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Irish transfer pricing: leaping ahead

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Friday, January 24th, 2020

Revised transfer pricing legislation set out in the Finance Act 2019 (No 45 of 2019), sections 24 to 27, represents a radical shift in the Irish approach to this area of international tax law. Transfer pricing legislation came somewhat later to Ireland than other OECD countries, having been first introduced in Finance Act 2010. The initial Irish legislation applied the 2010 OECD Transfer Pricing Guidelines to accounting periods from 1 January 2011 in respect of transactions agreed after 1 July 2010.

Again, somewhat slower than some other countries, the 2017 OECD Transfer Pricing Guidelines came into effect on 1 January 2020 in Ireland. This might be contrasted with early adopters such as the United Kingdom which incorporated the BEPS Actions 8 – 10 final report into domestic law for accounting periods from 1 April 2016, even before the Guidelines had been updated by the OECD and the 2017 OECD Guidelines apply in the United Kingdom for accounting periods from 1 April 2018.

Post 2019 Guidance adopted

The Irish Finance Act reveals a determination to keep up-to-date. In addition to the 2017 Guidelines, two BEPS follow-up reports that have not yet been included in the Guidelines by the OECD are given force of law in Ireland: the *Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles* and the *Revised Guidance on the Application of the Transactional Profit Split Method*. These reports have been approved by the Inclusive Framework on BEPS but do not the subject of yet formal recommendations of the OECD Committee on Fiscal Affairs.

Irish transfer pricing law will be considerably broader in light of Finance Act 2019. Previously, the arm's length principle was applied to trading transactions only (commonly operations of a commercial character that provide goods or services to customers for reward. Income from the ownership of property or assets is not normally income). Henceforth, the transfer pricing regime will apply to any source of income or gain including substantial capital transactions (market value €25 million). Domestic transactions will also be within the scope of the legislation if they are across the divide between trades that attract the 12.5% corporation tax rate and the more general 25% rate.

Recognition of transactions undertaken

In addition to a broad adoption of the 2017 Guidelines, the new Irish transfer pricing legislation requires the identification of "actual commercial or financial relations" and the "conditions and economically relevant circumstances attaching to those relations" (the 'identified arrangement'). This is a loose adaptation of the requirement in the Guidelines to identify transactions and to ensure that they are accurately delineated by supplementing contractual terms with the economically relevant characteristics (to ensure that a contractual arrangement is not varied by conduct of the parties).

The legislation will require that an identified arrangement is to be based on the substance of commercial and financial arrangements where the form of the arrangement is inconsistent with those relations. A divergence between the form and substance of a transaction was one ground for recharacterization authorised by the 2010 OECD Guidelines (e.g. debt recharacterized as equity in thin-capitalisation cases). The 2017 Guidelines make it clear that the substance of a transaction is identified by application of the Guidance on identifying the commercial or financial relations. This only emerges by inference in the Finance Act.

In contrast, the Finance Act, by introducing s 835C(5)(b) Taxes Consolidation Act 1997, explicitly refers to and incorporates the circumstances set out in the 2017 Guidelines in which an actual transaction may be disregarded for transfer pricing purposes. That is, if the identified arrangement, viewed in its totality, differs from that which would have been adopted by independent parties behaving in a commercially rational manner in comparable circumstances. In such cases, the Irish Revenue will be able to either disregard a transaction or replace it with "an alternative arrangement that achieves a commercially rational expected result".

This radical authority to recharacterise transactions for transfer pricing purposes is likely to be controversial. Recharacterization has been rejected by the courts in Australia and Canada in two recent transfer pricing decisions as being antithetical to the arm's length principle. In *Cameco Corporation v The Queen* (2018 TCC 195), the Tax Court of Canada addressed the issue, saying that "[706] The answer is not that one simply disregards all the transactions that did take place and taxes…as if nothing in fact occurred because arm's length persons would not have entered into the series. Such an approach …completely disregards the purpose and focus of the transfer pricing rules by circumventing the comparability analysis that is at the heart of the rules."

Similarly, in *Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* [2019] FCA 1432, the Federal Court of Australia rejected recharacterisation of a transaction on the basis that, recharacterisation of a transaction to what might have occurred at arm's length and then comparing the recharacterised transaction with an uncontrolled transaction, conflates the process of determining what constitutes the control transaction and the process of comparing it with an uncontrolled transaction.

UK Diverted Profits Tax recharacterisation

By comparison, the UK transfer pricing legislation itself contains no recharacterization authority. This power is given in relation to Diverted profits Tax,

however. Finance Act 2015 s 80 establishes a super transfer pricing rule for transactions lacking “economic substance”. Where these rules apply, an alternative transaction that arm’s length parties would have entered into may be substituted for the actual transaction. Among other requirements, the transaction must be designed to secure a tax reduction.

Compatibility with EU fundamental freedoms

The revised Irish transfer pricing law makes no attempt to give effect to or address the European Court of Justice decision in C 382/16, *Hornbach-Baumarkt-AG v Finanzamt Landau* ECLI:EU:C:2018:366.

in that case the Court ruled that German transfer pricing legislation which applies only in cross-border situations, infringed the right of establishment unless resident taxpayers have the opportunity to show that the terms of a related party transaction were agreed for commercial reasons resulting from their status as a shareholder of the non-resident company they control. The judgement appears to permit non-arm’s-length pricing if that pricing is commercially justified in the case of a shareholder investing in a company it controls. How this analysis might fit with transfer pricing analysis is not entirely clear.

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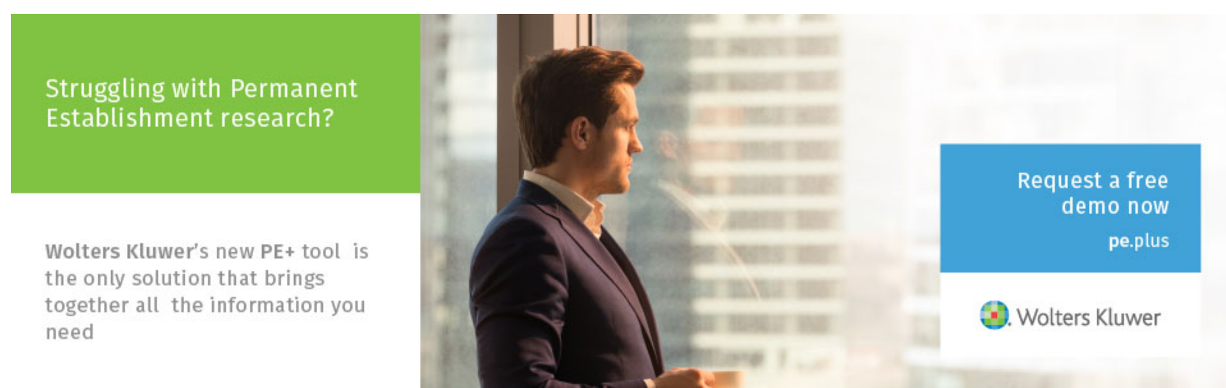

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