports

CbC reports will be exchanged between countries no later than 18 months following the end of the MNE's reporting FY. Therefore, assuming a reporting obligation for FYs starting on or after 1 January 2016 and an MNE's FY corresponding to the calendar year, the MNE will have to file the CbC report with its own government by 31 December 2017, and that government needs to exchange the report with other countries where the MNE is active by 30 June 2018 at the latest.

For subsequent years, the exchange must occur within 15 months from the end of the FY. Note that the EU-wide CbC reporting obligations foresee an identical 15-month exchange deadline for both the initial FY and subsequent FYs.

CbC EXCHANGE MECHANISM

Under the OECD guidance as transposed by most countries requiring the filing of CbC reports, there is a primary exchange mechanism and a secondary fallback exchange mechanism.

There is, furthermore, a third mechanism provided for under the EU-wide CbC reporting.

Standard primary mechanism

Under the primary exchange mechanism, the ultimate parent company of the relevant MNE files a CbC report with its own tax administration, whereupon this tax administration automatically exchanges the report with the countries in which the MNE has a Constituent Entity. The proper working of this primary exchange mechanism presupposes the satisfaction of three conditions:

1. The country of residence of the parent company must have a requirement in place for its parent companies to prepare and file qualifying CbC reports for the FYs concerned.
2. The country of the ultimate parent and the country of the Constituent Entity have concluded a CAA setting out the practical modalities of the exchange.
3. No systemic failure was notified by the country of the ultimate parent to the country of the Constituent Entity.

The conclusion of a qualifying CAA, which is the second condition above, presupposes in turn the satisfaction of a number of conditions, the most prominent of which is the existence of a qualifying international agreement to which both countries are party. Two countries cannot conclude a CAA and proceed with the exchange of CbC reports unless there is already between them an effective international agreement authorizing this exchange.

The reason for this is that the CAA is merely a means to work out the practical modalities of something – in this case, the automatic exchange of tax information – which is already authorized by a pre-existing international agreement. The CAA, in and by itself, is, therefore, a mere complement to the pre-existing international agreement; it does not substitute the agreement and does not authorize anything that was not authorized by the agreement in the first place.

There are three types of international agreements that qualify for the purposes of concluding CAAs dealing with the exchange of CbC reports:

1. The OECD-Council of Europe Mutual Assistance Convention.
2. A qualifying tax treaty.
3. A qualifying Tax Information Exchange Agreement (TIEA).

Knowing whether the agreement provides for the automatic exchange of tax information is the most important element in determining whether an international agreement is a qualifying agreement for the purposes of concluding a CAA. An agreement will so qualify if it specifically and expressly authorizes this automatic exchange. An agreement also so qualifies when it does not limit the exchange to specific forms only, such as exchange on request. In such a case, the fact that the exchange is not limited to a specific form only must be interpreted to mean that all forms of exchange, including automatic exchange, are authorized by the agreement.

In contrast, an agreement does not so qualify if it does not authorize the automatic exchange of tax information, either expressly or tacitly.

Mutual Assistance Convention

The Mutual Assistance Convention is, ipso facto, a qualifying international agreement for the purposes of concluding a CAA, albeit a multilateral CAA only. This is because the Convention authorizes the automatic exchange of tax information in its Art. 6 (and also the spontaneous exchange of tax information in its Art. 7).

The Mutual Assistance Convention will be the main instrument for the conclusion of CbC exchange CAAs since most of its signatories will also commit to the multilateral CbC exchange CAA which is based on the Convention. Note, however, that accession by one country to the Convention and the related multilateral CAA does not necessarily mean that that country will be able to exchange CbC reports with all of the remaining signatories.

Under the OECD guidance as transposed by most countries requiring the filing of CbC reports, there is a primary exchange mechanism and a secondary fallback exchange mechanism. There is, furthermore, a third mechanism provided for under the EU-wide CbC reporting.

There are two reasons for this. First, when signing the multilateral CbC CAA, countries must indicate either a commitment to exchange with all other signatories without restriction, or a commitment to exchange with a limited nominative list of signatories only. This means that two countries can be signatories to the multilateral CAA and yet may not be able to exchange CbC reports because of the selective commitment option. Second, a country acceding the Convention and related multilateral CAA can choose to qualify itself as a non-reciprocal jurisdiction. In that case, the country is still required to exchange CbC reports of its own MNEs with other relevant countries, but is not entitled to receive CbC reports filed by foreign MNEs with their respective governments.

Tax information exchange agreements

These agreements often follow a model agreement released by the OECD in 2002 which provides only for two types of tax information exchange: exchange on request and tax examinations abroad. That model does not provide for the automatic exchange of tax information.

Therefore, TIEAs based on the 2002 model do not qualify as a valid basis for the conclusion of CAAs for the exchange of CbC reports.

However, in June 2015, the OECD released a model protocol that countries can use to upgrade their existing TIEAs and make them suitable for the conclusion of CAAs for the exchange of either CbC reports or financial account information. TIEAs that are thus upgraded or that otherwise expressly or tacitly authorize the automatic exchange of tax information are qualifying international agreements for the purposes of concluding CbC exchange CAAs.

Tax treaties

The exchange of tax information is embodied in Art. 26 of the OECD Model Tax Convention. Although many aspects of the article address issues that can only arise in the context of exchange on request, the article itself does not specify a particular form of exchange. The absence of a limitative list of permissible forms of exchange must be interpreted to mean that the article authorizes all forms of exchange, including automatic exchange.

There are, however, two caveats here. First, the form of exchange must be worked out by the Competent Authorities of the Contracting Parties. Second, each treaty must be examined on its own merits, as individual bilateral treaties may specify a particular form of exchange, and thus potentially become unsuitable for the conclusion of CbC exchange CAAs.

Whether individual U.S. tax treaties authorize the automatic exchange of tax information must be examined on a case-by-case basis. In general, the U.S. Model Tax Treaty, in both its 2006 and 2016 versions, does appear to authorize automatic exchange. This is because it does not restrict the exchange of information to specific forms of exchange only, meaning that, in principle, all forms of exchange are possible. The technical explanations to the model, which indicate that various forms of exchange, including routine exchange, are possible, support this position. While the language used in the U.S. ("routine") is different from the language used by OECD ("automatic"), we submit that they convey the same meaning.

Secondary mechanism

The secondary mechanism kicks in when the conditions for the primary exchange mechanism are not met and that mechanism becomes inoperable. Under the secondary mechanism, the filing obligation is shifted to either a local entity or to a non-resident (third-country) surrogate parent. Also here, notification requirements kick in, including by the surrogate parent to its own tax authorities and by the Constituent Entities to their respective tax authorities.

POSITION OF U.S. MNEs REGARDING TIMING MISMATCHES

Three aspects of CbC filing put U.S. MNEs in a questionable position regarding compliance.

1. The U.S. chose to introduce CbC filing for FYs starting on or after 30 June 2016, thus creating a gap wherever the country of the Constituent Entity requires CbC filing for FYs starting on or after 1 January 2016.
2. Furthermore, the U.S. chose not to commit to a multilateral CAA, preferring to engage in the conclusion of bilateral CAAs. While this is most probably justifiable in view of taxpayer confidentiality concerns, it does restrict the opportunities for the U.S. to conclude the requisite CAAs, whether because of the lack of qualifying international agreements with a number of countries or simply because of time constraints.
3. Finally, the U.S. (probably justifiably so) chose to introduce CbC reporting through a code section applicable only to U.S. ultimate parent companies. The immediate consequence of this choice is that, unlike other countries, the U.S. cannot require local filing by the U.S. entities of foreign MNEs. This in turn may weaken the bargaining position of the U.S. in the context of negotiating CAAs. Indeed, there is little incentive for a foreign country to agree to a CAA with the U.S. when it knows it can require local affiliates of U.S. companies to file locally while the U.S. is precluded from requiring the same from the U.S. affiliates of its MNEs.

Whether individual U.S. tax treaties authorize the automatic exchange of tax information must be examined on a case-by-case basis. In general, the U.S. Model Tax Treaty, in both its 2006 and 2016 versions, does appear to authorize automatic exchange.

In the current state of affairs, where a gap arises and unless a filing delay option is available, foreign affiliates of U.S. MNEs may be required to file locally or the U.S. MNE may choose to appoint a qualifying third-country surrogate parent to file on behalf of the group.

TIMING MISMATCHES: THE RATIONALE FOR VOLUNTARY FILING

With U.S. MNEs at risk of being required to file locally or to appoint a surrogate reporting parent, the U.S., in close coordination with the OECD, devised the possibility for voluntary filing as a potential solution to the gap issue. The idea is that U.S. MNEs would file CbC reports voluntarily with the IRS even though they are not yet under a legal obligation to do so. The IRS would then exchange the reports with the countries where the MNE has Constituent Entities, thus releasing the MNE from the obligation to either file locally or appoint a surrogate parent.

The OECD acknowledged earlier the possibility that timing mismatches may occur since the legislative processes in the different countries do not necessarily take the same time lapse, but initially failed to lend any specific consequences to this acknowledgement. In fact, the final BEPS guidance clearly states that where the country of residence does not require CbC filing from the ultimate parent company for the FY concerned, which is the case of the U.S. during the gap period, then compliance with the reporting obligation may be required through local filing or be shifted to the next parent in line.

On 29 June 2016, however, only a few hours before the U.S. Treasury announced the voluntary filing option, the OECD released a guidance endorsing, for all purposes, voluntary filing as a solution to the gap issue. The guidance was updated on 16 August 2016.

Voluntary filing according to OECD

The OECD August 2016 guidance acknowledges the issues arising from the transition period, as it already did in the final BEPS report, but this time devises a new mechanism called "parent surrogate filing" to address them. Under this mechanism, which, according to the OECD, has been or is to be adopted by Japan, Russia, Switzerland, and the U.S., the country of residence may grant its ultimate parent companies the option to file a qualifying CbC report voluntarily, whereupon that country of residence exchanges the CbC report with other countries where the MNE has Constituent Entities. This voluntary filing would then satisfy the filing requirement in the country of the Constituent Entity and, as a result, release the MNE from the obligation to file locally.

The OECD calls this mechanism "parent surrogate filing" because, in its view, it is in fact "a form of surrogate filing." In other words, the OECD takes the position that voluntary filing is not a third alternative added expeditiously to the two existing alternatives available under the secondary filing mechanism, but a mere variation on one of those two existing alternatives.

In order for countries to adopt regulations granting the option of "parent surrogate filing" to their resident ultimate parent companies, the guidance prescribes that the five following conditions must be met:

1. The Ultimate Parent Entity has made available a CbC report conforming to the requirements of the Action 13 Report to the tax authority of its jurisdiction of tax residence by the filing deadline; and
2. By the first filing deadline of the CbC report, the jurisdiction of tax residence of the Ultimate Parent Entity must have its laws in place to require CbC reporting, even if filing of a CbC report for the Reporting FY in question is not required under those laws; and
3. By the first filing deadline of the CbC report, a qualifying CAA must be in effect between the jurisdiction of tax residence of the Ultimate Parent Entity and the Local Jurisdiction; and
4. The jurisdiction of tax residence of the Ultimate Parent Entity has not notified the Local Jurisdiction's tax administration of a Systemic Failure; and
5. The following two notifications have been provided to the extent required under domestic law:
   - the jurisdiction of tax residence of the Ultimate Parent Entity has been notified by the Ultimate Parent Entity, no later than the last day of the Reporting FY of such MNE Group; and
   - the Local Jurisdiction's tax administration has been notified by a Constituent Entity of the MNE Group that is resident for tax purposes in the Local Jurisdiction that it is not the Ultimate Parent Entity nor the Surrogate Parent Entity, stating the identity and tax residence of the Reporting Entity, no later than the last day of the Reporting FY of such MNE Group.

Binding nature of voluntary filing on Country of Constituent Entity

The voluntary filing option adopted in the OECD's August 2016 guidance does not directly state that the option, once exercised by the country of the ultimate parent, is binding on the country of the Constituent Entity. In fact, the conditions for exercising the option are addressed solely at the country of the ultimate parent and do not involve the country of the Constituent Entity.

In other words, the country of the ultimate parent must meet the conditions listed in order to be able to grant the option to its own ultimate parent companies.

Nevertheless, the guidance states that the exercise of the option then releases the MNE from the obligation to file locally. This suggests that the option, once exercised by the country of the ultimate parent, must be accepted by and is binding on the countries of the Constituent Entities. The guidance does not attempt to justify this other than by stating that "parent surrogate filing" is a "form of surrogate filing" and, moreover, makes it possible to respect the timing and deadlines of the country of the Constituent Entity.

Two questions then arise. Is the option merely a form of surrogate filing? Does its adoption by the country of the ultimate parent bind the country of the Constituent Entity?

Is "Parent Surrogate Filing" a form of surrogate filing?

No, not by any stretch of the imagination. Accepting this posture would mean ignoring the reason why primary filing was not possible in the first place.

As mentioned above, there are two options under the secondary CbC filing mechanism: local filing or shifting the filing obligation to a qualifying surrogate parent. This secondary mechanism kicks in when the primary mechanism is disqualified. A qualifying surrogate parent is the next parent in line, to the extent that entity, unlike the ultimate parent, is a qualifying entity. While not expressly spelled out, that surrogate parent would in all likelihood have to be a group entity resident in a third country, and not another group entity resident in the same country as the ultimate parent. In fact, if qualifying filing and qualifying exchange were not possible with the ultimate parent, then there is little reason to expect that they would be possible with a another group entity from the same country.

It is hard to argue the case that an ultimate parent that is disqualified for the primary mechanism suddenly becomes a qualified surrogate parent for the secondary mechanism. Indeed, if the entity meets the conditions to qualify as a reporting surrogate parent, then it must have met these same conditions to qualify as the reporting ultimate parent, and there would have been no need to move to the secondary mechanism at all.

Clearly, the voluntary filing option is not a mere form of surrogate filing as advocated by the OECD. Instead, it is a third option added to the two already existing options under the secondary mechanism. By discounting this new third option as a mere form of surrogate filing, the OECD did what it does best: When confronted with the limitations of a text or guidance, or even its plain incompatibility with a new-found wisdom, it does not change the fundamentals. Instead, it issues a clarification to reinterpret the fundamentals under a new light.

In this regard, it is interesting to note that OECD issued the August 2016 guidance to reinterpret the fundamentals, but somehow neglected to make the necessary corresponding changes in the CbC exchange XML Schema it produces. As per the guidance contained in the Final BEPS Report, the XML Schema still has only three entries for the reporting entity roles: ultimate parent, surrogate parent, and local filing. There is no entry for the new role of "parent surrogate filing," and it is clear that this role does not belong under any of the available categories. Therefore, even if an ultimate parent entity opts for this role, it will be at odds to fit it in the Schema.

Is "Parent Surrogate Filing" binding on the country of the Constituent Entity?

Most countries that have transposed the original OECD guidance prescribe a secondary mechanism consisting of either local filing or shifting to a qualifying third-country surrogate parent. Also, the EU-wide CbC reporting rules foresee local filing or shifting to a qualifying third-country surrogate parent. In order to deal with the transition issue, some countries provide for a filing delay, as do the EU-wide CbC reporting rules.

Whether "parent surrogate filing" is binding on the countries of Constituent Entities and effectively releases U.S. MNEs from the obligation to file locally or to appoint a qualifying third-country surrogate parent is, ultimately, a matter for the internal laws of each country to determine. While the position of the OECD is presumed to reflect that of its member countries, we are not aware at this stage of any country that has explicitly announced that it will no longer require local filing to the extent that the ultimate parent engages in voluntary filing with its own government.

The voluntary filing option adopted in the OECD's August 2016 guidance does not directly state that the option, once exercised by the country of the ultimate parent, is binding on the country of the Constituent Entity.

Ultimately, the final position – particularly in countries which have already devised secondary filing rules not referring to any "parent surrogate filing" option – will depend on whether the relevant country sees this option as a mere form of surrogate filing, or rather as a third standalone option under the secondary mechanism. In this regard, a complication could occur if the relevant country is an EU country and is simply transposing the EU-wide rules in its internal legal system. In that case, it is not clear whether a Member State can extend on its own the interpretation of the secondary mechanism rules contained in the EU Directive.

LIKELY OUTCOME FOR MNEs

One way to gauge the likely outcome for U.S. MNEs is to perform an exercise involving the conditions set forth in the OECD's August 2016 guidance. Doing this presumes that one accepts the questionable premise that the country of the Constituent Entity has no other choice but to accept voluntary filing from the moment this is accorded by the country of residence to the ultimate parent companies.

The exercise is based on a U.S. MNE active in 30 different foreign jurisdictions. Out of those jurisdictions, 10 have a tax treaty with the U.S., 10 have a TIEA with the U.S., and 10 have neither a tax treaty nor a TIEA with the U.S. For the purposes of the exercise, we will assume that all 30 jurisdictions endorse the OECD position and would refrain from requiring local filing where the foreign MNE resorts to voluntary filing with its own tax administration. Further assume that conditions 1, 2, and 4 are met by the MNE in question and/or the U.S.

This puts conditions 3 and 5 into focus for rigorous analysis.

Condition 3

For voluntary filing to be operable, the U.S. must conclude a qualifying CAA with the country of the Constituent Entity by 31 December 2017 at the latest. Regardless of the obvious time constraints, the situation with respect to the 30 foreign jurisdictions would look as follows:

Ten foreign jurisdictions covered by a tax treaty: There is a chance that many of those treaties would provide for the exchange of tax information without an express restriction as to the mode of exchange. In that case, the treaty should be interpreted as to allow the routine or automatic exchange of tax information and is, therefore, a valid basis for the conclusion of a bilateral CbC exchange CAA. We assume for the purposes of the exercise that eight out of the 10 treaties so qualify.

Ten foreign jurisdictions covered by a TIEA: It is quite likely that most of these TIEAs would only provide for the exchange of tax information on request, and as such would not form a basis for the conclusion of a bilateral CbC exchange CAA. This is, for example, the case of the TIEAs with Brazil or Hong Kong. We assume for the purposes of the exercise that four out of the 10 TIEAs qualify for the conclusion of CAAs.

Ten foreign jurisdictions not covered by a treaty or a TIEA: In the absence of a qualifying international agreement, it is not possible to conclude a CbC exchange CAA.

The balance of examining Condition 3 is that the U.S. will be able to conclude CbC exchange CAAs with only 12 out of 30 jurisdictions. This finding must be tempered by the fact that TIEAs are typically concluded with minor jurisdictions, some of which might not have CbC reporting requirements in the first place. Assuming those 12 jurisdictions all accept voluntary filing, and assuming further that the required notification is made to each of those jurisdictions as per Condition 5 below, and that the U.S. is able to conclude a CAA with each of them by 31 December 2017, the U.S. MNE in question is fairly safe in those jurisdiction.

It still has to contend with the 18 remaining jurisdictions.

Condition 5

The most relevant aspect of this Condition is the requirement of lodging a notification with the country of the Constituent Entity. Indeed, where the MNE in question resolves to use voluntary filing, each of its Constituent Entities in the 12 foreign jurisdictions identified above as suitable for the conclusion of CAAs must lodge a notification with their own tax administration to the effect that they are not a local reporting entity or a surrogate reporting entity, and that CbC reporting for FY 2016 will be done by the ultimate parent company in the U.S. under the "parent surrogate filing" mechanism. This notification must be filed by 31 December 2016, which, when considering the relationship between Conditions 3 and 5, creates a rather questionable legal position for the MNE.

The notification is not the end of the story. For voluntary filing to work, the U.S. and the foreign jurisdiction must also conclude a CAA by 31 December 2017.

On the other hand, (the local affiliate of) the MNE in question has to lodge a notification with the foreign jurisdiction by 31 December 2016, at which stage it has no assurance whatsoever that the U.S. and the foreign jurisdiction will indeed conclude a CAA by 31 December 2017.

Whether "parent surrogate filing" is binding on the countries of Constituent Entities and effectively releases U.S. MNEs from the obligation to file locally or to appoint a qualifying third-country surrogate parent is, ultimately, a matter for the internal laws of each country to determine.

Moreover, the guidance provides that the MNE in question may be required to notify its own tax administration, the IRS, by 31 December 2016 (or another date to be set by the U.S.) that it will avail itself of the voluntary filing option. To date, there is no indication as to whether the U.S. will adopt this requirement.

For the purposes of the exercise, we will assume that the MNE in question lodges the required notifications with all 12 jurisdictions by 31 December 2016, and the U.S. and six out of the 12 jurisdictions effectively conclude a CAA by 31 December 2017. This leaves the MNE in question to contend with whatever non-compliance sanctions the remaining six countries may provide for. Also, where voluntary filing proves eventually inoperable because of the failure to reach a CAA before the end of 2017, there is at this stage no assurance that the MNE in question can freely switch to local filing after having first notified voluntary filing to the local government.

The balance of the exercise shows that voluntary filing would work with six out of the 30 foreign jurisdictions, and might in effect trigger non-compliance sanctions in six other jurisdictions.

OUR CONCLUSION

Voluntary filing has been devised as a temporary solution to legitimate challenges: the mismatch in timing between the U.S. and other countries with respect to reporting requirements. Whether it is in fact a viable alternative to local filing is, however, highly doubtful.

The choice to take advantage of voluntary filing has some upsides. The MNE will deal with a familiar tax authority and familiar advisors, and will probably avoid the production of multiple reports to suit the different Constituent Entity countries – although the production of multiple reports can be made quite easy. On the flip side, voluntary filing is not a universal solution, and it does entail many risks, some of which are reasonably quantifiable.

It is not a universal solution because local filing will certainly still be needed for a large number of countries. Hence, voluntary filing will not work with the many countries that do not have a treaty or TIEA with the U.S. for the simple reason that it is then impossible to reach a CAA. For the same reason, it will not work with certain jurisdictions (such as Brazil or Hong Kong) that, though they have an international agreement with the U.S., the agreement is not suitable for the purposes of concluding a CAA. Therefore, even if an MNE elects voluntary filing, it will still have to contend with local filing for some of the jurisdictions.

Voluntary filing is not a quick fix. Moreover, it introduces risk.

One risk is whether the country of the Constituent Entity will go along with voluntary filing and release the MNE from the requirement to file locally or appoint a reporting third-country surrogate parent. As we have seen, even if voluntary filing has been endorsed by the OECD, there is no assurance that it will be as easily accepted by all countries.

Another risk is whether the U.S. and the foreign jurisdiction will effectively conclude a CAA before the end of 2017. In a best-case scenario, the MNE will file the necessary notifications with the foreign jurisdiction before the end of 2016, the foreign jurisdiction and the U.S. will conclude a CAA before the end of 2017, and all is well. In a worst-case scenario, however, the MNE would file the required notifications with the foreign jurisdiction, but the U.S. and the foreign jurisdiction would not reach a conclusive agreement on a CAA.

At this stage, the consequences are anybody's guess. It's worse than a risk. It's a complete uncertainty.

The MNE may face non-compliance penalties; it may be precluded from switching to local filing instead. Or the fact that it is in default of a qualifying CbC report may be a sufficient reason to subject it to further scrutiny or audit.

The reverse situation – one in which the MNE opts for local filing and complies with the notification obligation but the U.S. and the foreign jurisdiction subsequently reach a CAA allowing the exchange under voluntary filing – does not pose as many risks. In a worst-case scenario, the MNE can forego the voluntary filing opportunity presented and carry on with local filing.

We submit that local filing is most likely a more viable and less risk-prone choice for U.S. MNEs during the transition period.