[35A-01-01] Monitoring Compliance with Transfer Pricing rules contained in Part 35A TCA 1997

Reviewed June 2016

1. INTRODUCTION

1.1. This instruction sets out Revenue's approach to monitoring compliance with transfer pricing legislation contained in Part 35A of the Taxes Consolidation Act 1997 ("TCA 1997").

1.2. The transfer pricing provisions were enacted into law by section 42 of Finance Act 2010. The provisions —

- are effective for accounting periods commencing on or after 1 January 2011; and
- apply in relation to related-party trading transactions (referred to in the legislation as *arrangements*) any of the terms of which were agreed on or after 1 July 2010.

1.3. Returns for the first relevant 12-month accounting periods, being accounting periods ended on 31 December 2011, were due in September 2012.

2. BACKGROUND

2.1. *Arm's length principle*

Part 35A TCA 1997 sets out transfer pricing rules that apply the arm's length principle ("**ALP**"), whereby the amount charged by one related party to another for a product or service must be the same as would be charged between unrelated parties. The rules apply to trading transactions between associated persons. 'Arm's length' is to be construed as far as practicable in accordance with the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*1. If an expense incurred by a trader in dealings with an associated person is greater than the arm's length price, or receipts are less than the arm's length amount, the trader's profits will be understated for Irish tax purposes. The transfer pricing rules require this understatement of profits to be reversed so that the full arm's length profits will be taxed.

2.2. *Scope of the legislation*

The transfer pricing rules in Part 35A apply to:

- any *arrangement* involving the supply and acquisition of goods, services, money or intangibles;
- where at the time of supply and acquisition the relevant parties are *associated*; and
- the profits, gains or losses arising are within the charge to tax under Case I/ II of Schedule D (i.e. they arise from *trading* transactions) for either or both of the associated parties.

Part 35A applies to transactions any of the terms of which are agreed on or after 1 July 2010. The provisions apply to both cross-border and domestic transactions. Small and Medium Enterprises ("**SMEs**") are excluded from the scope of the specific transfer pricing rules in Part 35A TCA 1997. Broadly, SMEs are entities which, on a group basis, have less than 250 employees and either a turnover of less than €50m or assets of less than €43m. Despite not being subject to the specific transfer pricing rules, SMEs continue to be subject to general principles[2] that *inter alia* guard against abusive transfer pricing practices.

2.3. *Applicable periods*

As noted above, the legislation applies to accounting periods commencing on or after 1 January 2011 in respect of any transaction other than a transaction the terms of which were agreed before 1 July 2010 ("grandfathered arrangements" – see below). The first returns for relevant accounting periods were due on or before 21/23 September 2012.

2.4. *Grandfathered arrangements*

Transactions (referred to in the legislation as *arrangements*) all the terms of which were agreed before 1 July 2010 are not subject to the rules, and are "grandfathered". In deciding whether, in relation to an arrangement, the terms were agreed before 1 July 2010 it should be established that –

(a) the relevant agreement envisaged the arrangement or transaction concerned;
(b) the relevant agreement provides the price; and
(c) the relevant agreement is not merely an agreement for future agreements.

2.5. *Documentation and enquiries*

[2] For example, under section 81 TCA 1997, an expense is only deductible in computing taxable profits where it is incurred wholly and exclusively for the purposes of the trade concerned.

Persons involved in transactions that are within the scope of the transfer pricing legislation are required to have such documentation available as may reasonably be required to demonstrate compliance with the legislation, and specifically that the trading income is computed in accordance with the requirements of section 835C TCA 1997.[3] Compliance with the transfer pricing requirements is subject to Revenue enquiries, including audit where applicable.

3. APPROACH TO MONITORING COMPLIANCE

Revenue's aim is to optimise the use of resources in its transfer pricing intervention programme having regard to the complex and time-consuming nature of transfer pricing audits. Experience in other jurisdictions would suggest that transfer pricing cases are very fact-and-circumstance-dependent and authorities need to have a good understanding of the specific commercial context of each case. A risk assessment process is also central to the success of any transfer pricing programme.

The compliance monitoring programme will begin with *transfer pricing compliance review*s (see section 4 below for further details) and then, in time, progress to full transfer pricing audits, where appropriate. This incremental approach will build on the knowledge and experience gained at each stage.

4. TRANSFER PRICING COMPLIANCE REVIEW

4.1. *What is a Transfer Pricing Compliance Review?*

A TPCR is a self-review carried out by the company /group of its compliance with Part 35A TCA 1997 and the application of ALP in relation to relevant trading transactions between associated persons.

4.2. *Why a TPCR?*

A TPCR will give the relevant company/ group the opportunity to review its transfer pricing compliance and to provide Revenue with an assessment of that compliance. A TPCR will also result in Revenue receiving important information (such as facts and data on a particular company/ group's business structure, related party transactions and transfer pricing methodologies used). This information will assist Revenue with its risk assessment generally and its knowledge and understanding of the practical approaches applied by businesses in relation to transfer pricing.

4.3. *Escalation to audit*

[3] Tax Briefing No. 7 of 2010: Transfer Pricing Documentation Obligations

A case selected for TPCR may be escalated to an audit, where appropriate, based on an assessment of risk. For example, this might be considered appropriate where the company declines to complete a self-review or where the output from the review and any follow-up queries indicates that the transfer pricing appears not to be in accordance with ALP and therefore not in compliance with Part 35A TCA 1997.

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6. CONDUCT OF A TPCR

6.1. *Letter of notification of selection for a TPCR*

6.1.1. A letter will be issued to a company/ group selected for a TPCR requesting the company/group to undertake a self-review of its relevant related-party transactions and associated transfer pricing for a specified accounting period. A copy of the letter will also be issued to the appropriate tax agent. It is important that the taxpayer should understand that Revenue considers the TPCR to be a substantial compliance check in its own right and not normally a precursor to the conduct of a transfer pricing audit. This letter will be issued in all cases by an authorised officer who is specifically authorised for the purposes of Part 35A.

6.1.2. The notification letter will generally request the taxpayer to address the following matters during its self-review—

(a) the group structure;
(b) details of each category or type of related party transactions – identifying the associated companies involved;
(c) the pricing structure and transfer pricing methodology used in relation to each category or type of related party transactions;
(d) a summary of the functions, assets and risks of the relevant parties;
(e) a summary list of relevant documentation available and reviewed; and
(f) details of the basis on which it has been established that the arm's length principle is satisfied.

The taxpayer will also be requested to provide Revenue, within a period of 3 months of the date of issue of the notification letter, with a copy of a report that addresses each of the above matters in detailing the outcome of the self-review. In some cases, a transfer pricing study may already have been prepared for the relevant period and a further self-review may be unnecessary. See paragraph 6.1.3 below for further details.

6.1.3. To minimise compliance costs for the taxpayer, and in line with prior Revenue statements[4], the letter will make it clear that where, perhaps in satisfaction of transfer pricing obligations in another country, a transfer pricing report or study already exists, that report or study will suffice provided it contains the information listed above at 6.1.2.

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6.2. ***Code of Practice for Revenue Audit***

TPCRs will not be Revenue audits – nor will they be Revenue investigations – for *Code of Practice* purposes.[5]

7. OUTCOMES FROM A TPCR

7.1. A post-review letter will issue from Revenue. This may convey that no further enquiries are necessary in respect of the period concerned or it may indicate issues for further consideration or discussion within the TPCR process.

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7.3. In some instances other options may be considered, including a transfer pricing audit.

7.4. Where a case escalates from TPCR to a transfer pricing audit, an authorised officer will issue an audit notification letter.

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[4] Tax Briefing No. 7 of 2010: Transfer Pricing Documentation Obligations

[5] Consequently the opportunity to make an *Unprompted Qualifying Disclosure* will still be available to the company / group.

9. GOVERNANCE ARRANGEMENTS

Transfer pricing enquiries can only be initiated by authorised officers who have been specifically authorised in writing for the purposes of Part 35A TCA 1997.[6] While the enquiries must be initiated by an authorised officer, they can then be undertaken by other officers assigned to that task.

10. SUMMARY

Revenue's approach to monitoring compliance with the transfer pricing provisions contained in Part 35A TCA 1997 may be briefly summarised as follows:

- The compliance monitoring programme will begin with *transfer pricing compliance review*s.
- A selection of companies will be requested to conduct a TPCR as described in sections 4- 6 above.
- The initial focus will be on a number of cases selected across the range of large companies.
- The notification letters requesting TPCRs to be undertaken, in respect of specific accounting periods, will give companies a period of 3 months to conduct their review.
- A post-review letter will issue from Revenue conveying that no further enquiries will be made for the period concerned or identifying issues for further consideration/ discussion within the TPCR process.
- In some instances other options may be considered including a transfer pricing audit. Where a case escalates from TPCR to a transfer pricing audit, an authorised officer will issue an audit notification letter.

A *transfer pricing compliance review* is an important compliance intervention in its own right. Revenue will, over time, review and evaluate the effectiveness of the TPCR approach to monitoring compliance with Part 35A TCA 1997.

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