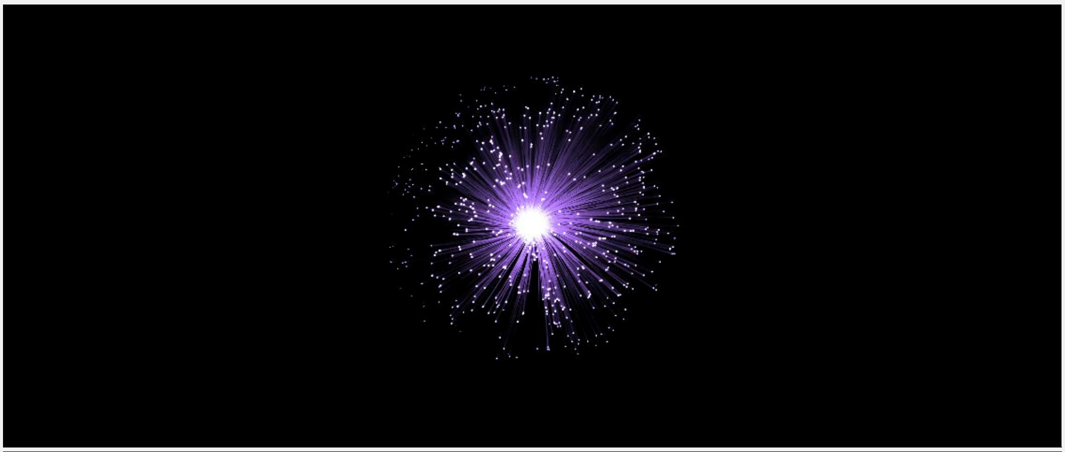

Irish report on corporation tax code includes transfer pricing recommendations

Global Transfer Pricing Alert 2017-039

The Irish government on 12 September published a report on its corporation tax code prepared by an independent academic that had been appointed to perform the review in October 2016.

The review's terms of reference encompassed the following matters:

- Ensuring that Ireland's corporation tax regime does not provide preferential treatment to some taxpayers;
- Further implementing Ireland's commitments under the OECD's base erosion and profit shifting (BEPS) project, which includes the transfer pricing guidance in actions 8-10 and 13;
- Achieving the highest international standards in tax transparency; and
- Delivering tax certainty for businesses and maintaining the competitiveness of Ireland's corporation tax offering including maintaining the 12.5 percent rate of corporation tax.

This alert details the key transfer pricing-related proposals arising from the review, including potential changes to Ireland's transfer pricing laws:

- Updating Ireland’s domestic transfer pricing laws to align them with the 2017 version of the OECD transfer pricing guidelines, including action 8-10 and 13

- Removal of the grandfathering exemption, whereby arrangements that were in place and the terms agreed before 1 July 2010 are outside Ireland’s domestic transfer pricing rules

- Expansion of domestic transfer pricing rules to non-trading transactions and capital transactions

- Imposition of an obligation on Irish taxpayers subject to transfer pricing laws in Ireland to have transfer pricing documentation in place in accordance with Action 13 and the new Chapter V of the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities*, that is, the master file and local file approach

- Consideration to extending domestic transfer pricing rules to small and medium-sized enterprise (SME) groups that are currently outside the scope of Ireland’s documentation regime.

Transfer pricing proposals

The key transfer pricing-related proposals are outlined below in more detail.

A – Further Implementation of Ireland’s commitments under BEPS actions 8-10 and 13

At present, Ireland’s domestic transfer pricing law is aligned with the 2010 version of the OECD transfer pricing guidelines. The report recommends that Ireland should update its domestic law to align with the current version of the OECD transfer pricing guidelines, which were published in July 2017. The new guidelines include the changes arising from the OECD BEPS project, including the principles contained in actions 8-10 (“Aligning Transfer Pricing Outcomes with Value Creation”) and action 13 (“Transfer Pricing Documentation and Country-by-Country Reporting”).

In relation to Actions 8-10, one of the main effects for companies operating in Ireland will relate to how entitlement to intangible-related returns are allocated among group members. The amendments in the 2017 OECD transfer pricing guidelines contain critical changes in relation to the allocation of risk and allocation of intangible-related profits. Legal allocation of risk under contract between related parties will be disregarded to the extent the allocation is not consistent with the actual conduct of the parties. The key factors are who controls risk and who has the financial capacity to bear risk. In relation to the allocation of intangible-related returns, the guidelines differentiate between economic ownership and legal ownership of intangibles, the execution of value-creating development, enhancement, maintenance, protection, and exploitation (the “DEMPE” functions) and the allocation of arm’s length remuneration thereto.

In relation to action 13, the main impact for companies operating in Ireland will be the introduction of a two-tier transfer pricing documentation requirement, which calls for filing a master file and a local file. Companies operating in Ireland will already be familiar with the other key pillar of action 13 – country-by-country reporting requirements that are already included in Ireland's domestic tax law. The significant difference between current documentation requirements and action 13 documentation requirements is that groups will be required to provide the tax authorities with substantially more information on their global operations than in the past, including specific information on intangibles, financing activities, the supply chain of key products/services, and details of relevant tax rulings and advance pricing agreements.

B – Application of transfer pricing law to arrangements whose terms were agreed before 1 July 2010 ("grandfathered" arrangements)

When Ireland's transfer pricing law was introduced in Finance Act 2010, Irish Revenue included provisions to ensure certain trading transactions would fall outside the transfer pricing documentation requirement. Such arrangements are termed "grandfathered arrangements." To the extent the terms of a grandfathered arrangement were not subsequently amended, then it was possible that the transaction in question did not fall within the ambit of transfer pricing laws in Ireland. The report indicates that if Ireland's domestic transfer pricing law is not extended to grandfathered arrangements, there will be no specific transfer pricing provisions – whether including or excluding the 2017 OECD transfer pricing guidelines – applying to such arrangements. The report also states that if legislative changes are introduced to remove this exemption, consideration would need to be given to the announcement and commencement date of any such changes.

C – Expanding domestic transfer pricing rules to non-trading and capital transactions

At present, Ireland's transfer pricing regime is relevant only for related-party transactions that are taxed at the 12.5 percent rate of corporation tax in Ireland. This means that certain transactions are not within the remit of transfer pricing in Ireland, including non-trading interest income, certain interest expenses treated as a charge on income, rental income, non-trading royalty income, foreign income, acquisitions/disposals of tangible and intangible assets, and assets subject to capital allowance claims. Also excluded currently are interest-free loan arrangements, which are considered non-trading in nature. The report recommends that consideration be given to extending domestic transfer pricing rules to non-trading transactions and capital transactions. The report also recognizes that certain of the above transaction classes, including capital transactions and capital allowances, have equivalent concepts in other parts of Ireland's tax laws to the arm's length principle that allow for the adjustment of capital values to reflect market value.

The report outlines a number of policy options available regarding the extension of transfer pricing rules to capital transactions, including:

- Continue to keep such transactions outside the scope of transfer pricing rules on the basis that existing rules have comparable concepts to the arm's length principle;
- Bring all capital transactions within the scope of transfer pricing rules; and
- Continue to keep such transactions outside the scope of transfer pricing rules but supplement existing market value rule contained in domestic law with the application of the OECD transfer pricing guidelines when appropriate.

D – Strengthening domestic transfer pricing documentation requirements

Irish Revenue issued guidance in 2010 (Tax Briefing Issue 7) that outlined good practices for Irish transfer pricing documentation. The guidance was subsequently reissued in August 2017. The existing guidance refers to Chapter V of the 2010 OECD transfer pricing guidelines and EU transfer pricing documentation as representing good practices for the format of documentation. Action 13 now provides for more detailed transfer pricing documentation in the format of a master file and a local file. The report suggests that there is a strong case for updating Ireland's domestic transfer pricing documentation law to align with the new Chapter V of the 2017 OECD transfer pricing guidelines.

E – Extending transfer pricing rules to small and medium-sized enterprises (SMEs)

Ireland's transfer pricing regime currently does not apply to some SMEs, as defined by an EU recommendation of 6 May 2003. An SME is defined as an enterprise with less than 250 employees and either turnover of EUR 50 million or less or total assets (before deduction of liabilities) of less than EUR 43 million. This exemption is applied on the basis that such small groups would incur an undue administrative burden if they were required to prepare transfer pricing documentation. The report states that the OECD transfer pricing guidelines already include provisions that allow for a pragmatic solution for smaller enterprises when considering the level of transfer pricing support that needs to be in place to demonstrate the arm's length nature of intercompany dealings. On that basis, the report outlines a number of policy options that could be considered:

- Retain the current SME exemption in Irish transfer pricing law
- Remove the SME exemption completely
- Reduce the size threshold to bring more companies within the scope of domestic transfer pricing law
- Remove the SME exemption completely and also reduce transfer pricing documentation requirements for small entities to reduce compliance burden
- Align with the approach taken in the United Kingdom, whereby certain transactions considered to be high risk are brought within the scope of transfer pricing.

Comments

Given the significant changes contained in the new 2017 OECD transfer pricing guidelines, it is likely that many of this report's recommendations will be formally adopted. The report indicates that the recommendations, if implemented, should be in place no later than the end of 2020. We would expect that the recommendations pertaining to alignment of Ireland's domestic transfer pricing law to the 2017 version of the OECD transfer pricing guidelines will be adopted in the short term. Other recommendations, such as removal of grandfathering status, expansion of transfer pricing law to non-trading and capital transactions, and potential removal of the SME exemption may be subject to additional consultation and analysis before any formal decision is taken.

Because these changes are likely to have a material impact for companies in Ireland, consultation and a period of advance notice of such changes would be welcome. Irrespective of the implementation date of any of the report's recommendations, companies should review their operations to determine the potential impact of these changes on their business and assess readiness to deal with any changes in a timely manner.

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