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Transfer Pricing for the International Practitioner

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1. What is the standard practice in selecting potential comparables? Are industry codes or key words used to accept or exclude comparables? What use is made of quantitative screens to exclude comparables?

The primary Irish transfer pricing legislation is contained in Part 35A of the Taxes Consolidation Act 1997 (the "TCA") which applies to accounting periods commencing on or after January 1, 2011 for transactions the terms of which were agreed on or after July 1, 2010 (the "TP Legislation"). The TP Legislation specifically endorses the 2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "OECD Guidelines") and provides that the TP Legislation is to be construed "to ensure, as far as practicable, consistency" between the "arm's length amount" to be determined in accordance with Part 35A of the TCA and the OECD Guidelines. The OECD Guidelines have recently been revised to incorporate the BEPS amendments. It is expected that the Finance Act 2016 will implement the revised OECD Guidelines in Ireland and that Part 35A of the legislation will be amended accordingly.

The TP Legislation does not contain specific commentary about the selection of potential comparables. The Irish Revenue Commissioners (the "Revenue") have not published guidelines and there is no stipulation that a comparability analysis must be confined to Irish or European comparables. There is also no published information or guidelines in relation to the use of quantitative screens to exclude comparables.

The Revenue typically adopts a pragmatic approach to the evaluation of comparables. The Irish tax legislation and the Revenue practice places considerable emphasis on the commerciality of a transaction and whether it is *bona fide* in nature. In this regard, results which do not make commercial sense (i.e., if there is substantial deviation from the results generated by other compareables are typically investigated further, in order to ascertain the appropriateness of the comparables identified.

The following factors are taken into account for the selection of potential comparable transactions:

- The economically relevant characteristics should be similar, and material differences between compared transactions should be taken into account.
- None of the differences between situations being compared should materially affect the condition which is being examined in the methodology.
- To eliminate the effect of any differences, reasonably accurate adjustments should be made.
- There should be understanding and comparison of transactions or enterprises that would affect conditions if the transaction was arm's-length.
- Relevant attributes include characteristics of property / services transferred, functions performed by the parties (assets used and risks assumed must also be taken into account), the terms of the contracts, economic circumstances of the parties and business strategies pursued by the parties.

2. What is the standard practice in making adjustments to improve comparability? Is very close comparability required before such adjustments are made? What sort of adjustments are usually made?

In accordance with the OECD Guidelines which are specifically endorsed by Irish law, a comparability adjustment should be considered only if it is expected to increase the reliability of the results and it will bear a material effect on the comparison. Relevant considerations include the materiality of the difference for which an adjustment is being considered, the quality of the data subject to adjustment, the purpose of the adjustment and the reliability of the approach used to make the adjustment. Examples of comparability adjustments include adjustments for accounting consistency designed to eliminate differences that may arise from differing accounting practices between the controlled and uncontrolled transactions; segmentation of financial data to eliminate significant non-comparable transactions; adjustments for differences in capital, functions, assets and risks.

3. How many comparables are required or preferred? Is there a desire or obligation to produce a statistically significant confidence level?

Generally, it is expected that the statistical set used will have a minimum number of comparables, in order to make the comparison as robust as possible.

In cases where the range includes a considerable number of observations, statistical tools that take account of a central tendency to narrow the range may be used, such as the interquartile range or other percentiles, in order to enhance reliability. The TP Legislation does not contain any specific commentary on the use of the interquartile range. The OECD Guidelines state that the use of an interquartile range may enhance the reliability of a range when non-qualifying defects remain, as a result of the limitations in available information on the comparables used. The interquartile range is most appropriate when all the comparables in use are more or less equally valid and there is no reason why the company being tested is performing better than the comparable compa-

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nies. Use of the interquartile range can cause problems by disregarding some of the more accurate comparables as they fall within the full range but outside of the interquartile range, which arises when some of the companies in the comparables list are less reliable comparables than other companies.

4. In practice, is there a preference for "internal" comparables? How much effort is made to identify any such benchmarks?

Internal comparables may be preferable in some cases as they may have a more direct and closer relationship to the transaction under review than external comparables, therefore, they may be more persuasive. Their use may result in an easier and more reliable financial analysis, as it will presumably rely on identical accounting standards and practices for the internal comparable and for the controlled transaction. Furthermore, access to information on internal comparables may be more complete and less costly.

In the event that a company does not have internal comparables which it can use, it may be possible to obtain data on the gross and net margins of comparable companies by accessing the annual returns of relevant Irish companies from the Irish Companies Registration Office (CRO). Irish company law requires that all Irish companies must file an annual return with the CRO, unless the company can avail of an exemption from filing under the legislation. Some companies are also required to file financial statements along with their annual return, depending on the size of the company in question.

However, it must be noted that internal comparables are not more reliable in all cases and it is not the case that a transaction between a taxpayer and an independent party can always be regarded as a reliable comparable for a controlled transaction carried on by that same taxpayer. Internal comparables must also satisfy the five comparability factors (mentioned in question 1 above) in the same manner as external comparables. The OECD Guidelines on comparability adjustments are also applicable when internal comparables are used.

5. Is there a practice to make reference to "secret comparables"?

The TP Legislation does not specifically deal with the use of secret comparables. The use of secret comparables has been regarded by the Revenue as unhelpful in the context of mutual agreement procedure cases between competent authorities. It is our experience that it is unlikely that the Irish Revenue would use secret comparables to alter the transfer pricing determined by the taxpayer. In the context of seeking an opinion on a proposed transfer pricing model, Revenue has indicated that it refers to information available internally as a sanity check or "smell test" to determine whether the pricing proposed by a taxpayer is in line with that which is generally acceptable by Revenue.

The OECD Guidelines require disclosure of secret comparables, which is likely to give rise to confidentiality issues, because even without the identification of the particular taxpayer in question, there is a risk that any comparable may be easily identifiable due to the relatively small size of the Irish market. For this reason we would not expect that the Revenue would use secret comparables to apply an alternative transfer pricing model to that proposed by a taxpayer; in line with the OECD Guidelines, identification of comparable third party transactions must be transparent, systematic and verifiable.

6. Are searches for comparables made every year? To what extent is it sufficient simply to update the figures for the original set of comparables?

Companies are obliged by Irish legislation to have records available as may reasonably be required for the purposes of determination of whether the company's trading income has been computed on an arm's length basis. The legislation does not prescribe the form that this documentation must take; however, Revenue has issued guidance on the transfer pricing documentation requirements.[1] There is no uniform standard form of documentation, however the EU Council Code of Conduct on Transfer Pricing Documentation and Chapter V of the OECD Guidelines are considered by Revenue to be good practice. Relevant documentation should be prepared and updated on a periodic basis in line with any changes in functions and risks of the Irish company. Best practice would dictate that the documentation to be prepared contemporaneously with the transaction in question. Typically, a new search for comparables will be performed every 3 years or earlier when there is a change in functions, assets or risks of the Irish company.

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[1] Tax Briefing 07/2010.