A&L Goodbody

A&L Goodbody
International Financial Services Centre
25-28 North Wall Quay, Dublin 1
D01 H104
T: +353 1 649 2000
DX: 29 Dublin | www.algoodbody.com

Dublin
Belfast
London
New York
San Francisco
Palo Alto

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Our ref	01410486
Your ref	

Email: tpreview@finance.gov.ie

Transfer Pricing Rules – Public Consultation
Tax Division
Department of Finance
Government Building
Upper Merrion Street
Dublin 2
D02 R583

Ireland's Transfer Pricing Rules – Public Consultation

Dear Sirs

A&L Goodbody has a wide range of domestic and international clients that will be affected by changes to Ireland's transfer pricing legislation and we welcome the opportunity to provide our views on the questions raised as part of the public consultation on the reform of Ireland's transfer pricing rules.

We have provided our responses below to certain specific questions raised in the consultation document. To the extent that any of our comments are unclear or require further expansion, we would be happy to engage with department officials if this would be considered useful.

Incorporation of the OECD 2017 Guidelines into Irish legislation

It is intended that Irish transfer pricing legislation will be amended to include a direct reference to the 2017 OECD Transfer Priding Guidelines.

Q: Do you consider that this proposed course of action will give rise to any specific issues?

The 2017 OECD Transfer Pricing Guidelines (the **2017 Guidelines**) contain (amongst other changes) material changes to the methodology for how income from intra-group arrangements should be allocated.

The starting premise of the approach contained in the 2017 Guidelines is that all members of a multinational company should receive an arm's length compensation for (i) the functions that they perform, (ii) the assets that they contribute and (iii) the risks that they assume in connection with the exploitation of intangible assets.

Under the 2017 Guidelines, there is a switch from a methodology where the group entity, which is the legal owner of a relevant intangible asset, has a right to the returns from the exploitation of that asset, to a differing methodology, providing that, for the legal owner to be entitled to the returns from the exploitation of intangible assets, it must perform key functions in the development, enhancement, maintenance, protection and exploitation (**DEMPE**) of the relevant intangible assets.

This is a major change in approach to intra-group income allocation. It will require groups to re-assess current arrangements to determine how (in light of the distribution of DEMPE functions) income from intangible assets should be allocated and to ensure that compensation in respect of any intra-group arrangements reflects the value of the contribution by various members of the group.

Groups (both multinational and domestic) will also need to consider the location of people functions and the optimal deployment of staff, as a result of the changes.

In light of the above, we suggest that:

1. A reasonable lead in time is provided before the 2017 Guidelines take effect, in order to provide companies with adequate time to prepare for the introduction of the new framework. Mr Coffey, in his Review of Ireland's Corporation Tax Code recommended an implementation date no later than the end of 2020 (being the year to which the OECD and G20 have agreed to extend their cooperation on BEPS to complete the current work) and we believe this would provide adequate time for taxpayers to organise their affairs.

2. Irish Revenue publishes clear and comprehensive guidance prior to the 2017 Guidelines taking effect, as to how they will administer the transfer pricing rules under the new framework.

3. The 2017 Guidelines should apply prospectively only.

4. It is ensured that Irish Revenue has the requisite staff and expertise to deal with the technical requirements and resources required to adequately and fairly administer the new framework. This additional manpower and resources will also be required to deal with the likely increase in international transfer pricing disputes and challenges raised by foreign tax authorities.

Removal of the exemption for arrangements in place since pre July 2010

It is intended to extend the transfer pricing legislation to arrangements the terms of which were agreed before 1 July 2010, commencing from 1 January 2020.

Q: Do you consider that this proposed course of action will give rise to any specific issues?

What are the key considerations regarding the implementation of this recommendation?

A transitional period providing a reasonable lead in time for the removal of the exemption should be provided if the exemption currently in place for "pre-1 July 2010 arrangements" is to be removed and the Irish transfer pricing regime (updated to the OECD 2017 Guidelines) is to apply to such arrangements.

This will allow entities which have pre-1 July 2010 intra-group arrangements, time in order to allow them to (i) review such arrangements and (ii) consider and action the changes necessary to align the arrangements with the updated Irish transfer pricing legislation.

Additionally, if the transfer pricing rules are extended so that they apply to SMEs, any exemptions, or simplified documentation requirements for SMEs in respect of intra-group arrangements, should also apply where the relevant arrangement is a pre-1 July 2010 arrangement entered into by such a SME.

Extension of transfer pricing rules to SMEs

Q: Do you consider that transfer pricing legislation should be extended to small and medium enterprises?

No, the transfer pricing legislation should not be extended to capture SMEs. The purpose of transfer pricing rules is to reduce the opportunities for corporate profits to be manipulated through related-party, cross-border transactions. The existing SME exemption ensures that the transfer pricing rules do not apply to entities which would be disproportionately burdened by the cost (in terms of time and expense) of complying with transfer pricing obligations relative to the transfer pricing risk they pose.

The SME exemption under Irish law relies on the EU law definition of SME in Commission Recommendation (2003/361/EC). This definition consolidates entities which are connected through capital, voting rights or common control for the purposes of applying the various SME thresholds. This means that enterprises with significant international operations (i.e. those with capacity to take advantage of non-arm's length pricing) would rarely qualify for the SME exemption.

Further, the existing Irish tax rules already adequately limit the ability of SMEs to abuse non-arm's length transactions, including the market value substitution rule for capital disposals, the close company provisions, general anti-avoidance rules and the limit on deductibility of any expenditure above market price.

Therefore, overall, eliminating the SME exemption would place additional administrative burden on SMEs and Irish Revenue without an obvious increase in tax revenues.

Q: What level of documentation do you feel would be appropriate to require SMEs to maintain to demonstrate compliance with transfer pricing rules?

SMEs should be exempt from the transfer pricing regime. In this case, SMEs should only be required to maintain documentation that adequately evidences that the entity qualifies as an SME (as defined for Irish transfer pricing purposes). The prescribed corporate tax return form could make provision for corporates to indicate whether or not the entity qualifies for the SME exemption to ensure that Irish SMEs analyse whether the SME test is satisfied on a regular basis and Irish Revenue have oversight over which entities are claiming the exemption.

The OECD recommends that SMEs should not be required to produce the same level of documentation as larger enterprises. This reflects the fact that the cost of compliance with transfer pricing obligations should be proportionate to the risk that the taxpayer poses.

Therefore, if the existing SME exemption is not adopted in the revised transfer pricing rules, (which is not the recommend approach), then:

- Legislative de minimis thresholds (which exempt low value transactions) and safe harbour rate ranges (for common types of related-party transactions) should be provided for to limit the transactions for which transfer pricing documentation is mandatory.
- A simplified documentation framework should be made available to SMEs (for transactions above the de minimis threshold or above/below the applicable safe harbour rate range). This framework should provide flexibility such that the documentation is commensurate to the complexity and value of the transaction (i.e. essentially similar to the existing provisions relating to documentation).
- Any penalties for failure to maintain complying documentation should be reduced for SMEs to reflect the increased difficulty SMEs face (as compared with large taxpayers) sourcing and funding the technical expertise required to prepare documentation evidencing the application of complex transfer pricing methodologies.

Q: If transfer pricing rules are extended to SMEs, what other measures might be considered to mitigate the compliance burden for SMEs?

If the transfer pricing rules are extended to SMEs (which is not the recommended approach) it will be necessary to implement a number of measures that mitigate the burden for SMEs. Examples of measures that may assist with efficient implementation of the new regime as well as limit the negative outcomes for SMEs are set out below.

A generous grace period should apply before the transfer pricing regime commences for SMEs (i.e. 1 January 2021 at the earliest) with grandfathering of existing transactions. This will allow SMEs to develop an understanding of the complex transfer pricing requirements and prepare any necessary documentation.

The scope of the transfer pricing rules for SMEs should be narrow and targeted at high risk transactions (e.g. transfer pricing should only apply to trading transactions that involve a cross-border element).

SMEs should also be given discretion to apply reduced documentation requirements.

It will be essential that Irish Revenue publish detailed guidance on the transfer pricing rules (as applicable to SMEs) and a step-by-step compliance manual for SMEs (with worked examples and documentation template examples). Irish Revenue would also need to consult with the SME community in advance of the extension of the transfer pricing rules (e.g. host training conferences for SMEs across Ireland).

Additionally, Irish Revenue could establish a well-resourced department with transfer pricing expertise in order to address ongoing queries from the large number of taxpayers that will be dealing with transfer pricing compliance for the first time (and therefore have no experience in this field).

Any failure to comply penalties which relate to transfer pricing should be significantly reduced for SMEs to reflect the lack of experience and technical expertise available to smaller taxpayers in this complex area.

Q: What particular issues do you consider might arise from the application of transfer pricing rules to SME transactions with effect from 1 January 2020?

Administrative burden

Transfer pricing is a highly specialised area of law. The transfer pricing rules and pricing methodologies are complex. Applying these methodologies to determine an arm's length price involves a technical assessment. The complexity is illustrated in high profile disputes between large taxpayers (who have the assistance of highly regarded transfer pricing experts) and revenue authorities in Ireland and abroad about both the choice and application of transfer pricing methodologies. The largest accounting firms and law firms typically have individuals specialising solely in transfer pricing. SMEs are unlikely to have sufficient resources to hire an in-house transfer pricing specialist or engage external specialists to undertake detailed transfer pricing analysis. Further, the cost of an SME obtaining transfer pricing advice is disproportionate to the risk that its transactions pose from a transfer pricing perspective.

Lack of expertise

A significant proportion of enterprises operating in Ireland are SMEs – these entities have little, or in most cases, no in-house transfer pricing experience. Extending the transfer pricing rules to SMEs would substantially increase demand for transfer pricing expertise. It will take a considerable period of time for the Irish market to upskill in this field. In the meantime, there will be a lack of expertise to service the increased demand for transfer pricing assistance. This will result in uncertainty, errors and additional pressure on Irish Revenue which will need to deal with queries, review documentation and liaise with a large number of SMEs.

Government resources

Irish Revenue will need additional resources to deal with the larger number of SMEs brought within the ambit of the transfer pricing rules. Additional transfer pricing expertise will be crucial to assisting and monitoring taxpayer compliance. The required transfer pricing expertise may not be readily available.

Competitiveness

Ireland should not impose any regulatory burden on taxpayers which is not strictly required. SME exemptions are adopted in many jurisdictions (e.g. the UK exempts most SMEs). Repealing the SME exemption will make Ireland a less attractive place for SMEs to operate (as compared with the many jurisdictions which provide for the exemption).

The SME sector is unarguably important for the development of entrepreneurship and job creation. Additional administrative obligations will make Ireland a less attractive investment option and hinder the growth of domestic business (which ultimately diminishes the potential for Irish businesses to expand).

<u>Extending Transfer Pricing Rules to non-Trading Income and Capital Transactions</u>

It is intended to extend the transfer pricing rules to non-trading income chargeable to tax under Case III, Case IV and Case V of Schedule D where such an extension would reduce the risk of aggressive tax planning as recommended by the Coffey Review.

Q: Are there any issues which may arise through the extension of transfer pricing rules to non-trading income and how may any such issues be resolved?

Unlike most other jurisdictions, Ireland has two rates of corporation tax – a 12.5% rate applying to trading income; and a 25% rate applying to non-trading, passive income. This rate differential gives rise to a risk of mismatches and double taxation if transfer pricing rules are extended to non-trading transactions. This risk is particularly evident in the context of intra-group financing transactions. In its simplest form, an intra-group loan provided by an Irish holding company to its Irish operating subsidiary would trigger a tax charge at the 25% rate with a deduction at the 12.5% rate if brought within the scope of transfer pricing rules. We understand that this rate differential was one of the primary reasons for excluding non-trading transactions from the scope of Irish transfer pricing rules when they were introduced in 2011, as it was already viewed as an adequate deterrent against abuse.

Because of this rate mismatch, interest free lending is an extremely common means of deploying capital among Irish companies and a change to Ireland's transfer pricing rules bringing these transactions within scope would have a significant impact on most corporate groups operating in Ireland. In his report[1], Mr Coffey noted that "there is a strong rationale to extend domestic transfer pricing rules to non-trading income where it would reduce the risk of aggressive tax planning". The recommendation was based on a report carried out for the European Commission as part of a Study on Structures of Aggressive Tax Planning & Indicators, which identified the non-application of transfer pricing rules to intra-group non-trading interest free loans as rendering Ireland vulnerable to aggressive tax planning in the context of intra-group financing.

While we believe that mismatches of that nature should, in the first instance, be addressed in the counterparty jurisdiction which grants a notional deduction (in the absence of any actual payment of interest), to the extent that changes are required to Irish rules, we believe that these should be by way of targeted measures. We believe that the disadvantages of extending transfer pricing rules to non-trading transactions outweigh the benefits and that aggressive tax planning may be effectively curtailed, where necessary, through specific measures.

If, however, transfer pricing rules are extended to non-trading transactions, it is vital that tax neutrality is preserved. One means of achieving this would be to move to a single 12.5% rate of corporation tax for trading and non-trading income. It would appear that one of the key historic drivers of maintaining the higher 25% rate for "passive" income was to ensure that low substance, "brass plate" operations could not be established in Ireland benefitting from Ireland's low corporate tax rate. The extension of Ireland's transfer pricing rules to encompass non-trading transactions coupled with the likely adoption of the 2017 Guidelines would mean that this should no longer be a concern. This outcome is also in line with the overall aim of the OECD BEPS Project. These combined measures would protect against abuse of the 12.5% rate by ensuring that only profits attributable to Irish based substance would be ascribed to the Irish operation in any event.

Given the fundamental nature of this proposed change, if it is to be adopted, it is vital that draft legislation is made available and consulted upon well in advance of enactment and accompanied by comprehensive guidance from Irish Revenue. Again, we believe that the recommended implementation date of the end of 2020 (as outlined in Review of Ireland's Corporation Tax Code) would provide adequate time for taxpayers to organise their affairs. In our view, any changes to be adopted should also take effect on an accounting period basis rather than calendar year basis (e.g. for accounting periods commencing after 31 December 2020) in order to avoid difficulties for taxpayers in implementing any changes midway through an accounting period.

Q; Do you believe that the current market value rules are sufficient so that capital transactions do not need to be subject to separate transfer pricing rules?

[1] *Review of Ireland's Corporation Tax Code*

Irish capital gains tax legislation contains a range of anti-avoidance measures which ensure that market value is applied to capital transactions between connected parties. This existing legislation has the effect of applying arm's length principles to intra-group capital transactions. The inclusion of transfer pricing measures in addition to these existing rules would add significant complexity which is unnecessary. As a result, we believe that capital transactions should remain outside the scope of transfer pricing rules. We understand that a similar approach is taken in the UK and we believe that the risk of non-arm's length pricing being applied to intra-group capital transactions is equally low in this jurisdiction.

Q: Could these rules be supplemented by additional documentation requirements?

We do not see the need for additional documentation requirements in connection with these rules.

<u>Extending Transfer Pricing Documentation</u>

Q: What particular issues do you consider might arise if the enhanced documentation requirements were to apply from 1 January 2020?

Many taxpayers are unlikely to have the capabilities required to comply with the more extensive tiered approach to transfer pricing documentation by 1 January 2020. The enhanced documentation requirements represent an increased reporting burden for Irish companies. For an efficient transition to the 2017 Guidelines, Irish businesses will need sufficient time to find the necessary resources (manpower, expertise and budget) and align their systems to deal with the additional burden.

There will also be insufficient time for Irish Revenue to publish comprehensive guidance (which has been consulted on) well in advance of the new documentary requirements (as well as other complex matters, e.g. mechanism for adjustments / grouping of transactions / applications of results over multiple tax periods). This will be particularly important in relation to simplified reporting frameworks that less sophisticated taxpayers will adhere to.

Are there any circumstances in which the documentation requirements should be reduced or limited in specific respects?

The documentary requirements should be limited in a number of instances to reduce the administrative burden on taxpayers and Irish Revenue. Some examples of circumstances in which exceptions to full formal documentation requirements should be given to taxpayers are provided below.

- SMEs should be generally exempt from maintaining any documentation.
- Materiality levels are recommended by the OECD. De minimis thresholds and safe harbour rate ranges should exempt low value or low risk transactions from documentary requirements. These thresholds should reflect the size and nature of the multinational groups in Ireland.
- In the absence of a full exemption, at a minimum, SMEs should be subject to a simplified documentation framework.
- The existing documentation regime is robust and provides taxpayers flexibility to prepare documentation that is suitable to their business. A grace period should apply from 1 January 2020 throughout which the current standard for documentation should be the default requirement (with a choice for early adoption of the enhanced documentation from 1 January 2020).
- Only significant global entities should be required to lodge a Master File. The Country-by-Country Reporting threshold (i.e. consolidated group revenue of €750 million or more in the immediately preceding year) could be adopted as the Master File threshold.
- The OECD recommends that transfer pricing documentation (Local File and Master File) are reviewed annually. This imposes an unnecessary burden on taxpayers. Instead, review should be required where there has been a material change (e.g. in the function and risk profile of the transacting parties). In particular, there is no benefit in benchmarking studies being reviewed annually given that comparable data is not typically updated this frequently.

- Irish entities should continue to be able to rely on counterparty documentation (provided that it satisfies the Irish standard for documentation as prescribed under the new rules) to limit duplication and transfer pricing costs.

Yours faithfully

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