

# Challenges ahead. How robust is your transfer pricing?

## Points of view by Gavan Ryle

Partner, Transfer Pricing  
PricewaterhouseCoopers



**Gavan Ryle**

[gavan.ryle@ie.pwc.com](mailto:gavan.ryle@ie.pwc.com)

Tel: + 353 (1) 792 8704

“More and more countries are introducing transfer pricing rules and there is ever-increasing scrutiny from tax authorities worldwide. Don’t run the risk of disputes. Now, more than ever, it is critical for multi-nationals to have robust transfer pricing arrangements in place”.

So far, 2010 has seen a continuation of the trends – tougher regulation, greater scrutiny – keeping transfer pricing at the top of the tax agenda for multi-nationals. Multi-nationals in Ireland – and I am including Irish headquartered multi-nationals in this regard – have always been affected by transfer pricing developments in the other territories where they are located, but this year the most significant development in transfer pricing for multi-nationals in Ireland has taken place at home.

Ireland brings in new rules – time for review

Following the enactment of Finance Bill 2010, we have now entered a new era of regulation and enforcement from an Irish transfer pricing perspective with the

introduction of broad based transfer pricing legislation in Ireland.

For accounting periods beginning on or after 1 January 2011, related party dealings within the scope of the new Irish rules will need to be entered into on an arm’s length basis so as not to understate the taxable profits reported in Ireland. For a related party dealing to be within the scope of the new Irish transfer pricing rules, that dealing needs to relate to:

- (i) activities taxed at Ireland’s 12.5% tax rate for trading activities; and
- (ii) an arrangement with an associated related party the terms of which were agreed after 1 July 2010.

Consequently, multi-nationals with operations in Ireland that are reviewing their current transfer pricing policies, perhaps as a result of the changed economic conditions or changes to the business arising from the downturn, will now be expected to consider whether any new policy is defensible as arm’s length from an Irish perspective.

This sounds like more work to do, but is it a bad thing?

The impact of the new regulations – potentially positive development for Ireland

The new transfer pricing rules may mean some additional compliance obligations for multinationals in Ireland

as the Irish tax authorities need taxpayers to be able to demonstrate their compliance with the new rules when requested.

However, in many cases, this will be a positive development. The new requirement to consider whether the Irish operations will achieve an arm's length outcome from potential changes to the intercompany business model is more likely to prove beneficial to the multi-national.

Ireland's low rate of corporation tax makes it an attractive home for multinational profits, but up to now and unlike many other territories, Ireland did not require an arm's length outcome. As such, and human nature being what it is, greater importance was generally placed on managing the risk of transfer pricing audits and adjustments in territories with transfer pricing regulations than on getting the answer right for Ireland. This has often led to the focus of projects dealing with business model changes being on territories other than Ireland – with the consequence that the Irish outcome was derived from what worked best for the other territories involved, not from what worked best for the Irish operations.

Now we are heading in to an era where Ireland is on an equal footing with other territories that have enacted legislation to ensure an arm's length outcome is achieved. It can only be a good thing for the Irish operations, and lead to a more balanced attribution of profits within the multi-national, if greater time and attention is paid to the contribution made by Ireland in determining the appropriate transfer pricing policy to implement.

Multi-nationals that pay careful attention to performing the necessary analysis to develop appropriate, defensible business models relevant to their Irish operations, and prepare proper supporting documentation for these arrangements, are ultimately best placed to withstand the ever increasing scrutiny of their transfer pricing arrangements.

It is also worth noting that Ireland's adoption of the new transfer pricing rules also places the Irish tax authorities on a stronger footing to engage with their counterparts in bilateral negotiations such as Advance Pricing Agreements and Mutual Agreement Procedures under the provisions of Ireland's double tax treaties.

#### Other developments – compliance key to increased enforcement

Ensuring compliance with transfer pricing regulations has emerged as a key element of tax administrations looking to maintain their revenues during the difficult economic climate. A quick review of the "Pricing Knowledge Network" news alerts issued to date in 2010 by the global transfer pricing practice of PwC, demonstrates that ongoing development of transfer pricing related regulations and increasingly active tax authority enforcement are consistent themes in the news alerts.

So far this year, we have also heard news of tax administrations in Brazil, Russia, Egypt, France, Australia and Italy announce the introduction of / changes to transfer pricing legislation or documentation requirements. News has also been circulated in relation to the continued focus on transfer pricing enforcement in Australia, Poland, China and, in particular, the US where the IRS has designated transfer pricing as a key focus of its international compliance initiatives. In this regard, the IRS has begun to select transfer pricing issue specialists. It has formed a national transfer pricing group and has begun to hire additional economist resources. These initiatives are aimed at increasing the number and depth of transfer pricing examinations in the near future. Such international developments and events are indicative of the strategy of tax administrations across the globe to continue to develop and enforce transfer pricing regulations.

While to some extent this is a natural response to the growth of multi-nationals and ever increasing globalisation, there is no doubt that the difficult and uncertain economic conditions have also led to the

increased enforcement in recent times.

#### Tough times for multi-nationals too

The irony of the current situation for many tax directors in multi-national companies is that they are now experiencing tougher rules and greater scrutiny at a time when the financial performance of their organisation is being negatively impacted by the economic downturn. As such, a large proportion of multi-nationals may not have at their disposal what is probably the most effective tool in mitigating the risk of transfer pricing audits and adjustments - sufficient profit for every jurisdiction where they do business.

With a smaller pie to be divided up, and hungrier tax administrations, the amount and intensity of disputes relating to transfer pricing is only expected to increase.

#### A time of change

However, it should be borne in mind that another consequence of the economic downturn is the reorganisation and restructuring of businesses to adjust to the changed market conditions. Sustainable intercompany business models are built around the operations of a multi-national organisation. As such, within a multi-national, such changes in the business – be they strategic, operational or organisational – often necessitate a re-evaluation of established intercompany business models.

With greater enforcement, a smaller pie and business change - if ever there was an ideal time to consider the appropriateness and robustness of current transfer pricing policies – that time is now.

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