

Irish Revenue Transfer Pricing Tax and Duty Manual – what does it mean for Irish taxpayers?

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In brief

Irish Revenue recently released Part 35A-01-01, Transfer Pricing Tax and Duty Manual (Tax and Duty Manual). The Manual seeks to give taxpayers additional guidance on the new rules introduced by Finance Bill 2019.

Note: Parallel to issuing the guidance described in this summary, Irish Revenue issued Part 35A-01-02 on the Transfer Pricing Documentation Obligations and Part 35A-01-03 about Guidelines on Low Value Intra-Group Services, which are applicable for accounting periods prior to January 1, 2020.

Finance Bill 2019 introduced significant changes to the Irish transfer pricing rules, principally updating the Irish legislation to refer to the 2017 OECD Transfer Pricing Guidelines, widening the scope of Irish transfer pricing rules to include non-trading and certain capital transactions, removing grandfathering and introducing the Master File and Local File, and adopting the documentation requirements as set out in the OECD BEPS Action 13 on Transfer Pricing Documentation.

The Tax and Duty Manual is a significant step in development of the Irish transfer pricing regime, not just because it gives additional background on the application of the wide-ranging changes introduced by Finance Bill 2019, but also because this is the first time that Irish Revenue has provided insight into how it will consider intercompany transactions going forward.

Action item: Taxpayer's should review the guidance in the Tax and Duty Manual to determine the potential impact. The key takeaways from the Manual are discussed below.

In detail

Endorsement of the 2017 OECD Transfer Pricing Guidelines

An important and significant change in Irish legislation was the endorsement of the 2017 OECD Transfer Pricing Guidelines. That not only paved the way for the introduction of the BEPS Action 13-compliant Master File and Local File rules (see more details below), but also incorporated the Guidance on Hard to Value Intangibles and the revised guidance on the Application of the Transactional Profit Split Method.

In line with the 2017 OECD Transfer Pricing Guidelines and the recommendations of BEPS Actions 8-10, the accurate delineation of the arrangements and accordingly the substance of related-party transactions will be in the center of the transfer pricing analysis. The Tax and Duty Manual confirms that intercompany transactions can be disregarded and, if appropriate, replaced by an alternative transaction where the identified arrangement — viewed in its totality — differs from an arrangement that would have been entered into by independent parties under similar circumstances. However, the Tax and Duty Manual explicitly states that such a re-characterization may be considered only in exceptional circumstances, which aligns the legislation with the 2017 OECD Transfer Pricing Guidelines.

Additionally, following the BEPS Action Plans, the 2017 OECD Transfer Pricing Guidelines places significant emphasis on aligning substance with value creation. This includes the introduction of important functions relating to intangible property, the so-called DEMPE (Development, Enhancement, Maintenance, Protection, Exploitation) functions, and guidance around the appropriate allocation of risk between related parties and its impact on the allocation of profits.

Observation: The endorsement of the 2017 OECD Transfer Pricing Guidelines brings the Irish transfer pricing rules in line with international best practice and aligns with the approach set out in “Ireland’s Corporation Tax Roadmap” published in September 2018 and enacted in Finance Act 2019.

Transfer pricing documentation requirements

As mentioned above, Finance Act 2019 introduced BEPS Action 13-compliant documentation requirements — Master File and Local File — into Irish law. The requirement to prepare the files is subject to de minimis group turnover-based thresholds (€250m for Master File and €50m for Local Files).

Further to the description of the minimum content requirements of transfer pricing reports, the Tax and Duty Manual explains how frequently those should be revised. It clarifies that transfer pricing documentation may be carried forward from one year to the next to the extent that facts and circumstances are materially unchanged, but information showing how the transfer pricing policy actually was applied in each period should be updated annually.

The Tax and Duty Manual also touches on the requirements of benchmark analyses and confirms that for a Transactional Net Margin Method (TNMM) benchmark study, Irish Revenue generally will expect a full benchmark study to be prepared every three years and for the financials of the accepted comparables to be updated or refreshed at least annually.

Importantly, the Tax and Duty Manual gives further background on the application of penalties should a taxpayer fail to meet the above requirements, and elaborates on how it can be demonstrated that reasonable efforts have been made to avail of the penalty protection measures.

The Manual also clarifies that the previous guidance on low value intra-group services (Revenue eBrief No. 37/18) now has been superseded by the guidance in Section D of Chapter VII of the 2017 OECD Guidelines for accounting years commencing on or after January 1, 2020, both in terms of the applicable mark-up (5%) and the documentation requirements. **Note:** The eBrief and the OECD Guidelines are substantially similar in content and approach.

Finally, the Tax and Duty Manual identifies and discusses several simplification measures intended to help minimize the burden of compliance on taxpayers, including the aggregation of smaller transactions, the use of a single “Country File” instead of several entity-level local files, and the use of transfer pricing documentation prepared by counter-parties and held outside of Ireland.

Observation: The modernization of the Irish transfer pricing documentation regime that had been introduced by Finance Act 2010 also was expected. The implementation of requirements contained in the 2017 OECD Guidelines brings the Irish rules in line with international best practice. The guidance relating to the additional simplification

measures covered in the Tax and Duty Manual is helpful. However, the practical benefits of those measures and the extent of their take-up by taxpayers are yet to be seen.

Debt capacity

The Tax and Duty Manual gives guidance on application of the “Transfer Pricing Guidance on Financial Transactions,” published by the OECD in February 2020, which will form part of the OECD Transfer Pricing Guidelines. Irish Revenue (at section 4.4.2 of the Tax and Duty Manual) confirms that “while this guidance has not yet been implemented into Irish law and is subject to a future Ministerial Order, it will be considered as best practice by Revenue when analyzing transfer pricing issues associated with financial transactions.” Additionally, Revenue is of the opinion that the guidance provides direction on how to apply the approach set out in Chapter I, D.1 of the 2017 OECD Guidelines to Financial Transactions.

Accordingly, in addition to seeking to price interest rates in accordance with the arm’s-length principle, MNE groups must be able to demonstrate that the debt capacity of the borrower and serviceability tests have been considered. The Tax and Duty Manual clarifies that this requirement is relevant for any interest deductions taken in financial years ending after January 1, 2020, regardless of when the loan originated. The Tax and Duty Manual also notes that the debt capacity of a borrower should be considered at the time the arrangement was entered into, which may raise similar challenges in relation to historical intercompany debt balances.

The Tax and Duty Manual also clarifies that for loans qualifying under section 247 of the Taxes Consolidation Act 1997 (TCA), debt capacity and serviceability tests will apply where the interest relates to, and is paid in, an accounting year ending after January 1, 2020 (i.e., it will not apply to interest accrued in prior periods and paid on or after January 1, 2020).

Observation: The clarification provided by the Tax and Duty Manual about Irish Revenue’s expectation on debt capacity and serviceability requirements is helpful. However, some practical questions remain in relation to the actual and practical application of these, particularly in relation to loans drawn down prior to 2020.

Capital transactions

Finance Bill 2019 also extended transfer pricing rules to capital transactions from January 1, 2020, but only where the capital expenditure incurred on an asset or the market value of an asset exceeds €25 million. The exclusion is subject to an anti-avoidance provision intended to prevent fragmenting an asset into separate assets to avoid the €25 million threshold.

The Tax and Duty Manual clarifies that the transfer pricing rules apply where the event giving rise to the balancing allowance or balancing charge occurs on or after January 1, 2020 (irrespective of when the related expenditure was incurred). Where transfer pricing rules do apply, they apply in place of the existing market value rules used for CGT purposes. However, with respect to certain CGT intergroup provisions in relation to intergroup transfers, they are “disapplied.” **Note:** In circumstances where the transfer pricing rules are applied, if the application of the transfer pricing rules would result in a higher allowance (or a reduced balancing charge) than would be the case if the market value rules applied, the transfer pricing rules (including documentation requirements) are effectively “disapplied.” Finally, Irish Revenue notes the transfer pricing rules do not apply to “deemed” transactions for Capital Allowances and CGT purposes.

Observation: The extension of the transfer pricing rules to capital transactions has been part of the broader effort to align the Irish transfer pricing rules with international best practice. The guidance provided in the Tax and Duty Manual should be a helpful resource for taxpayers and prove useful in understanding the interactions between existing Group relieving provisions and the Transfer Pricing documentation requirements for capital gains and capital allowances transactions.

Non-trading transactions

One significant change put forward by Finance Bill 2019 was the extension of transfer pricing rules to non-trading arrangements. According to the new rules, non-trading transactions (except for a limited range of domestic transactions) are subject to transfer pricing rules from January 1, 2020. However, during the application of the new legislation, several practical questions have arisen that the Tax and Duty Manual attempts to clarify in order to provide additional guidance to taxpayers.

One of the most complex areas of the new transfer pricing rules proved to be the application of the domestic exemption provided for non-trading transactions. The Tax and Duty Manual clarifies that this exclusion does not include all domestic non-trading transactions. A non-trading transaction will be excluded from the new transfer pricing rules only if it meets certain, specific criteria, and the exclusion is itself also subject to anti-avoidance provisions.

As per section 835E, the most critical condition is that the supplier and the acquirer each need to meet the definition of “qualifying relevant persons,” i.e., the requirement that the parties be Irish tax resident, subject to tax under Schedule D, and not be a company qualifying under section 110 of the TCA. The Tax and Duty Manual aims to provide additional clarity where it is unclear whether the exclusion applies. **Note:** Finance Bill 2020 introduced subsequent modifications to section 835E, the commencement of which will be subject to a Ministerial Order. Given that the Ministerial Order was not yet in place at the time of issuing the Tax and Duty Manual, Revenue refrained from providing extensive guidance in relation to the application of the exclusion from the transfer pricing rules for domestic non-trading arrangements.

The extension of transfer pricing rules to non-trading transactions has brought historic intercompany debt balances within the Irish transfer pricing regulations that to this point had been disregarded. Given the historic nature of these loan balances, the Tax and Duty Manual acknowledges the potential difficulties in tracing their origins, and confirms that where it is not possible to trace the origin of each movement, the balance should be treated as arising from the earliest date for which reliable information is available.

Observation: The extension of transfer pricing rules to non-trading transactions also has been an expected step announced some time prior to enactment. However, the item that received the most attention was the practical guidance around the application of the domestic exclusion rules. Notwithstanding the efforts in the Tax and Duty Manual to shed light on practical questions arising in relation to the application of the new rules to non-trading transactions, additional insight into Irish Revenue’s interpretation of the practical implementation of these new rules would be welcomed by taxpayers.

Grandfathered transactions

When first introduced in 2010, transfer pricing legislation did not apply in respect of transactions the terms of which were agreed before July 1, 2010 (i.e., ‘grandfathered transactions’). Finance Act 2019 applies transfer pricing rules to previously grandfathered transactions for chargeable periods commencing on or after January 1, 2020. While these transactions are subject to transfer pricing rules (unless the exemption under section 835E applies), exemptions from the documentation requirements are discussed in section 8.12 of the Tax and Duty Manual apply.

The Tax and Duty Manual provides further background on the application of transfer pricing rules to previously grandfathered transactions. The Tax and Duty Manual notes that transfer pricing documentation requirements do not apply to pre-July 1, 2010 arrangements if both the supplier and the acquirer are “qualifying relevant persons;” therefore, the exemption from documentation requirement would only apply in limited instances.

Observation: As a further measure to align the Irish rules with international best practice and as was announced well in advance of its enactment in Finance Act 2019, the guidance in the Tax and Duty Manual in relation to grandfathered transactions is as expected.

Small and medium enterprises (SMEs)

In relation to SMEs, Finance Bill 2019 kept micro and small enterprises outside the scope of transfer pricing rules, but set out the option for medium enterprises to be brought in under the rules through a future Ministerial order. The Tax and Duty Manual clarifies the definition of SMEs as well as the specific requirements of the new rules and the exemption applicable for medium enterprises once the Ministerial order is issued. These requirements include the medium enterprise to have transfer pricing documentation in place for a “relevant arrangement.”

A relevant arrangement is an arrangement between a medium enterprise and an associated person who is not a qualifying relevant person (as per the non-trading transactions paragraph above) and the consideration exceeds €1 million. A relevant arrangement also includes an arrangement between a medium enterprise and an associated person who is not Irish resident, where that arrangement involves the disposal or acquisition of a chargeable asset for the purposes of chargeable gains, the asset has a market value exceeding €25 million, and the asset ceases to be a chargeable asset in the case of a disposal or was not a chargeable asset before its acquisition in the case of an acquisition.

The transfer pricing documentation required where there is a relevant arrangement is reduced and simplified, as compared to the transfer pricing documentation required to be provided by larger enterprises.

A medium enterprise will be required to have the following transfer pricing documentation available:

- A description of the business of the medium enterprise, including its organizational structure, business strategy, and key competitors, and,

in relation to each relevant arrangement:

- A copy of all relevant agreements;
- A description of the transfer pricing method used and the reasons the method was selected, along with the evidence to support the price selected as being an arm’s-length amount;
- The amount of consideration payable or receivable under the arrangement; and
- A description of the functions performed, risks assumed, and assets employed.

Observation: The guidance on the reduced documentation requirements for medium-sized enterprises should prove a useful resource for those taxpayers once the relevant legislation is enacted by the Minister of Finance.

The takeaway

The Tax and Duty Manual should prove a useful tool for taxpayers. Further guidance would be welcome in the area of debt capacity, where practical issues most likely will arise in relation to historic transactions and some specific structures, and the exemption to transfer pricing rules available for certain domestic non-trading transactions. In any event, the guidance likely will need to be updated in due course as Finance Act 2020 changes to section 835E are enacted and as the updated OECD Guidelines and its Financial Transactions Paper eventually are enacted within Irish law.

Let's talk

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