



# Transfer Pricing Legislation in Ireland – A New Reality?



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## Introduction

The Finance Bill 2010, as initiated during the first week of February 2010, introduces a formal transfer pricing regime into Irish tax law. The law will apply to companies and Irish branches with accounting periods beginning on or after 1 January 2011.

Transfer pricing is concerned with the pricing of transactions between connected companies and is a key issue facing multinational companies that are operating in an environment of unprecedented complexity. The internationally agreed standard for setting transfer prices is the “arm’s-length principle”. Intra-group transfer prices should be similar to those that would be charged between independent persons dealing at arm’s length in otherwise similar circumstances. The arm’s-length principle is incorporated into

Article 9 of the OECD Model Tax Convention on Income and on Capital, with further guidance included in the OECD publication *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, which was first published in 1995.

Although no codified transfer pricing regime was in place before this year’s Finance Bill, there are a number of sections and cases that are of relevance to transfer pricing and require the application of the arm’s-length principle, including s81 of the Taxes Consolidation Act 1997 (“TCA 1997”) – which is concerned with ensuring that expenses deducted for the purpose of calculating tax are “wholly and exclusively” laid out or expended for the purpose of a company’s trade in Ireland and are not of a capital nature –

and the case of *Belville Holdings v Cronin* [1985] IR 465.

There are also other provisions in Irish tax law, including anti-avoidance measures, that deal with transfers of land between connected persons, Ireland’s tonnage tax regime, the imposition of market value for capital gains tax purposes on the disposal of assets between connected persons and the transfer of trading stock on the discontinuance of a trade.

## Transfer Pricing – The Principles of the New Law

The Finance Bill 2010, when enacted, will incorporate a new Part 35A in the TCA 1997. Sections 835A–G will include the new rules in relation to transfer pricing.

Section 835C contains the basic rules of the new regime. Subsection (1) states that transfer pricing will apply:

“to any arrangement:

- (a) *involving the supply and acquisition of goods, services, money or intangible assets,*
- (b) *where, at the time of the supply and acquisition, the person making the supply...and the person making the acquisition are associated, and*
- (c) *the profits or gains or losses arising from the relevant activities are within the charge to tax under Case I or II of Schedule D in the case of either or both of them.”*

The section makes it clear that the law will apply only to transactions that are trading in nature that are taxed under Case I or II of Schedule D, whether at 12.5% or 25%. Financial services and treasury companies that are taxed on interest income and other associated activities at the 12.5% corporation tax rate will also be within the remit of the new law, as well as intellectual property companies that are trading. Income that is subject to tax at the 25% passive rate of corporation tax, such as rental income, interest income in a non-trading environment and certain dividend income, will not be within the remit of the new law. Also outside the scope of the new law will be non-trading transactions that are capital in nature and certain interest-free loans that are not classified as trading activities.

The term “trade” is not comprehensively defined in Irish tax law,<sup>1</sup> but a body of Irish and UK case law and the rules drawn up by the UK Royal Commission on the Taxation of Profits and Income in 1955 (the “Badges of Trade”) provide some guidance. More recently, the Irish Revenue Commissioners have provided assistance in their publication “Guidance on Revenue Opinions on Classification of Activities as Trading”.

The law is to apply to “any arrangement” that is defined in s835A as “any agreement or arrangement of any kind (whether or not it is, or is intended to be, legally enforceable)”. This will include written legal agreements and unwritten

understandings that are in place between both companies.

Only related-party arrangements involving the supply of:

- › goods
- › services
- › money
- › intangible assets

fall within the scope of the transfer pricing law. At present, no detailed guidance has been issued by Revenue on how widely these terms are meant to be interpreted. However, as the new law is to be interpreted in accordance with the OECD *Transfer Pricing Guidelines*, certain guidance is available.

The preface to the OECD *Transfer Pricing Guidelines* states that:

“Transfer prices are the prices at which an enterprise transfers **physical goods and intangible property** or provides **services** to associated enterprises [emphasis added].”

The terms “goods”, “intangibles” and “services” appear frequently in the guidelines, but the term “money” does not. It is hoped that guidance on these terms, and in particular on the term “money”, will be provided by the Irish Revenue Commissioners shortly.

Section 835C(1)(c) states that the profits are to be within the charge to tax in the case of “either or both of them”. This means, for example, that, where a company within the charge to tax in Ireland on its trading activities transacts business with a group company that is taxed at the 25% rate on passive income arising from the transaction, the trading company will have to ensure that its pricing with that other group company is set at arm’s length. No charge could arise on the company that is not trading in respect of the transaction.

The law allows only for income to be adjusted upward and expenses to be adjusted downward to an arm’s-length figure where not otherwise reflected at arm’s length. There are no specific penalties arising from adjustments under this law, and normal interest and penalties would apply. Neither is there currently provision for

self-correction, which could be required as a result of a transfer pricing study being produced after statutory accounts have been signed, and in such a case a decision will need to be made on how to deal with the outcome of the study. It would be useful for Revenue itself to have some formal process to deal with this, whether in line with the UK or otherwise.

A double tax agreement will need to be used to access tax relief if an Irish company seeks a downward adjustment to income because of an overseas transfer pricing adjustment that increases income in the counterparty company.

In order to fall within the remit of the new regime, s835C(1)(b) states that both the person making the supply and the person making the acquisition must be “associated”. Section 835B(1) states that for the purpose of the new law:

“(a) 2 persons are associated at any time if at that time –

- (i) one of the persons is participating in the management, control or capital of the other; or
- (ii) the same person is participating in the management, control or capital of each of the 2 persons,

and

- (b) a person (in this paragraph referred to as the ‘first person’) is participating in the management, control or capital of another person at any time only if that other person is at that time –
  - (i) a company, and
  - (ii) controlled by the first person.”

The term “control” is to be interpreted in accordance with s11 TCA 1997. It is the ability of a person to direct that the affairs of a company are to be conducted in accordance with the wishes of that person. This ability may be evidenced by the person’s holding of shares or possession of voting rights in that company or any other company or by the existence of any powers conferred by the articles of association or other document regulating the company or any other company.

1. Section 3 TCA 1997 defines trade as including “... every trade, manufacture, adventure or concern in the nature of a trade”, but this does not provide significant guidance in itself.

For the purposes of the new law, this broadly means that companies are connected where there is at least a 50% relationship.

A company will be connected to another company if that other company has control of it or if that other company and persons connected with that other company together have control of the company. Two companies will also be connected if the same person has control over both companies. An individual that controls a company will be connected with that company. Furthermore, a company shall be treated as controlled by an individual if it is controlled by the individual and persons connected with the individual (which include certain relatives of the individual). However, while the company will be subject to the transfer pricing law, the individual will not be.

### Construing Transfer Pricing Rules in accordance with OECD Guidelines

Section 835D(2) provides that the basic transfer pricing rules are to be interpreted in accordance with the OECD *Transfer Pricing Guidelines* as originally published in 1995 (as subsequently updated) and future guidance published by the OECD (as designated by Ministerial Order). Interestingly, s835D(1) does not specifically mention the report that supplemented the guidelines in relation to conducting advance pricing arrangements under the mutual agreement procedure as adopted by the Committee on Fiscal Affairs on 30 June 1999, as included in the annex to Chapter 4 of the guidelines. Advance pricing agreements (APAs) are an important element of any transfer pricing regime. We understand that the Irish Revenue Commissioners have facilitated a number of APAs in the past but, as the new transfer pricing regime will shortly take effect, formal guidance in this area would be welcomed.

As would be expected, s835D(2) states that the provisions of double taxation arrangements take precedence over the transfer pricing law.

### Exemption for Small and Medium-Sized Entities

The law provides for an exemption from applying the transfer pricing rules where a company is a small or medium-sized entity. Section 835E(2) defines a small or medium-sized entity in accordance with the Commission

Recommendation 2003/361/EC of 6 May 2003. An entity qualifies as either small or medium-sized if it meets the staff headcount ceiling of less than 250 and one (or both) of the following financial limits:

- › turnover of €50 million or less,
- › balance sheet total of €43 million or less.

The balance sheet total means total assets and should not be taken as net of any liabilities. Where the entity is a member of a group, or has an associated entity, these limits apply to the whole group and not the specific entity. These figures are assessed annually on a group-wide basis.

The inclusion of this exemption for small and medium-sized companies will ensure that a significant number of domestic Irish trading groups will fall outside the ambit of the new law.

### Documentation Requirements

Section 835F deals with transfer pricing documentation requirements. This section requires companies that are within the remit of the transfer pricing regime to:

*“have available such records as may reasonably be required for the purposes of determining whether, in relation to the arrangement, the income of the person chargeable to tax under Case I or II of Schedule D has been computed in accordance with this Part”.*

Guidance from Revenue on the term “as may reasonably be required” would be helpful so that taxpayers can plan their documentation requirements. Documentation prepared by the counterparty company in the other tax jurisdiction may suffice for the purpose of meeting the Irish documentation requirement. For example, if the counterparty company is a US entity and a US transfer pricing report has been prepared to support the arm’s-length nature of the transaction with its Irish related company, this report may be used to meet the Irish documentation requirement.

In addition, as the law is to be interpreted in accordance with OECD principles that include guidance on documentation, transfer pricing documentation prepared in accordance with OECD guidelines is acceptable.

To the extent that documentation is not available in the counterparty jurisdiction – for example, if no transfer pricing regime exists or documentation is not yet prepared in the other jurisdiction – then the Irish company will be required to ensure that documentation is made available to Revenue on request.

The records referred to in s835F(1) are required to be prepared on a “timely basis”, which is undefined in the law. Guidance from Revenue on what exactly this means would be welcomed, but it is understood that it is not the intention of Revenue that companies should have contemporaneous documentation in place. However, the timing of preparation of documentation is important, particularly as companies have an obligation under self-assessment to file corporate tax returns in accordance with the law. Typically, it is beneficial if some work is carried out at the time that the transaction takes place or soon thereafter, as it may prove difficult to ascertain retrospectively if the arm’s-length standard is satisfied.

The provisions of s886(3) TCA 1997 are to apply to the documentation requirements of s835F(1). This means that the documents must be maintained in an official language of the State, i.e. Irish or English. If the records are not in a written form, then records derived from a computer-based accounting system will suffice.

The provisions of s900 TCA 1997 are also to apply to the transfer pricing documentation. This requires documents to be made available for inspection by Revenue within a specified period of not less than 21 days from the date of the request and assistance to be provided to Revenue in interpreting the information. Where a request for information is not complied with or assistance in interpreting the documentation is not granted, a penalty of €4,000 will apply. Section 901 TCA 1997 also applies to the transfer pricing documentation, which allows an authorised officer to apply to a judge of the High Court for an order requiring persons to furnish the authorised officer with their transfer pricing documentation.

### Domestic Provisions and Elimination of Double Counting

Section 835G(1) provides that a company may claim compensating relief where an arrangement

made between that company (the “affected person”) and the another Irish company (the “first-mentioned person”) gives rise to a transfer pricing adjustment to the tax computations of the first-mentioned company. The purpose is to prevent the same trading profits being subject to Irish corporation tax twice. Section 835G will operate where the profits of the first-mentioned person that are chargeable to tax under Case I or Case II of Schedule D are computed in accordance with s835C (i.e. the arm’s-length price is imposed) and the affected person is within the charge to corporation tax under Schedule D (not only Cases I and II but potentially also Cases III–V) in respect of profits arising from the relevant activity.

Section 835G(2) provides that, when an adjustment is made to the affected person’s profits in accordance with s835G(1) by way of an increase in the cost of purchases and where any part of these purchases remains in stock at the end of the chargeable period, the closing value of the stock will not be affected by the adjustment provided for under s835(1). This ensures that no cash-flow disadvantage arises for the group.

In accordance with s835G(3), a compensating adjustment will be available only where the additional tax due and payable by the first-mentioned person arising as a result of the s835C adjustment has been paid.

Section 835G(4) will apply where a claim for an adjustment is made under s835G(1) and the claimant is entitled to double taxation relief in respect of foreign tax suffered on income arising from the transactions in connection with which the claim is made. Section 835G(4) seeks to restrict the amount of double taxation relief to that which would have been available had the arm’s-length provision applied. This will occur in situations where there is a transaction between an Irish company and a foreign branch of a connected Irish company.

Section 835G(5) considers the situation where a company is engaged in “excepted operations” as defined in s21A(1) TCA 1997, being dealing in development land, the profits arising from which are taxable at 25%. Section 835G(5) provides that, where such land is transferred to another group company, both companies can elect by

notice in writing to the appropriate Inspector that s835C and s835G will not apply to that transaction. The election must be made on or before the corporation tax return filing date of the first-mentioned company. As the election does not apply to land relating to construction operations or “qualifying land”, being land that has been fully developed, the election seems limited in its scope.

Section 835H provides that the transfer pricing rules shall not apply for the purposes of computing capital allowances. This is because separate legislation already exists in the form of s312 TCA 1997, which imposes market value in situations where assets that qualify for capital allowances are sold between connected parties.

### Grandfathering Provisions

The law will apply to arrangements “the terms of which are agreed on or after 1 July 2010”.

This allows for the “grandfathering” of existing arrangements made before 1 July 2010.

This gives companies an opportunity to assess the impact of the new law on existing arrangements. At this stage, companies should undertake a review of all inter-company arrangements within the scope of the new law to identify any situations where the transfer pricing law will apply. Where a company determines that its existing arrangements will be subject to the new law, it may take steps to ensure that these arrangements are updated and the terms agreed before 1 July 2010, thus taking these arrangements out of the scope of transfer pricing. In addition, where companies are considering entering into new arrangements, there is an opportunity to put these arrangements in place now to avail of the grandfathering provisions. The legal implications, and also the tax and legal implications for the counterparty company to the arrangements, should be reviewed.

### Summary

Given the significant changes in the global tax environment in the last few years, it is not unexpected that a formal transfer pricing regime has been introduced in Ireland. Most of our significant trading partners and the main OECD countries have formal transfer pricing regimes. On the ground, Revenue is dealing with an increasing number of correlative adjustments as

a result of transfer pricing adjustments imposed in foreign tax jurisdictions. The presence of a formal transfer pricing regime should provide additional credibility for Revenue when dealing with these cases and the protection of the Irish tax base.

The impact of the new law for companies will vary. From a domestic point of view, the majority of Irish companies will qualify for the small and medium-sized entity exemption. Given that the law applies only to trading transactions and given the availability of grandfathering provisions, the law should be relatively neutral for domestic companies in most cases. For larger domestic groups, there is potentially an additional burden of reviewing and documenting inter-company transactions, which, in the current economic climate, could be a significant additional economic burden.

Large global multinational groups operating in Ireland will already be very familiar with the concept of transfer pricing and its impact on their activities. As counterparty documentation can satisfy Irish documentation requirements, the regime may not be a significant additional burden. This will depend, however, on what countries the Irish companies do business with, and so, for example, as many of the European countries do not require transfer pricing studies to be prepared in sufficient time to provide comfort for filing Irish tax returns, decisions will have to be taken on how best to proceed. Grandfathering arrangements, which can be availed of before 1 July 2010, also provide ample opportunity for companies to structure their affairs so as to fall outside the remit of the law in respect of certain transactions.

Given the scope of the law and the renewed focus on regulation globally, the introduction of the regime should be neutral as regards Ireland’s attractiveness as a location for investment.