Transfer Pricing Express | Issue #1

In this issue:

Ireland-transfer pricing developments in 2016

International developments such as the OECD's Base Erosion and Profit Shifting ("BEPS") project, the EU's Anti-Tax Avoidance measures and recent State Aid cases undertaken by the European Commission have put Ireland's tax and transfer pricing regime into prime focus.

Over the last 12 months, Irish Revenue have introduced a number of transfer pricing-related BEPS measures and updated our dispute resolution procedures to facilitate advance pricing agreements ("APAs").

(i) BEPS Action 13 in Ireland

The final Action 13 paper entitled *"Transfer Pricing Documentation and Country-by-Country Reporting"* was issued by the OECD in October 2015. The content of the report completely rewrites Chapter V of the current version of the OECD Transfer Pricing Guidelines by introducing a three-tier transfer pricing documentation approach consisting of a master file, a local file and a country-by-country report ("CbCR") for multinational groups.

In December 2015, Irish Revenue issued regulations in relation to the implementation of CbCR from 2016 onward. Implementation in Ireland will be aligned with the OECD Action 13 report. In June 2016, Irish Revenue also released a guide containing frequently asked questions and answers regarding CbCR. This guide was subsequently updated in October 2016 with details about CbCR notification procedures for Irish companies within scope. For accounting periods ending on 31 December 2016, notification of which group company will be filing the CbCR needs to be provided to tax authorities before the end of 2016. For Ireland, it has been confirmed that such notification will be via the Revenue Online Service ("ROS") platform.

For further information relating to CbCR regulations issued by Irish Revenue, please follow this link to our global transfer pricing alert.

For details in relation to Irish Revenue's updated frequently asked questions and answers pertaining to CbCR, including notification requirements, please follow this link to our global transfer pricing alert.

While CbCR has captured all of the attention over the last 12 months or so, it is important to be aware of the significant transfer pricing documentation changes contained in Action 13 that are now being introduced by many jurisdictions globally. To date, Irish Revenue have not announced changes to Ireland's documentation rules. Ireland's domestic transfer pricing law is still aligned to the 2010 version of the OECD Transfer Pricing Guidelines. As part of his Budget 2017 speech in October 2016, Ireland's Minister for Finance released a document entitled *"Update on Ireland's International Tax Strategy"*. In the section on Ireland and BEPS implementation, it is stated that consideration needs to be given to what changes are needed to ensure Ireland's transfer pricing rules meet the standards set by the OECD. This work is linked to the broader review of Ireland's corporation tax regime currently underway. The review will make recommendations to the Minister by mid-2017.

Any recommendations relating to the implementation of the rest of Action 13 (master file and local file) are likely to be effective in Ireland from 2018. However, companies need to be aware that even though Ireland has not yet formally introduced the new two-tier documentation approach, many other jurisdictions have, so groups operating on a global basis need to consider where the new requirements apply. Please refer to our related article in this newsletter about this issue.

(ii) BEPS Action 8-10 in Ireland

Action 8-10 deals with aligning transfer pricing outcomes with value creation and is likely to have a significant impact on many operating models where substance and ownership of key assets, such as intangible assets, are separate. Allocation of profits continues to be based upon functions performed, risks assumed and assets utilised. However, the OECD updates in Action 8-10 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. What is key is who controls risk and who has the financial capacity to bear risk. In relation to the allocation of intangible-related returns, the new guidance differentiates between economic ownership and legal ownership of intangibles, the execution of value-creating development, enhancement, maintenance, protection and exploitation (known as "DEMPE" functions) and allocation of arm's length remuneration thereto.
The Irish transfer pricing legislation still explicitly refers to the 2010 version of the OECD Transfer Pricing Guidelines. As part of the review of Ireland's implementation of BEPS, as noted above, it is likely that Action 8-10 principles will be included in next year's Finance Bill and effective from 2018. For APA purposes, Irish Revenue have indicated that Action 8-10 principles will be followed in bilateral negotiations.

(iii) Formalisation of Bilateral APA Regime

While Ireland has in the past facilitated bilateral and multilateral APAs, in July 2016 a formal regime was launched. It will now be possible to initiate an APA with the Irish Competent Authority. It should be noted that it will not be possible to obtain a unilateral APA from the Irish Competent Authority. Similar to other jurisdictions, entry into the APA regime is confined to complex transfer pricing-related transactions that are likely to give rise to double taxation. The term of an APA that Irish Revenue will agree to will be three-to-five years. Rollback of APAs will be available in appropriate cases. No filing fees apply in Ireland for an APA application.

For further information relating to the new APA regime in Ireland, please follow this link to our global transfer pricing alert.

Gerard Feeney

Head of Transfer Pricing

OECD approves incorporation of BEPS amendments into transfer pricing guidelines

In a June 2016 press release, the OECD announced that the OECD Council on 23 May formally approved amendments to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "Transfer Pricing Guidelines") set out in the 2015 BEPS report on Actions 8-10, *"Aligning Transfer Pricing Outcomes with Value Creation*", and the report on Action 13, *"Transfer Pricing and Country-by-Country Reporting".*

In the press release, the OECD stated that *"the amendments provide further clarity and legal certainty about the status of the BEPS changes to the Transfer Pricing Guidelines,"* which were endorsed by the Council on 1 October 2015, by the G20 Finance Ministers on 8 October 2015 and by the G20 leaders on 15-16 November 2015.

The amendments approved by the Council, the OECD's governing body, incorporates the BEPS transfer pricing measures into the current Transfer Pricing Guidelines. Given that the Transfer Pricing Guidelines are integrated into the domestic law of some countries, including, in some cases, by direct reference to the guidelines themselves, this approval process further clarifies the status of the BEPS reports' changes to the Transfer Pricing Guidelines.

According to the press release, the continuing efforts to make conforming amendments to the remainder of the Transfer Pricing Guidelines (and in particular to Chapter IX on the transfer pricing aspects of business restructuring) are well advanced. Working Party No. 6 of the Committee on Fiscal Affairs is expected to shortly invite interested parties to review the conforming changes to Chapter IX to establish that real or perceived inconsistencies with the revised parts of the Transfer Pricing Guidelines have been appropriately addressed and duplication appropriately removed.

The conforming changes are expected to be approved later in 2016 or early in 2017. Until then, it is stipulated that the provisions of the Transfer Pricing Guidelines should be interpreted to be consistent with those provisions contained in the BEPS reports on Actions 8-10 and 13 and, in case of perceived inconsistencies, the modified provisions prevail.

How countries adopt these changes should be considered on a case-by-case basis. Ireland's domestic transfer pricing law is still aligned to the 2010 version of the Transfer Pricing Guidelines. It was recently announced, as part of Budget 2017, that the current review of Ireland's corporation tax regime will include how BEPS will be implemented into Irish domestic law. The review will make recommendations by mid-2017. Any recommendations relating to the implementation of Action 8-10 and Action 13 (master file and local file) are likely to be effective in Ireland from 2018. For APA purposes, Action 8-10 principles are effective now and will be followed by the Irish Competent Authority in negotiations with treaty partners.

For further information relating to the OECD's approval of the BEPS amendments, please follow this **link** to our global transfer pricing alert.

Wilco Froneman

Manager, Transfer Pricing

Additional guidance on permanent establishment

The definition of Permanent Establishments ("PE") forms a crucial part in the determination of whether a non-resident enterprise must pay corporate income tax in another State. Action 7 of the BEPS Action Plan redefines the concept in a new Article 5 of the OECD Model Tax Convention ("MTC") in order to prevent the artificial avoidance of a PE status through the use of commissionaire and other arrangements.

However, the clarification of the newly defined PE required guidance on the attribution of profits to newly identified PEs. The preliminary work on the attribution of profit issues that was carried out under the report on Action 7 focused on whether the existing rules of Article 7 of the MTC would be appropriate for determining the profits that would be allocated to PEs resulting from the changes. In July 2016, the OECD released its discussion draft on attribution of profits to PEs. The discussion draft draws on the existing guidance as set out in the OECD's 2010 Report on the Attribution of Profits to Permanent Establishments. The key building blocks of the 2010 report are: (1) that a PE should be treated as if it were distinct and separate from its overseas head office; and (2) that assets and risks should be attributed to the PE or head office in line with the locations of the *"significant people functions"*.

The July 2016 draft includes factual examples and focusses on the changes to the threshold for PEs concerning dependent agents and warehouses. The examples illustrate the effect of changes in the facts of each case, particularly in relation to the location of significant people functions. The examples illustrate how to attribute profits to PEs in the light of changes made by Action 7, and in particular the new tax rules for dependent agent PEs, as well as the BEPS changes to the OECD Transfer Pricing Guidelines. These examples remain limited in their fact patterns and do not in totality recognise or address the complexities of profit attribution in a post-BEPS environment, implying that although there will be an increase in the numbers of PEs, the principles behind the attribution of profits have not changed.

In addition, the draft refers to the Authorized OECD Approach ("AOA") under Article 7, but not all jurisdictions have implemented the 2010 version of Article 7, which could result in countries not starting from a common approach when it comes to the attribution of profits.

A public consultation on the draft was held on 11 and 12 October in Paris, with a number of major disagreements aired on specific areas, including: (1) disagreement as to the status of the AOA; and (2) conflict between Article 9 and Article 7 of the MTC; and (3) the lack of clarity between these articles regarding the allocation of assets and risks.

Adoption of the changes to the definition of PE will be made by way of a multilateral instrument, which is currently being negotiated.

With the expectation that work on the multilateral instrument will be finalised shortly, the resolution of the fundamental disagreements as outlined above is a critical issue to be resolved.

For further information relating to the July 2016 OECD additional guidance document, please follow this **link** to our global alert.

Wilco Froneman

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Revised guidance on profit splits

Although the BEPS final report on Action 8-10, “Aligning Transfer Pricing Outcomes With Value Creation” was released in October 2015, follow-up work was required on the profit-split method and in particular on the use of profit splits.

A discussion draft was released on the 4 July 2016, which addressed the follow-up work and proposed, revised guidance on the use of the profit split method. The OECD, however, has clarified that, at this stage, the revised draft on profit splits does not represent the consensus position of the OECD Committee on Fiscal Affairs or its subsidiary bodies.

The discussion draft considers revisions to be included in Chapter II of the OECD Transfer Pricing Guidelines. The discussion draft provides guidance on when a profit-split method might be most appropriate and on its application. It also articulates the role of a value-chain analysis in accurately delineating the actual transaction, to determine whether circumstances exist to support the profit-split method as the most appropriate method.

There is also a new discussion on two broad ways of splitting profits – splitting actual profits or splitting anticipated profits. The discussion draft further emphasises the role of risk-sharing or the integration of risks between related parties as an important factor in the determination of whether a profit-split method is appropriate.

The discussion draft outlines circumstances when the profit-split method is likely to be the most appropriate for determining arm’s length pricing:

- When both parties to a transaction make unique and valuable contributions; and
- When a multinational entity’s business operations are highly integrated, such that strategic risks are jointly managed and controlled by more than one party.

The paper also discusses both strengths and weaknesses of the profit-split method, and also adds some discussion of situations when a profit-split approach might not be most appropriate. The profit-split method is not considered appropriate as a default method when comparables are hard to find, other methods are not reliable, or when group synergies exist.

The discussion draft emphasises that lack of comparables alone is insufficient to warrant the use of a profit-split method. In cases where one party to the transaction bears limited risks, but reliable comparable data is scarce, it may still be more reliable to use the inexact comparables with adjustments than to use a profit-split method.

The OECD, thus, has tried to address concerns expressed by commentators on the first discussion draft on potential overuse of profit splits.

The discussion draft regards value-chain analysis as a tool to assist in delineating controlled transactions. A value-chain analysis considers where and how value is created in the business operations. Guidance is provided on when and how a value-chain analysis may be a useful tool to identify when the profit-split method may be appropriate and how the method should be applied. A value-chain analysis considers the economically significant functions, assets and risks, which entities perform them, and how they may be interlinked.

It is not considered sufficient for a value-chain analysis to show value creation in multiple places to warrant, in itself, application of the profit-split method. However, the value-chain analysis may indicate features of the transaction that indicate the profit-split method may be the most appropriate method.

As mentioned above, the profit splits can be applied by splitting actual profits or anticipated profits, and discussion about “profits” should be taken as applying equally to losses.

The profit-split method may be applied using either the more direct contribution analysis or the more indirect residual analysis. The discussion draft identifies the two approaches to the splitting of profits:

- **A contribution analysis** – This divides total profits between the parties based on the division of profits that would be expected between independent enterprises, and can be supported either with comparable data, when available, or based on the relative value of each party's functions (considering their assets used and risks assumed)
- **A residual analysis** – This first assigns profits to the routine contributions of each party and then allocates the remaining combined profits between the parties based on the relative value of their contribution to the residual profit.

The profit-split method is complex and subjective and will always have an element of uncertainty around the arm's length split of profits. It has historically not been used as frequently as other methods because of its subjective element, although it provides greater flexibility in application. In general, one-sided methods, such as the transaction net margin method ("TNMM"), are easier to apply in practice and are less subjective.

Due to the subjective nature of the profit-split method, where generally third-party comparables are not used, there is always a risk that arbitrary enforcement by tax administrations could lead to disputes that cannot be resolved even through mutual agreement procedures ("MAP"), such that double taxation remains unsettled. The disputes between the taxpayers and tax administrations could also be over the existence of an intangible and the measurement of its value in the transaction.

The revised discussion draft on profit splits is a welcome relief to taxpayers as the guidance has emphasised the limited circumstances in which the profit-split method may be used for setting transfer prices. At the same time, in cases where controlled taxpayers participate in highly integrated operations and contribute valuable intangible assets in respect of a joint business opportunity, the profit-split method may still be the most appropriate method. The discussion draft's guidance on the use of profit splits and the actual split of the profits or losses from the combined activity on an economically valid basis to approximate an arm's length return to the respective contributors is useful.

Based on experience, the application of a profit-split method works well in a collaborative environment between tax authorities and taxpayers. Therefore, consideration should also be given by taxpayers applying the profit-split method to enter into programs such as an advance pricing agreement ("APA") with tax authorities.

An APA is an opportunity to reach an agreement with tax authorities on the application of the arm's length principle for dealings with international related parties.

A public consultation on the draft was held on 11 and 12 October in Paris, with further guidance expected later this year or early next year.

For further information relating to the July 2016 OECD discussion draft, please follow this **link** to our global transfer pricing alert.

Kumar Das

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New transfer pricing documentation requirements under Action 13 – the challenges facing groups

Background

With the release of the revised Chapter V of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, the OECD has adopted a three-tiered approach to documentation that includes: (1) the country-by-country ("CbC") reporting template, which is intended to provide a financial picture of a company's global operations; (2) the master file, which is intended to provide a high-level view of a group's business operations, along with important information on the group's global transfer pricing policies on intangibles and financing; and (3) the local file, which is intended to provide information and support of the intercompany transactions that the local company engages in with related parties.

Master file

The guidance states that the master file is intended to provide a high-level blueprint of the multinational group to place the group's transfer pricing practices in their economic, legal, financial, and tax context. In keeping with this high-level view, it is not necessary to provide exhaustive detail of the group's operations or provide comprehensive lists of required items. Rather, companies can use prudent business judgement to determine the appropriate level of detail.

Local file

The guidance goes on to state that detailed transactional transfer pricing information should be contained in the relevant local file, specific to each country, identifying material related-party transactions, the amounts involved in those transactions and the company's analysis of the transfer pricing determinations they have made with regard to those transactions.

The challenge

The revised OECD guidance regarding transfer pricing documentation requirements, in effect, represents a minimum standard for countries to follow. However, the fact remains that a particular country may, and indeed certain countries have already chosen to, impose additional requirements or have a different interpretation of the OECD requirements. Thus, what is clear is that the 'one-size-fits-all' approach to transfer pricing documentation is coming to an end. Careful consideration is now needed to determine the specific local country documentation requirements 'in play' and to tailor the transfer pricing documentation strategy accordingly in order to satisfy all local requirements in force in a given year.

For example, the UK have indicated that they will not be adopting the master file/local file approach. Meanwhile the Netherlands, Denmark, Australia, China and Spain are examples of countries that have adopted the master file/local file approach. China requires some additional information in the form of a special issues file, Australia has two options for the local file and each of the countries apply varying thresholds in order for the new documentation rules to apply. Australia, for example, applies an AUS$1bn turnover threshold and Netherlands applies a €50 million turnover threshold. Other countries don't apply a turnover threshold at all and instead look at headcount, value of intercompany transactions, balance sheet totals or some other metric. In addition, some countries have implemented the new rules effective for 1 January 2016, while other countries have adopted a later implementation date.

This leads to an unprecedented level of complexity for groups with global operations in seeking to tailor their approach to transfer pricing documentation in order to satisfy all relevant local requirements.

Potential approach

In order to meet the challenges ahead from a transfer pricing documentation viewpoint, it is important to modernise the approach to the collation and storage of transfer pricing documentation. A potential approach is to store the relevant transfer pricing documentation in 'modules' containing transfer pricing data relevant for one or more transfer pricing reports.

These modules can then be updated in isolation, as needed, and once all transfer pricing documentation modules have been completed, they then come together to form a database of transfer pricing information.

What this approach achieves is the ability to tailor individual transfer pricing reports for specific local country requirements at the point in time that a tax authority request is made or the point in time that the relevant transfer pricing report needs to be submitted to the relevant tax authority. It also achieves global consistency as the information submitted via the transfer pricing report is a fundamental pillar of any robust audit defense strategy in a post-BEPS era.

Conclusion
It must be remembered that although Ireland has not yet formally indicated whether they will adopt the master file/local file approach, Irish-headquartered groups will nevertheless need to prepare a group master file to the extent they have a presence in other international locations where the master file/local file approach has been implemented and where the relevant threshold has been exceeded. This is a key point that companies need to be aware of.

Considering the approach to transfer pricing documentation management, evolving implications from the OECD's Action 13 guidance are challenging businesses to find more efficient, centralized and integrated ways to plan and manage transfer pricing documentation processes. Tax audit activity is increasing as tax authorities seek to widen tax bases. Increased desire for transparency is compelling businesses to adopt a centralised transfer pricing documentation approach and examine transfer pricing on a unified, consistent global/regional basis. The 'modular' approach to transfer pricing documentation achieves the optimum in terms of adjustability to specific local country requirements and global consistency of data submitted, which is essential from an audit defence viewpoint.

Further information relating local country implementation of the BEPS Actions, including BEPS Action 13, can be found **here.**

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Section 110 companies - recent legislative changes and their transfer pricing impact

Although not technically within the scope of Ireland's formal transfer pricing legislation, there has always been an arm's length requirement for Irish securitisation vehicles taxed under Section 110 of The Taxes Consolidation Act of 1997 ("TCA 1997"). However, proposed changes to the legislation, as announced in September 2016 and contained in the recent Finance Bill, are likely to increase the relevance of transfer pricing principles for certain Section 110 vehicles ("S110 vehicles") managing and/or holding loans, swap agreements or other derivatives that derive their value directly or indirectly from Irish property and land.

Irish S110 vehicles are taxed at the 25 per cent rate of corporation tax on any profits. However, in many instances such companies pay little or no tax in Ireland due to the ability to deduct profit participating interest or other payments (i.e. broadly, interest or other specific payments dependent on the profits generated by the S110 vehicle in the holding or managing of assets) in respect of funding notes issued to investors. It is important to note that any other transaction or arrangement entered into by the S110 vehicle is required to be made at arm's length in order to qualify for S110 treatment. The intention of the legislation is that the tax would be suffered at the level of the investment and investor jurisdictions, so that there would be two levels of taxation rather than three.

However, following intense media scrutiny and political attention in relation to S110 vehicles and funds that derive profits directly or indirectly from Irish property and land, a proposed draft of amendments to S110 TCA 1997 was published in early September 2016.

Finance Bill 2016 also includes amended draft legislation. It is key to note that the proposed amendments only target certain S110 vehicles (Irish property transactions - i.e. broadly, debt secured on Irish property acquired at a discount by non-Irish private equity funds). Furthermore, the revised draft amendments includes certain specific exclusions to remove certain securitisation transactions not targeted by the proposed legislative changes.

The effect of the change is to treat the holding and/or managing of loans, swap agreements or other derivatives ("specified property business") held by certain securitisation vehicles that derive their value directly or indirectly from Irish land (hereinafter referred to as "Irish property-related assets") as a separate business within the vehicle. This will mean apportioning income, profits and expenses to that separate business on a 'just and reasonable basis', including the abovementioned profit participating interest on funding notes issued to investors. In relation to the profit participating interest attributed to the specified property business, a partial deduction will only be allowed for such interest or payment that would represent no more than a reasonable commercial rate of return (i.e. essentially an arm's length requirement). The proposed amendments will apply to accounting periods commencing after 6 September 2016 and where the accounting period of the S110 vehicle begins before that date and ends after that date; the accounting period will be divided into two parts, one for the period pre 6 September 2016 and one for the period post 6 September 2016.

For any S110 vehicles within scope of the new provisions, it will be important to assess the level of interest that may be deductible on the portion of the profit participating note and other expenditure attributable to the specified property business to estimate the likely tax impact going forward. This will initially require a consideration of OECD transfer pricing principles to apportion income, profits and expenses (including the profit participating interest) to the specified property business on a just and reasonable basis. Furthermore, it will be necessary to consider what arm's length interest rate is appropriate and supportable on the profit participating interest based on

OECD transfer pricing principles. In this regard, there may be a number of potential approaches that can be considered from a transfer pricing perspective to support the level of interest rate that may be charged. For example, factors such as the credit rating of the S110 vehicle and the relevant terms and conditions of the profit participating note may have an impact on the interest rate.

The proposed amendments to Section 110 TCA 1997 have the potential to significantly impact certain S110 vehicles managing and/or holdings assets that derive their value directly or indirectly from Irish property and land. It is now advisable that affected groups undertake an impact assessment to determine whether the proposed changes in law apply, and then consider what the arm’s length position would be using transfer pricing principles.

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