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Financial Accountability & Corporate Transparency

April 30, 2018

The Honorable Steve Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

Re: Notice 2018-31 Creating a National Security Exception to a Corporate CbC Reporting Requirement

Dear Mr. Secretary:

We are writing in response to Notice 2018-31, “National Security Considerations with Respect to Country-by-Country Reporting,” released March 30, 2018, which states that the Department of the Treasury (Treasury) and Internal Revenue Service (IRS) are amending an IRS rule requiring certain large U.S. multinational corporations to file annual Country-by-Country (CbC) Reports on Form 8975 under 26 CFR §1.6038-4.

We are writing on behalf of the Financial Accountability and Corporate Transparency (FACT) Coalition, a non-partisan alliance of more than 100 state, national, and international organizations working toward a fair tax system that addresses the challenges of a global economy and promoting policies to combat the harmful impacts of corrupt financial practices.¹

Notice 2018-31 announces that Treasury and the IRS have determined to create a national security exception to the CbC reporting requirement for corporations that are federal contractors where “more than 50 percent of the U.S. MNE [multinational enterprise] group’s annual revenue, as determined in accordance with U.S. generally accepted accounting principles, in the preceding reporting period is attributable to contracts with the Department of Defense or other U.S. government intelligence or security agencies.”² The Notice gives the new exception immediate effect and states that it applies to “CbC reports and amended CbC reports filed after March 30, 2018.”³ The Notice characterizes its creation of the national security exception as providing interpretative “guidance,” rather than exercising federal rulemaking authority.

The Notice does not contain any factual explanation or reasoned analysis justifying creation of the national security exception. Nor does the Notice acknowledge that the 2016 CbC rulemaking explicitly solicited public comment on the creation of a national security exception, reviewed multiple responsive comments on that matter, and explicitly decided against creating the exception, in part

¹ A list of FACT members is available at <http://thefactcoalition.org/about/coalition-members-and-supporters/>.

² Notice 2018-31, at 2.

³ Id. at 4.

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because the “Department of Defense concluded that [CbC] information reporting generally does not pose a national security concern.”⁴ The Notice does not provide any facts, data, other information, or reasoned analysis that would justify reversing that rulemaking determination, made just two years ago after a public comment process. Nor does the Notice explain why creating the national security exception was previously considered to be part of a rulemaking but is now treated as a matter of guidance.

In addition, the Notice fails to justify the criteria used to define the scope of the exception and fails to provide critical implementation information. It fails to identify, for example, the “U.S. government intelligence or security agencies” whose contracts are relevant to determining which corporations may take advantage of the national security exception. Questions include the relevance of some or all contracts issued by the Department of Homeland Security, Drug Enforcement Agency, and Department of Justice. Additional questions involve Defense Department contracts with no apparent relationship to intelligence or military concerns that require secrecy, such as contracts issued by the Army Corps of Engineers, Defense Finance and Accounting Service, or Defense Health Agency, including Tricare programs for military retirees.

The Notice also fails to cite any facts, data, or other information justifying the 50 percent of annual revenues threshold for granting an exception to the CbC reporting disclosures. Nor does it explain the contours and membership of the multinational enterprise group whose revenues will determine the exception’s application. The Notice also fails to cite any facts, data, or explanation for why the exception requires covered corporations to provide some information elements required by Form 8975, but not others. It similarly fails to cite any facts, data, or explanation for why the exception is given immediate effect or why previously filed Forms 8975 should be amended. Nor does the Notice provide any data or estimates on the number or percentage of corporations which are expected to be excused from providing key CbC reporting elements due to the exception.

The U.S. CbC reporting requirement was undertaken in connection with the Base Erosion and Profit Shifting (BEPS) Project of the Organization for Economic Co-operation and Development (OECD), an international organization of 34 countries of which the United States is a prominent member. All 34 countries agreed to obtain the same CbC disclosures from their large multinational corporations and endorsed a CbC reporting template which the United States used to design the U.S. CbC reporting form. Yet the Notice makes no mention of the BEPS Project, the CbC template, the United States’ commitment to the OECD’s CbC reporting regime, or the notable absence of a national security exception in the international consensus agreement. The Notice does not present, explain, or respond to the position of the OECD or its member countries related to the U.S. national security exception.

The Notice also does not acknowledge or respond to significant concerns raised during the 2016 public comment process responding to a Treasury-IRS request for comments on a possible national security exception. The FACT comment letter, for example, offered extensive comments not only in opposition to creating a national security exception, but also on what procedures should be adopted to prevent abuses if such an exception were to be established:

⁴ “Country-by-Country Reporting,” 81 FR 126 (June 30, 2016), at 42484.

“Creating a National Security Exception. The proposed rule states that “consideration has been given to the possible need for an exception to filing some or all of the information required on Form XXXX, Country-by-Country Report, for national security reasons,” and seeks input on the procedure that should be followed to demonstrate whether such an exception is warranted. Since creating such an exception is unnecessary and would require expensive, time-consuming procedures that would likely contribute little to national security, we recommend against proceeding with this proposal.

“It is important to note in the first instance that none of the CbC Report information being collected should give rise to a national security risk if: (i) reported to the IRS on a confidential basis, (ii) provided to the tax authority of a foreign country that meets the required standards of confidentiality, or even (iii) if made publicly available as recommend in these comments. As stated above, CbC Reports include financial information on multinational corporate revenues, profits, income tax paid or accrued, capital, earnings, number of employees, and value of tangible assets. None of that information is national security-sensitive. As a result, we do not believe there is any justification for a national security exception. We have not seen any arguments in favor of such an exception, and it is not recommended or even contemplated in the OECD’s CbC reporting standards.

“Moreover, if the United States were to create such an exception, other countries are bound to follow, and multiple large multinationals deemed critical to the security of their home countries may be exempted from the CbC reporting obligation. Challenging the national security judgments of other countries would be extremely difficult. The United States should not initiate such a potentially disruptive set of exceptions to this important international effort.

“If the decision is nevertheless made to create a national security exception, a careful process should be established to prevent abuses. Any national security exception should be granted only with the joint concurrence of the Secretaries of the Treasury, State, and Defense Departments, after review of a specific application requesting the exception by the parent entity otherwise obligated to file a CbC Report. Applications by existing multinationals could be required to be filed within 60 days after promulgation of the final rule, with final decisions on exceptions to be made within 60 days thereafter, with a possible extension for up to an additional 60 days. For entities formed after the effective date of the rule or for existing entities that meet the threshold reporting requirement for the first time after the rule’s promulgation, they could be given 60 days from the end of the fiscal year in which they meet the threshold to apply for a national security exception, with a final decision on the applications to follow within 60 days, with a possible extension for up to an additional 60 days.

“In reviewing an application, the Secretaries should consider such factors as the likelihood of harm to national security if the information were to become public, the importance of complying with the United States’ international obligations, and any evidence that the entity may be engaging in profit shifting or other tax avoidance practices. The Secretaries should also consider whether any additional confidentiality restrictions, such as by classifying the CbC Report itself, would provide sufficient national security protection to allow the report to be filed. In any case where an application is denied, the entity should be required to file a CbC Report for the year in which the request was denied, as well as subsequent years. In cases

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where an application is approved, the exception should extend for only one year, with one-year renewals permitted if the parent entity files a renewal application explaining why the national security exception continues to be necessary.

“Given that granting national security exceptions is a discretionary function and the criteria used to grant specific exceptions are unlikely to become public, the Secretaries should provide the Senate Committee on Finance, House Committee on Ways and Means, and the Senate and House Select Committees on Intelligence with an annual letter indicating the number of national security exceptions granted during the year, the general reasons for granting those exceptions, and the opportunity to obtain more detailed information upon request.”⁵

The Notice fails even to acknowledge, much less respond to, those and other significant concerns and recommendations expressed during the public comment process. Those failures are in addition to the Notice’s abject failure to acknowledge or respond to the rulemaking itself, which explicitly rejected creation of a national security exception.

Given the failure of the Notice to provide a factual basis or reasoned explanation justifying its determinations, as well as its failure to respond to significant public comments related to this matter, the Notice’s creation of an immediate national security exception to the CbC reporting requirement is arbitrary and capricious. We respectfully request that Treasury and the IRS withdraw Notice 2018-31, reconsider the matter, and consult with interested parties. If a decision is made to proceed with the national security exception, we respectfully request issuance of a proposed rule with a detailed justification and 90-day public comment period.

Thank you for taking into consideration our concerns. We would like to meet with Treasury or IRS personnel to discuss this matter further. To set up a meeting or obtain answers to questions about this letter and its requests, please contact Clark Gascoigne from the FACT Coalition at cgascoigne@thefactcoalition.org or (202) 810-1334.

Sincerely,

Gary Kalman
Executive Director
The FACT Coalition

Clark Gascoigne
Deputy Director
The FACT Coalition

cc: Melinda E. Harvey, Office of Associate Chief Counsel (International), Internal Revenue Service

⁵ FACT Coalition comment letter on proposed IRS REG-109822-15, Country-by-Country Reporting (March 22, 2016), at 15-16.