Dillon Eustace Transfer Pricing Release Finance Act 2010

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Transfer Pricing Release Finance Act 2010

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Introduction

The Irish Finance Act 2010 (the "**Act**") which was enacted in April of this year inserted a new Part 35A into the Taxes Consolidation Act 1997 ("**TCA 97**") which provides for the introduction of **limited** transfer pricing ("**TP**") measures.

The principle of arm's length pricing, which is central to the concept of TP, has been part of Irish tax law for many years despite the absence of specific TP measures (with the exception of manufacturing relief). For example the "*wholly and exclusively*" test contained in Section 81 TCA 97 would operate to deny a tax deduction for an amount of a payment between connected parties in excess of the arm's length amount. In addition tax law as interpreted by the courts has permitted an upward adjustment to profits to reflect the arm's length price in certain cases.

The official line is that the new TP measures are designed to align Ireland with best international practice by formally adopting the OECD Transfer Pricing Guidelines, while at the same time removing the uncertainty regarding the application of internationally accepted transfer pricing standards in Ireland. The new measures are also in accordance with the Irish Tax Authorities long standing and stated approach of addressing TP issues in accordance with OECD guidelines.

When applicable, the effect of the new measures will (in certain cases) increase understated receipts and reduce overstated expenses of companies and branches in Ireland. The sole aim of the measures is to increase profits which have been understated in Ireland (although most international groups have not to date used Ireland in a manner to minimize profits arising in Ireland – indeed quite the opposite!). Reading between the lines, the introduction of these proposed TP measures is not to raise revenues for the Irish Tax Authorities but for Ireland to be able to run with the herd at an OECD level and not to be in the vulnerable position of standing by itself with no TP rules.

In addition, there are some important exclusions from the new TP measures and a generous grandfathering rule which are explained below.

New Measures

The new TP rules apply to any *arrangement* involving the supply and acquisition of goods, services, money or intangible assets, where at the time of the supply and acquisition, the person making the supply and the person making the acquisition are *associated* and the profits or gains or losses arising are within the charge to tax as trading or professional activities in the case of either **or** both the supplier and acquirer.

For the purpose of the above, persons are associated if **(i)** one person is directly or indirectly participating in the management, control or capital of the other **or** **(ii)** a person is directly or indirectly participating in the management, control or capital of each of the two persons. The term *arrangement* is defined widely to mean any agreement or arrangement of any kind (whether or not it is or is intended to be, legally enforceable).

When applicable, the effect of the new measures will be to increase understated receipts and reduce overstated expenses. This will be achieved by the imposition of the "*arms length amount*" which is defined to be the amount of the consideration that independent parties would have agreed in relation to the arrangement had those independent parties entered into that arrangement. The TP measures, which fall within the scope of the normal self assessment regime applicable in Ireland, cover both domestic and cross border transactions.

It is specifically provided for that the TP measures are to be interpreted, for the purpose of computing profits or gains or losses, in accordance with *Article 9(1) of the OECD Model Tax Convention*, regardless of whether such double taxation relief arrangements actually apply. This is designed to ensure, as far as practicable, consistency between the Irish TP measures and the OECD measures. However it should be noted that this is subject to the provisions of any relevant double taxation treaty taking precedence.

Scope of the Provisions (and more importantly what is excluded!)

An important point to note is that non-trading activities do not fall within the scope of the proposals. Accordingly, interest free loan structures (in a non-trading context) will continue to be possible. Likewise, the new TP measures will not apply to lease and royalty agreements which are not taxed under Case I or II as trading profits. In addition, special purpose companies which qualify for the favourable tax treatment set out in Section 110 TCA 97 (commonly referred to as "Section 110" companies) will not be subject to the TP legislation (as notwithstanding the fact that the profits and gains of such qualifying companies are computed in accordance with trading principles, they remain chargeable to corporation tax at

the passive 25% rate under Case III of Schedule D). Income from real estate will also be excluded from the new TP measures

Small or medium - sized enterprises will be exempt from the TP measures. For the purpose of this exemption a person will be regarded as a "*small or medium-sized enterprise*" if they fall within the definition of "***micro, small and medium-sized enterprises***" as outlined in the Annex to Commission Recommendations of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises[1]. This will essentially exclude an enterprise which employs fewer than 250 persons and which has an annual turnover not exceeding Euro 50 million **and/or** an annual balance sheet total not exceeding Euro 43 million. These figures will be assessed, where appropriate, on a worldwide group wide basis.

Relevant Dates (including generous grandfathering provisions)

The TP measures come into effect on 1st January 2011 in relation to any arrangements (as defined above), the terms of which are agreed on or after 1st July 2010. Revenue has clarified that, if the terms of an agreement materially change after 1 July 2010 it will be considered a new agreement. Also if terms are subject to expiry at a specified date, any following agreement will be a new agreement for the purposes of the legislation.

The grandfathering provisions present considerable tax planning opportunities for persons who will be subject to the new TP measures, where the terms of future arrangements and existing arrangements may be agreed in advance of 1st July 2010. **The grandfathering provisions are obviously generous in that they are applicable for an indefinite period of time.**

Record Keeping

Under the TP measures a taxpayer is required to retain such records "*as may reasonably be required*" for the purpose of establishing that the pricing arrangements are in accordance with the arm's length principle. The documentation need not be prepared or kept in Ireland, where it exists elsewhere nor does it need to be kept in standard form. This may be particularly relevant for multinational groups already operating in compliance with other TP regimes, where the Irish record keeping obligations will require existing information systems to incorporate the Irish TP measures. Any documentation is however required to be prepared on a timely basis and must be made available to the Irish Tax Authority on request. Therefore, the approach adopted in relation to the documentation requirements is a practical

[1] OJ No. L124, 20.05.2003, p.36

one and should hopefully limit the compliance burden of those companies falling within the new TP measures.

For further details in relation to TP documentation obligations please see Tax Briefing Issue 07 of June 2010 - http://www.revenue.ie/en/practitioner/tax-briefing/2010/no-072010.html.

Some Immediate Considerations

- Companies currently doing business in Ireland should undertake a careful review of all existing arrangements in place in order to determine whether the TP measures will apply to them.

- Of particular relevance would be future arrangements the terms of which may be agreed in advance of 1st July 2010 and which accordingly may benefit from the grandfathering provisions. As noted above, such arrangements should not come within the scope of the TP measures to the extent that the agreed terms are not amended on or after 1st July 2010.

- In addition to the above, existing arrangements should be carefully reviewed and appropriately documented in advance of 1st July 2010. The wide definition of *arrangement* to include any agreement or arrangement not (or not intended to be) legally enforceable needs to be borne in mind.

- Companies that will be subject to the new TP measures need to consider how existing information systems are to be adopted to cater for the TP measures.

- In addition to the above other tax considerations such as Value Added Tax may be relevant and need to be considered.

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