Position Paper in response to the European Commission's Public Consultation on a proposal for a Council Directive on Transfer Pricing

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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 6,000 is part of the international CTA network which has more than 32,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, the Taxation Institute of Hong Kong and the South African Institute of Taxation. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Executive Summary

The Irish Tax Institute welcomes the opportunity to contribute to the European Commission's public consultation on the proposal for a Council Directive on Transfer Pricing (the Directive).

The objective of the Directive is to increase tax certainty, reduce compliance costs, mitigate the risk of double taxation by harmonising transfer pricing norms within the EU through the incorporation of the arm's length principle into EU law and provide clarification on the role and status of the OECD Transfer Pricing Guidelines.

The Institute is supportive of the objective of increasing tax certainty and reducing compliance costs for taxpayers in applying transfer pricing rules. However, as currently drafted, we consider that the Directive is likely to result in a divergence between the transfer pricing rules applying to transactions within the Single Market and the rules which apply to transactions with third countries. Consequently, while the Directive may result in less transfer pricing disputes arising between EU Member States, in our view, it will lead to an increase in such disputes with third countries.

Two sets of transfer pricing rules operating in parallel would undoubtedly add further complexity, in particular for multinational enterprises in scope of Pillar Two, as the Global Anti-Base Erosion (GloBE) Rules require intra-group transactions to be priced consistently with the arm's length principle.

Our members, who are tax professionals that provide tax services and business expertise to Irish owned and multinational businesses, have raised a number of concerns regarding the rules set out in the proposed Directive. These concerns, which have been set out in detail in Section 3 of this paper, include the following:

- It is intended that the latest version of the OECD Transfer Pricing Guidelines will be binding when applying the arm's length principle in Member States. In order to provide certainty to taxpayers, it would be important that any newly established principles or concepts developed under the OECD Transfer Pricing Guidelines would apply on a prospective basis only. In addition, the adoption of the latest version of the OECD Transfer Pricing Guidelines should only take place following consultation with Member States.

- Rather than detailing the transfer pricing rules in the Directive, in our view, it would be preferable for the Directive to simply make reference to the rules as set out in the OECD Transfer Pricing Guidelines. This would help to minimise the inconsistencies in interpretation which may arise between the application of transfer pricing rules under the Directive and the OECD Transfer Pricing Guidelines.

- As currently drafted, the definition of 'associated enterprises' in the Directive is broader than what exists at present in certain Member States, including Ireland, and therefore is likely to result in an increase in the number of transactions that will be subject to transfer pricing rules in such countries. The 25% threshold also establishes a different criterion to define a group from those which are contained in the proposed Council Directive on Business in Europe: Framework for Income

Taxation (BEFIT) and the Pillar Two GloBE Rules. In so doing, this adds further complexity and compliance costs for business. In our view, a 50% shareholding requirement would be more appropriate to determine the requisite association for transfer pricing rules.

- The Directive provides that a permanent establishment (PE) shall be considered an associated enterprise of the enterprise of which it is a part of. Given the legal and economic differences between a PE and legally independent enterprises we consider it essential that the Directive does not seek to equate a PE with an associated enterprise.

3. Observations on the detailed rules of the Directive

We have set out below some further observations on the detailed rules set out in the Directive as currently drafted.

3.1 Article 3 - Definitions

OECD Transfer Pricing Guidelines

The Directive defines the OECD Transfer Pricing Guidelines as those endorsed by the OECD Council pursuant to the OECD Council Recommendation of the Council on the Determination of Transfer Pricing between Associated Enterprises [C(95)126/Final], and as amended in January, 20 2022 and included in Annex I, any further amendments to these OECD Transfer Pricing Guidelines that the Union approved in the context of the OECD Committee on Fiscal Affairs via the adoption of a Union position under Article 218(9) of the Treaty on the Functioning of the European Union (TFEU).

The Explanatory Memorandum clarifies that to ensure a common application of the arm's length principle, the latest version of the OECD Transfer Pricing Guidelines will be binding when applying the arm's length principle in the Member States. It also states that as the OECD Transfer Pricing Guidelines will be amended from time to time that these new guidelines should be the new binding reference framework.

Adopting a dynamic approach to the definition of the OECD Transfer Pricing Guidelines enables mere clarifications of the rules to be applied immediately. However, in order to provide certainty to taxpayers, it would be critical that any newly established principles or concepts developed under the OECD Transfer Pricing Guidelines would apply on a prospective basis only. In addition, the adoption of the latest version of the OECD Transfer Pricing Guidelines should not occur automatically without first consulting and obtaining input from Member States.

3.2 Chapter II - Transfer Pricing Rules

Article 14.1 provides that Member States shall include in their national rules transposing the transfer pricing rules laid down in Chapter II of the Directive,

provisions which ensure that those transfer pricing rules are applied in a manner consistent with the OECD Transfer Pricing Guidelines.

Chapter II of the Directive includes articles on transfer pricing methods (Article 9), comparability analysis (Article 11) and determination of the arm's length range (Article 12). However, many of these areas are already addressed in detail in the OECD Transfer Pricing Guidelines which will be included as an annex to the Directive. Consequently, the proposed approach gives rise to the possibility of a different interpretation of the transfer pricing rules applying to transactions intra-EU to that which would apply for transactions with third countries.

For example, Article 12 of the Directive adopts a different approach to the determination of the arm's length range than the OECD Transfer Pricing Guidelines where the application of a transfer pricing methodology produces a range of values. The Directive prescribes that Member States may only make adjustments if the results fall outside the (interquartile) arm's length range, unless it can be demonstrated that an alternative position within the range is justified by the facts and circumstances of the specific case.

If an adjustment is made, it should be made to the median, unless it can be shown that a different position in the range is justified by the facts and circumstances of the specific case. This proposed different approach to determine the arm's length range under the Directive will impact the pricing of existing intra-EU transactions.

As it is intended that the rules set out in the Directive should be applied in a manner 'consistent with' the OECD Transfer Pricing Guidelines, albeit 'consistent with' is not defined, we consider rather than detailing the transfer pricing rules in the Directive, it would be preferable for the Directive to simply make reference to the rules as set out in the OECD Transfer Pricing Guidelines. This would help to ensure inconsistencies in interpretation do not arise between the application of the rules under the Directive and the OECD Transfer Pricing Guidelines.

If policymakers determine that it is preferable to elaborate further on the rules in the Directive, then care must be taken to ensure that the terminology and principles used in the Directive are harmonised with the OECD Transfer Pricing Guidelines. Accordingly, such newly established principles or concepts should only be considered to form part of a Member State's reference framework after their adoption and of no effect retrospectively.

Article 14 – Application of the Arm's Length Principle

Article 14(2) of the Directive provides as follows: "*The Council may lay down further rules, consistent with the OECD Transfer Pricing Guidelines, on how the arm's length principle and the other provisions laid down in Chapter II of this Directive are to be applied in specific transactions to ensure more tax certainty and mitigate the risk of double taxation."*

We consider the provisions of Article 14(2) create the potential for competing and divergent transfer pricing rules applying to transactions within the Single Market with

the rules that apply to transactions with third countries. Such a divergence could lead to increased uncertainty and increased disputes.

Article 14(2) delegates authority to the Council to create new transfer pricing rules in respect of certain types of transactions provided they are consistent with the OECD Transfer Pricing Guidelines. Article 14(3) provides that these rules shall be taken by means of Council implementing acts based on a proposal from the Commission. The commentary on the grounds for the proposal notes that the Commission aims to draft Implementing Acts for the majority of transactions listed in Article 14 in the first five years of application of the Directive.

As tax is a national competence and sovereignty in tax matters is a fundamental principle of EU law, it would be an imperative for the Directive to address the need for unanimity among Member States to adopt any Implementing Acts in this regard.

3.3 Article 5 - Associated Enterprises

The Explanatory Memorandum to the Directive notes that differences can exist across Member States in the definition of 'associated enterprises' and in particular on the concept of 'control', which is normally the pre-condition to apply transfer pricing. It notes that certain Member States apply a 25% shareholding requirement while others apply a threshold of 50% when it comes to determining whether the control criterion is met.

Article 5 of the Directive proposes a threshold of 25% to determine whether enterprises are associated. It also proposes that an associated enterprise may include a person who participates in the management of another person and can exercise "significant influence" over the other person. However, no definition of significant influence is provided in the Directive.

As currently drafted, the definition of 'associated enterprises' is broader than what exists at present in certain Member States, including Ireland, and therefore is likely to result in an increase in the number of transactions that will be subject to transfer pricing rules in such countries.

The 25% threshold also establishes a different criterion to define a group from those which are contained in the BEFIT proposal and the Pillar Two GloBE Rules and in so doing adds further complexity and compliance costs for business. We believe a 50% shareholding requirement would be more appropriate to determine the requisite association for transfer pricing rules under the Directive.

Permanent Establishment (PE)

Article 5(7) of the Directive provides that a PE shall be considered an associated enterprise of the enterprise of which it is a part of. In light of the legal and economic differences between a PE and legally independent enterprises, we consider it essential that the Directive does not seek to equate a PE with an associated enterprise.

By requiring a PE to be considered an associated enterprise of the enterprise of which it is a part of, it would appear to impose the transfer pricing rules set out in Chapter II of the Directive applying to transactions between associated enterprises to similarly apply to transactions with a PE.

At the same time, Article 14(2) of the Directive provides that further rules may be laid down in a number of areas consistent with the OECD Transfer Pricing Guidelines, on how the arm's length principle and other provisions laid down in Chapter II of the Directive should be applied to specific transactions, to ensure more tax certainty and mitigate the risk of double taxation.

One of the specific transactions listed in Article 14(2) includes dealings between a head office and its permanent establishments. Notably, Article 7(2) of the OECD Model Tax Convention (MTC) contains the Authorised OECD Approach (AOA) to determine the profits attributable to a PE. Guidance on the application of the AOA is set out in the OECD's 2010 Report on the Attribution of Profits to Permanent Establishments. We believe the AOA approach should continue to apply to determine the attribution of profits to PEs and this should be reflected in any proposed Directive on Transfer Pricing at EU level.

3.4 Article 6 - Corresponding Adjustments

Article 6 of the Directive proposes to limit access to the mutual agreement procedure (MAP) for intra-EU adjustments in certain circumstances. Our members have raised concerns that this approach could potentially result in extreme positions being adopted by individual Member States within the EU, with no ability to manage these adjustments through the MAP process. This could also lead to knock-on consequences for multinational groups in-scope of the Pillar Two GloBE Rules.

In our view, a preferable approach would be to create a streamlined procedure for intra-EU negotiations which would include arbitration, to expedite the MAP process while ensuring that Member States continue to have the right to negotiate and or defend their positions.

3.5 Article 13 - Transfer Pricing Documentation

The potential harmonisation of transfer pricing documentation requirements is a welcome feature of the proposed Directive. A possible approach could be to use the existing Local and Master Files templates as included in Annex I – II to Chapter V of the OECD Transfer Pricing Guidelines as a common template across Member States. Consideration could also be given to harmonising the criteria for when the Local File and Master File documentation requirements apply, as well as simplified documentation requirements for SMEs in scope of transfer pricing that would not fall under the Local File and Master File documentation requirements.