

## **Attribution of profits to a branch**

### **Part 02-02-04a**

This document should be read in conjunction with sections 25 and 25A of the Taxes Consolidation Act 1997

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## Introduction

Section 28 of Finance Act 2021 inserted a new section 25A into the Taxes Consolidation Act 1997<sup>1</sup> to provide for the application of an OECD-developed mechanism (the “authorised OECD approach” or “AOA”) for the attribution of income to a branch or agency<sup>2</sup> of a non-resident company operating in the State.

The OECD mechanism combines a general rule with detailed guidance as to the application of that rule. The rule is contained in Article 7(2) of the OECD Model Tax Convention (“MTC”), for the determination of profits attributable to a permanent establishment (“PE”). The guidance on the application of this rule is set out in the OECD’s 2010 Report on the Attribution of Profits to Permanent Establishments, published in July 2010<sup>3</sup> (the “AOA Guidance”).

The new section 25A applies for accounting periods commencing on or after 1 January 2022. The purpose of this manual is to provide an overview of, and guidance in relation to, the legislation contained within section 25A.

## 1 Overview of Section 25A

Section 25A provides for the following:

- For the purposes of section 25(2), the amount of any trading income arising directly or indirectly through or from a branch and any income from property or rights used by, or held by or for, the branch (the “relevant branch income”) will be an amount that is attributable to the branch in accordance with the provisions of section 25A. The relevant branch income is the amount of income which it would have earned, in particular from its dealings<sup>4</sup> with the other parts of the company, if it were a separate and independent company engaged in the same or similar activities under the same or similar conditions.
- Attributing relevant branch income to a branch shall be done in accordance with the AOA Guidance.
- There are additional documentation requirements to assist in ensuring relevant branch income has been computed in accordance with section 25A. These documents are known as ‘relevant branch records’.
- Proportionate penalties for taxpayers who fail to comply with a request to provide relevant branch records to Revenue.

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<sup>1</sup> The legislative provisions referred to in this manual are contained in the 1997 Taxes Consolidation Act, as amended (“TCA 1997”), unless otherwise stated.

<sup>2</sup> For the purposes of this manual references to “branch” mean “branch or agency”.

<sup>3</sup> <https://www.oecd.org/ctp/transfer-pricing/45689524.pdf>

<sup>4</sup> “Dealings” are described in the AOA Guidance (para. 14) as “the intra-enterprise equivalents of separate enterprise transactions”.

- Protection from tax-gear penalties where a taxpayer prepares such documentation and provides it to the Revenue on a timely basis and the documentation demonstrates reasonable efforts to comply with section 25A.

## 2 Overview of the AOA Guidance

The AOA seeks to attribute to a PE and, in an Irish context, to a branch, the profits that it would have earned at arm's length if it were a legally distinct and separate enterprise<sup>5</sup> performing the same or similar functions under the same or similar conditions<sup>6</sup>. Therefore, it incorporates separate entity<sup>7</sup> and arm's length principles. The aim of the AOA Guidance is to apply to intra-company 'dealings'<sup>8</sup> (i.e. transactions between separate parts of a single enterprise) transfer pricing principles that apply to inter-company transactions (i.e. transactions between different, albeit associated, enterprises)<sup>9</sup>. The AOA Guidance seeks to achieve this by applying a two-step approach.

The first step requires a functional and factual analysis to be conducted, which involves 'hypothesising' the PE as a distinct and separate enterprise. The functional and factual analysis provides the basis for attributing assets, risks and "free" capital<sup>10</sup> to the PE.

Under the AOA Guidance:

- A PE is regarded as assuming risks in respect of which the significant people functions<sup>11</sup> relevant to the assumption and/or management of that risk are performed by people in the PE<sup>12</sup>.

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<sup>5</sup> The term "enterprise" is used in the AOA Guidance. When reading the AOA Guidance, for the purposes of section 25A, "enterprise" may be read as "company".

<sup>6</sup> Para. 9 AOA Guidance, 'B-2 Basic premise of the authorised OECD approach'.

<sup>7</sup> Para. 8 AOA Guidance, 'B-1 The "functionally separate entity approach"'.

<sup>8</sup> Para. 55 AOA Guidance.

<sup>9</sup> The OECD MTC distinguishes between the attribution of profits to a PE and transfer pricing in respect of transactions between separate entities. Article 7 deals with the attribution of business profits between the parts of a single entity using the *hypothesized separate entity* and *arm's length* principles whereas Article 9 deals with transfer pricing between two separate enterprises using the arm's length principle.

<sup>10</sup> "Free" capital is defined in the AOA Guidance (para. 105) as "an investment which does not give rise to an investment return in the nature of interest that is deductible for tax purposes under the rules of the host country of the PE".

<sup>11</sup> The AOA Guidance also details '*special considerations*' for banks, enterprises carrying on global trading of financial instruments and insurance companies. These *special considerations* include using the concept of Key Entrepreneurial Risk-Taking Functions ("KERT functions"). Because of the special relationship between risks and financial assets in those specific sectors, the AOA uses the KERT function terminology in describing the functions relevant to the attribution of both risks and assets, but that terminology is not used for other sectors.

Assets are generally<sup>13</sup> attributed to a PE where the significant people functions relevant to the economic ownership of those assets are performed by people in the PE<sup>14</sup>.

- Capital is allocated to the PE to support the functions it has performed, the risks assumed and assets attributed to the PE<sup>15</sup>.
- Internal dealings are recognised between the PE and other parts of the enterprise (which would include the head office or other PEs of the enterprise)<sup>16</sup>.

Under the second step, the remuneration of any dealings recognised between the PE and the enterprise, of which it is a part, is determined by applying, by analogy, the Article 9<sup>17</sup> transfer pricing tools (as articulated in the OECD transfer pricing guidelines, which are applied under Irish transfer pricing legislation<sup>18</sup> in relation to transactions between associated persons). This may involve comparing dealings between the PE and the enterprise, of which it is a part, with transactions between independent enterprises.

Section 2 of this Tax and Duty Manual, particularly references to specific sections/paragraphs of the AOA Guidance, is provided for informational purposes only, to provide an overview of the AOA. This section is not intended to be, and should not be relied upon as, a substitute for the AOA Guidance itself.

### 3 Key definitions

Section 25A(1) contains definitions for various terms used in the section.

The key definitions contained within the subsection are:

- ‘authorised OECD approach guidance’ means the guidance on the attribution of profits to permanent establishments set out in the 2010 Report on the Attribution of Profits to Permanent Establishments approved for publication by the Council of the OECD on 22 July 2010<sup>19</sup>, supplemented by the whole or

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<sup>12</sup> Paras. 21-27 AOA Guidance.

<sup>13</sup> The AOA Guidance considers the attribution of assets to a PE in detail and provides guidance for both tangible and intangible assets e.g. Part 1: General Considerations, section D-2(iii) of the AOA Guidance.

<sup>14</sup> Paras. 18-20 AOA Guidance.

<sup>15</sup> Paras. 28-32 AOA Guidance.

<sup>16</sup> Paras. 33-38 AOA Guidance.

<sup>17</sup> Article 9 ‘Associated Enterprises’ OECD’s Model Tax Convention.

<sup>18</sup> Irish transfer pricing legislation is contained in Part 35A TCA 1997 and ‘transfer pricing guidelines’ are defined in section 835D TCA 1997, which is referenced in section 25A(4)(b) TCA 1997.

<sup>19</sup> <https://www.oecd.org/ctp/transfer-pricing/45689524.pdf>

part of such additional guidance on the attribution of profits to permanent establishments, published by the OECD on or after the date of the passing of the Finance Act 2021, as may be designated by the Minister for Finance for the purposes of this section by order made under section 25A(5) TCA 1997.

- 'Article 7 of the OECD Model Tax Convention' means the provisions contained in Article 7 of the Model Tax Convention on Income and on Capital published by the OECD on 21 November 2017.
- 'branch', in relation to a company which is not resident in the State, means a branch or agency through which the company carries on a trade in the State.
- 'medium enterprise' and 'small enterprise', for the purposes of the section, have the same meaning as that provided for by section 835F, and 'small or medium-sized enterprise' shall be construed accordingly.

The definitions of 'medium enterprise' and 'small enterprise' in section 835F are closely based on the category of micro, small and medium-sized enterprises as set out in the Annex<sup>20</sup> to the EU Commission Recommendation of 6 May 2003. Certain modifications to the definitions contained in the Annex apply for the purposes of defining a medium enterprise and a small enterprise in an Irish context. Please refer to sections 7.2 and 7.3 of Tax and Duty Manual [Part 35A-01-01](#) for further details.

## 4 Relevant branch income

For the purposes of section 25(2):

- (i) the amount of any trading income arising directly or indirectly through or from a branch, and
- (ii) any income from property or rights used by, or held by or for, the branch,

(collectively referred to as 'relevant branch income') shall be an amount that is attributable to the branch in accordance with subsections (3) and (4) of section 25A.

## 5 Attribution of profits to a branch

Subsections (3) and (4) of section 25A provide the mechanism by which the AOA is applied to arrive at the relevant branch income that is attributable to the branch.

Section 25A(3) contains the provision derived from Article 7(2) of the MTC. By virtue of this provision, the branch is hypothesised as a separate company independent of the company of which it is a part. Dealings are recognised between the branch and the other parts of the company. The relevant branch income attributable to the branch is the income it would have earned in respect of such dealings if it were treated as a separate and independent company engaged in the same or similar activities under the same or similar conditions, while taking into account the functions performed, assets used and risks assumed by the company (of which the branch is a part), through the branch and through other parts of the company.

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<sup>20</sup> [Annex to the EU Commission Recommendation 2003/361/EC](#)

Section 25(4)(a) is the method by which the AOA Guidance is applied. It requires that section 25A(3) be construed to ensure, as far as practicable, consistency between:

- the effect given by subsection (3), and
- the effect which would be given if a double tax treaty entered into by the State, incorporating Article 7(2) of the OECD Model Tax Convention, were to be applied in accordance with the AOA Guidance in computing so much of the profits that are attributable to the branch that comprise relevant branch income, regardless of whether a double tax treaty entered into by the State incorporating Article 7(2) of the OECD Model Tax Convention actually applies.

In short, section 25A(3) must be construed in such a way as to ensure, as far as practicable, consistency with the AOA Guidance.

Section 25A(4)(b) requires that references to “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” and references to “the Guidelines” as these appear in the AOA Guidance, are to be construed, as far as is practicable, as references to the “transfer pricing guidelines” as defined in section 835D TCA 1997. This provision clarifies the transfer pricing guidelines that are to be used in applying the AOA and ensures consistency with the transfer pricing guidelines that are already provided for in Irish legislation.

Section 25A(5) allows the Minister for Finance to designate by order the whole or part of such guidance, on the attribution of profits to permanent establishments, as is published by the OECD on or after the date of the passing of the Finance Act 2021 as being comprised in the definition of “authorised OECD approach guidance” (which is defined in section 25(A)(1)).

## 6 Documentation requirements

### 6.1 Overview

As is the case with transfer pricing generally, supporting documentation is fundamental to validating and explaining the attribution of profits to a branch. Section 25A(7) contains the documentation requirements to be satisfied.

Section 25A(7)(a) requires companies to have available, and to provide on request in writing from a Revenue officer, such records as may reasonably be required for the purposes of determining whether the relevant branch income of the non-resident company for the accounting period has been computed in accordance with section 25A. These records are referred to as “relevant branch records”.

### 6.2 Relevant branch records

Section 25A(7)(b) provides details regarding the specific documents that should be included (at a minimum) within the relevant branch records.

Section 25A(7)(b) provides that the relevant branch records must include:

- A description of the company, i.e. the non-resident company as a whole, and of its business, organisational structure, business strategy and competitors.
- A description of the branch itself, and of its business, organisational structure, business strategy and competitors.
- A functional and factual analysis which contains such information as may reasonably be required for the purposes of determining:
  - the existence, characterisation and terms of any dealings between the branch and other parts of the company, and
  - the appropriate attribution of assets, risks and free capital to the branch.
- Calculations supporting the attribution of free capital to the branch.
- Accounting records and contemporaneous documentation which support the existence of dealings between the branch and other parts of the company.
- Information on the transfer pricing method used by the company relating to dealings between the branch and other parts of the company. There is also a requirement to record the reason for selecting the transfer pricing method employed.
- Details of the tested party, where applicable, and the reasons for selecting that party to a dealing as being the tested party.
- Details of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in attributing the relevant branch income to the branch, including a description of the comparable search methodology and the source of such information.
- For each of the dealings between the branch and other parts of the company, information and allocation schedules showing how the transfer pricing method has been used to determine the relevant branch income attributable to the branch.

References in subsection 7 of section 25A to ‘functional and factual analysis’ and ‘free capital’ shall be construed in accordance with the AOA Guidance. References in the subsection to certain transfer pricing terminology (‘transfer pricing method’, ‘tested party’, ‘selected comparable uncontrolled transactions (internal or external)’, ‘relevant financial indicators for independent enterprises’ and ‘comparable search methodology’) shall be construed in accordance with the transfer pricing guidelines (within the meaning of section 835D).

### 6.3 Frequency of review of relevant branch records

The relevant branch records must be up to date and contemporaneous and must be reviewed regularly to determine whether:



- the relevant branch income which is attributed to the branch is the amount of such income which it would have earned if it were a separate and independent company, engaged in the same or similar activities, under the same or similar conditions, and
- the relevant branch records adequately demonstrate this.

Information showing how the policy for attributing profit to the branch was actually applied in each period should be updated annually. This information should include a reconciliation between the transfer pricing method, applied by analogy, and the relevant branch income (and/or that of the tested party). How financial data used in applying transfer pricing methods ties to the relevant branch income and the level of detail required will depend on the individual facts and circumstances of the case. Of note, this includes the financial results of a single material dealing which must similarly be evaluated on an annual basis. To the extent that other facts and circumstances are materially unchanged, the content of relevant branch records may be carried forward from one year to the next and updated at less regular intervals.

## 6.4 Compliance requirements

Relevant branch records must be prepared by a company no later than the date on which a tax return for the chargeable period is required to be delivered and must be provided to Revenue within 30 days of a request by a Revenue officer made in writing.

## 6.5 Exclusions from relevant branch records requirement

As set out in [section 10](#) below, section 25A does not currently apply to a company for an accounting period where the company is a small or medium-sized enterprise for that accounting period. Therefore, the specific documentation requirements provided for in section 25A do not currently apply to such companies.

Section 25A will apply to a small or medium-sized enterprise for accounting periods commencing on or after such day as the Minister for Finance may appoint by order. Where such an order is made, the specific documentation requirements provided for in section 25A may still not apply to such companies, provided certain conditions are satisfied.

Companies which are small enterprises for an accounting period are not required to maintain relevant branch records in respect of that accounting period.

In addition, companies which are medium-sized enterprises for an accounting period are also not required to maintain relevant branch records for such accounting periods provided the relevant branch income attributable to the branch of the company in that accounting period is less than €250,000.

# 7 Penalties

## 7.1 Fixed penalties

As outlined above, relevant branch records should be prepared no later than the date on which a return for the chargeable period is due to be filed and must be

made available to Revenue within 30 days of a written request from a Revenue officer. Where a company fails to comply with the requirement to provide relevant branch records within 30 days of such a written request, a fixed penalty of €4,000 will apply.

Where the company is not a small or medium-sized enterprise, the fixed penalty is increased from €4,000 to €25,000 plus €100 for each day on which the failure continues.

## 7.2 Penalty protection

In line with Irish transfer pricing legislation, contained in section 835G(7)TCA 1997 (which in turn follows the OECD recommendation<sup>21</sup> that where transfer pricing documentation requirements are satisfied and submitted on time, the relevant person may be exempt from penalties or subject to a lower penalty where a transfer pricing adjustment is made), section 25A(10) provides for protection from tax geared penalties, in certain circumstances provided necessary conditions are satisfied.

A 'relevant branch adjustment' is defined as the amount of any difference between:

- the amount of chargeable profits included in a return delivered by or on behalf of a company on or before the specified return date for an accounting period, and
- the amount of chargeable profits that should have been included in the return delivered by or on behalf of the company on or before the specified return date for the accounting period,

which arose by virtue of the chargeable profits, included in the return delivered by or on behalf of the company, not being computed in accordance with section 25A.

Section 25A(10)(b) provides that a relevant branch adjustment will not be taken into account in determining whether a penalty referred to in section 1077F(2) for a careless default applies to a company (or in computing the amount of such a penalty), where the company:

- has fulfilled the requirements of the section to prepare, and provides upon request, relevant branch records within the specified timeframes; and
- the records provided are accurate and demonstrate that, notwithstanding the relevant branch adjustment, the company has made reasonable efforts to comply with the requirements of this section in determining the relevant branch income attributable to the branch.

Protection from tax-geared penalties only applies to relevant branch adjustments that fall within the careless behaviour category of default. Where any additional tax due relates to a deliberate behaviour category of default, the relevant tax-geared penalty will apply even where relevant branch records are provided within 30 days of a written request from a Revenue officer.

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<sup>21</sup> Chapter V, D.7 of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022.

Where the conditions set out in section 25A(10)(c) are not satisfied, then penalties provided for in section 1077F will apply in the normal manner.

### 7.3 Reasonable efforts to comply with section 25A

Section 25A(10)(c)(iii) requires the company to demonstrate “reasonable efforts to comply with this section” as part of the criteria for penalty protection. Reasonable efforts may be demonstrated by including a description of the work actually undertaken when preparing the relevant branch records. This could include:

- Details of the functional analysis interviews undertaken.
- The steps taken by the company to ensure factual information remains up to date.
- The company’s policy for periodically reviewing the dealings between the branch and the other parts of the company.
- Describing the roles of those involved in preparing the relevant branch records.
- Evidence of the company’s controls to manage the implementation of the company’s pricing of the dealings between the branch and the other parts of the company.

## 8 Record keeping

The rules in section 886(3) and 886(4) that apply in respect of the obligation to keep certain records also apply to relevant branch records.

## 9 Exclusion for certain life assurance business

Life assurance business written on or before 31 December 2000 is taxable under an aggregate system known as the I-E (or income less expenses) system.<sup>22</sup> The I-E tax computation in respect of old basis business is based on investment return (i.e. Case III, Case IV, Case V and Chargeable Gains) as opposed to trading profits.

Given these specific rules, the provisions implementing the AOA do not apply to such business carried on by an overseas life assurance company.

In this regard, section 25A does not apply to so much of the trade of an overseas life assurance company (within the meaning of section 706) as is life assurance business written on or before 31 December 2000, which is taxable under the I-E (or income less expenses) system i.e. not new basis business (within the meaning of section 730A).

## 10 Small and Medium-sized enterprises (“SMEs”)

Section 25A does not currently apply to a company for an accounting period where the company is a small or medium-sized enterprise for that accounting period.

Section 25A will apply to a small or medium-sized enterprise for accounting periods commencing on or after such day as the Minister for Finance may appoint by order.

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<sup>22</sup> Guidance on the taxation of life assurance companies is available at <https://www.revenue.ie/en/companies-and-charities/financial-services/life-assurance/index.aspx>