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IRELAND'S INTRODUCTION OF TRANSFER PRICING: A NEW INSTITUTIONAL THEORY PERSPECTIVE

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ABSTRACT

This article explores the rationale for Ireland's introduction of transfer pricing legislation in 2010. For most multinational corporations, tax planning involves structuring the business in a way that justifies the location of profits in low-tax jurisdictions, underpinned by transfer pricing methodologies/legislation. This may involve the use of tax haven locations or the use of hybrid structures to reduce a group's effective tax rate. The continuing facilitation of such structures by tax authorities may impact on Ireland's legitimacy internationally. Such an appeasement may bring into question the State's 'organizational identity' (Dhalla and Oliver, 2013, p. 1804).

Drawing on new institutional sociology (NIS), a theoretical framework is established of the context and processes connected with designing, endorsing and diffusing transfer pricing policies. It draws on the work of Dillard, Rigsby and Goodman (2004) and Mulligan (2008, 2012) in developing the framework. NIS is 'primarily concerned with an organization's interaction with the institutional environment, the effects of social expectations on the organization, and the incorporation of these expectations as reflected in organizational practices and characteristics' (Dillard et al., 2004, p. 508).

The evidence in this study was collected using semi-structured in-depth personal interviews with thirteen senior tax advisors. The recurring evidence emerging from the research was that Ireland's need to achieve and protect its international legitimacy as a mature fiscal jurisdiction underpinned the rationale for the introduction of transfer pricing. Both coercive and normative isomorphism forces were also at play in the introduction of the rules, emanating from

mounting institutional pressure from various parties including the Organisation for Economic Co-Operation and Development (OECD),¹ Group of Twenty (G20), International Monetary Fund (IMF) and other governments.

INTRODUCTION

This paper addresses the research question, ‘What was the rationale for Ireland introducing transfer pricing in 2010?’ The manner in which such a fundamental and normative component of tax policy was introduced and subsequently monitored is arguably sacrosanct in ensuring Ireland’s reputation and legitimacy is upheld. The paper should assist tax policy makers and other observers in Ireland and elsewhere in gaining a greater understanding of the process and practice of transfer pricing, which in turn may contribute towards a more successful implementation of Irish tax policy in an ever changing global economic climate. Transfer pricing challenges from overseas tax jurisdictions could have serious multimillion Euro implications for the Irish exchequer, presenting the government with significant challenges in the advance planning of tax revenue.

The term ‘transfer pricing’ literally means the pricing of business transactions between associated persons (Li, 2002, p. 824). In an international tax context, transfer pricing often refers to the artificial arrangement of internal pricing within a multinational corporation (MNC), with the intention of creating a tax advantage sometimes referred to as mispricing, which some commentators consider ‘crosses the line from tax avoidance into outright tax evasion’ (Morais, 2009). Transfer pricing has become an important international tax concern for three main reasons: globalisation, the opportunity this provides to taxpayers to manipulate their transfer pricing and the need for revenue authorities to protect their revenue base (Eden, Dacin and Wan, 2001).

Transfer pricing practices matter to the state as they affect the taxes that it can impose on corporations’ profits to finance the provision of public goods and services and thereby secure legitimacy (Sikka and Willmott, 2010). Accordingly, transfer pricing is central to both the debate about the legitimacy of the State and the social responsibility and accountability of corporations. The ability for MNCs to undertake transnational income shifting has significant repercussions for international fiscal policy makers (Li, 2002).

One of the consequences of the recent global economic downturn is an increase in the level of complex and prescriptive worldwide regulation. The effectiveness of the larger nations and indeed the OECD in driving the tax agenda was in evidence through the efforts of the G20 in increasing the level of exchange of tax information and the focus on tax transparency. Within this economic, political and social environment, the introduction of a formal new transfer pricing regime in Ireland in 2010 was not unexpected.

Globalisation creates ‘integrated businesses with enormous cross border transfers while corporate income tax systems remain nationally based’ (Eden et al., 2001, p. 1). They highlight that governments contend globalisation enables MNCs to

beguile transfer prices and curtail their tax exposures, thereby requiring 'tighter regulation' (Eden et al., 2001, p. 1).

TRANSFER PRICING - IRISH CONTEXT

MNCs operating in Ireland have benefited from a favourable corporate tax regime over many years with a range of tax rates from 0 per cent (export sales relief (ESR)/Shannon relief) to 10 per cent (manufacturing and financial services) and finally to the more recent 12.5 per cent rate (which is now available to *all* trading companies). This array of low taxation rates has provided an attractive fiscal environment for foreign direct investment (FDI) and the potential to shift profits into Ireland (PricewaterhouseCoopers, 2009). A number of commentators have highlighted the extent to which MNCs have been using transfer pricing to shift profits into Ireland (Stewart, 1989; Honohan and Walsh, 2002; Sullivan, 2004; Conefrey and Fitzgerald, 2009).

Recent United States (US) Internal Revenue Service (IRS) challenges have also illustrated the extent to which the Irish state has been used by MNCs to shift profits into Ireland, to avail of its low corporate tax rate of 12.5 per cent. This is particularly prevalent in the high technology and pharmaceutical sectors, as highlighted by Sikka and Willmott (2010). Up until recent taxation changes regarding intellectual property in 2009, transfer pricing provisions in Irish tax legislation were only of limited application, and few resources had been devoted to the area by the Irish Revenue Commissioners (PricewaterhouseCoopers, 2009). Eden et al. (2001) note that small capital importing countries (like Ireland) historically tended to pay little regard to transfer pricing. Yet transfer pricing was a significant issue both for MNCs operating in Ireland and for Irish companies investing abroad, due to the interventions of foreign tax authorities.

The introduction of transfer pricing must be considered in the context of the evolution of Irish tax policy over the last 60 years from the early days of ESR²/Shannon exemption,³ to the transition from the 10 per cent rate to the 12.5 per cent rate of corporation tax in 2003, to the eventual introduction of transfer pricing in the Finance Act 2010. This was discussed at length during the interviews and provided a rich contextual backdrop to the research question. The contrasting perspective when Ireland was at a stage of industrial infancy (1950s to mid-1990s) compared to the era of the so-called 'Celtic Tiger' (1995-2007) is demonstrative of the political nature of institutional change both incremental and radical (Dillard et al., 2004; Greenwood, Raynard, Kodeih, Micelotta and Lounsbury, 2011).

The Irish government introduced transfer pricing law in the Finance Act 2010, which applies to accounting periods commencing in 2011. The provisions provide that 'income' can be adjusted upwards or 'expenditures' downwards (section 835C(2), Taxes Consolidation Act 1997) so these provisions may not give rise to any fiscal deterioration for the Irish exchequer. The fact that the new laws only provide that income can be adjusted upwards may not prevent the age-old conundrum of profit shifting.⁴ This approach is consistent with the views of Sikka and Willmott (2010, p. 353), who highlight that '... low or no tax jurisdictions have little direct interest in monitoring transfer pricing practices to ensure that they comply with the

arm's length principle'. A double tax agreement using the mutual agreement procedure (MAP) must be used if an Irish company seeks a downward adjustment to its income for tax reporting purposes, resulting from an overseas transfer pricing adjustment that increases income in the overseas counterparty company.

The new regime⁵ includes many features expected of a jurisdiction introducing transfer pricing rules for the first time, but interestingly the legislation contains two unique characteristics. First, the new regime is confined to related party dealings that are taxable at Ireland's corporate tax rate of 12.5 per cent (i.e. trading transactions⁶); and second, a 'grandfather' clause whereby arrangements entered into between related parties prior to 1 July 2010 are excluded from the new transfer pricing rules. The exclusion of non-trading income from the new transfer pricing provisions preserves an important tax arbitrage opportunity for the FDI community in Ireland (this is typically achieved by lending the after-tax Irish-sourced profits on an interest-free basis to a related company in Luxembourg which secures a deduction for 'notional interest' deemed payable to the Irish lender. Typically the Luxembourg company then lends on the monies (at an arm's length interest rate) to another affiliate in another jurisdiction which secures tax relief on the interest it pays the Luxembourg company, sometimes referred to as a deduction/no inclusion outcome (D/NI)). The consensus amongst interviewees was that this 'carve out' was as a result of a compelling lobby from the FDI community in Ireland (Heij, 2012; Roberts and Bobek, 2004; Suchman and Edelman, 1991), in so doing recognising the conflicting institutional demands (Pache and Santos, 2010).

Having provided a contextual background for this research, we now present the theoretical lens through which the research was undertaken. We then outline in turn our theoretical model, the research methodology adopted and our findings from our fieldwork and in our concluding remarks identify future research possibilities in this important field.

NEW INSTITUTIONAL SOCIOLOGY

There are three strands of institutional theory identified in the literature, namely old institutional economics, new institutional economics and new institutional sociology (NIS). The research addressed in this paper focuses on NIS as this facilitates the consideration of the 'social, political and economic aspects that make up the context within which an organisation functions' (Dillard et al., 2004, p. 511). These assist in constructing a theoretical framework of the context and the processes associated with creating and adopting transfer pricing policies.

NIS is primarily concerned with an organisation's interaction with the institutional environment, the effects of social expectations on the organisation and the incorporation of these expectations as reflected in organisational practices and characteristics (Martinez and Dacin, 1999). The goals of NIS are to develop potent explanations of the ways in which institutions assimilate historical experiences into their rules and organising logics (DiMaggio and Powell, 1991a). It focuses on the 'importance of the social context within which organizations operate' (Scott, 2008, p. 211). Institutional theorists recognise the interplay of both top-down and

bottom-up processes in shaping, constraining and empowering actors within the organisational field (Scott, 2008).

So what is an institution? Peters (1999, p. 29) describes it as a compilation of values and rules, mainly normative rather than cognitive in the way in which they impact institutional members, as well as the routines that are established to implement and enforce those values. North (1990, p. 4) notes that 'an essential part of the functioning of institutions is the costliness of ascertaining violations and the severity of punishment'.

Hussain and Hoque (2002, p. 164) advocate that institutional theory 'adopts a broader, multi-dimensional approach for focusing on issues of external (macro) and internal (micro) organizational contexts'. They also posit that this perspective 'has contributed significantly to the understanding of the relationship between organizational structures and the wider social environment in which organizations are situated'. North (1990, p. 64) notes that 'a theory of institutions also inevitably involves an analysis of the political structure of a society and the degree to which that political structure provides a framework of effective enforcement'.

Dillard et al. (2004, p. 507) recognise the limitations of extant institutional research and criticise the lack of consideration given to the 'dynamics associated with change or the role of human agency' and to the role played by power, special interest and the political dimensions of organisations. Indeed Tuttle and Dillard (2007, p. 390) recognise the political process as one in which 'interested actors organize and mobilize their power to influence the field'. In their theoretical model, Dillard et al. (2004) emphasise the continuous recursive nature of their model, noting that the organisation field practices and criteria will also affect the economic and political level criteria, by either accepting the norms and practices articulated by the powerful interest groups, modifying them, or eliminating them and thereby affecting the resource allocation process within a society and the recognised social order (Dillard et al., 2004, p. 514).⁷ Dillard et al. (2004, p. 518) specify three constructs, namely representation, rationality and power, to analyse and understand organisational actions within a larger institutional and societal context. They believe the advantage of the NIS-based approach is that it enables consideration of the social, political and economic aspects of the organisational field in which the MNC operates (Dillard et al., 2004, p. 511).

An organisation and its environment are located in a larger organisational field (DiMaggio and Powell, 1991b, p. 65), which they define as being composed of the organisations that produce the same good or service, supply the resources they require and consume their products, and also the regulatory agencies and various occupational associations that govern them. It includes within its 'purview' parties that are meaningfully involved in some 'collective enterprise' (Scott, 2008, p. 208). DiMaggio and Powell (1991b, p. 65) emphasise that the conception is not confined to competing firms or networks and note the significance within their definition of including the 'totality of relevant actors'. In so doing, the concept comprehends the importance of both connectedness and structural equivalence (Mulligan, 2008). Scott (2008, p. 186) notes the uniqueness of each field, which is 'composed of some combination of regulatory and normative controls over activities and actors within the field'.

DiMaggio and Powell (1991b) note that highly structured fields provide a context in which tax issues of a mutual concern (e.g. transfer pricing) amongst governments can be viewed. Notably in the context of attempts by a state to take a unilateral approach to transfer pricing, DiMaggio and Powell (1991b, p. 64) advocate the homogeneity of institutional practice, noting that 'highly structured fields provide a context in which individual efforts to deal rationally with uncertainty and constraint often lead, in the aggregate, to homogeneity in structure, culture, and output'.

Three common themes permeate through NIS – namely legitimacy, isomorphism and decoupling – and are discussed in turn.

Legitimacy

This concerns legitimacy-seeking behaviour, which refers to what is considered appropriate behaviour by actors in the environment within which organisations must interact (Mulligan, 2008, 2012). This theme directs that organisations need to be socially acceptable and credible in order to survive in their social environment (Scott, 2001). Scott (2001, p. 59) posits that legitimacy is 'a symbolic value to be displayed in a manner such that it is visible to outsiders'. He positions the source of legitimacy beyond the boundaries of an individual organisation in super-organisational beliefs about social reality that are widely accepted by powerful actors.

How an organisation (in this case a government) is perceived by the array of external constituents present in the tax arena (in this case other governments and corporations), which have many and sometimes conflicting views or 'competing sovereigns' (Scott, 2001, p. 60) on what constitutes legitimate behaviour, represents a rich case study in the management of legitimacy. One might, for example, regard the introduction of transfer pricing legislation in Ireland as being a symbolic attempt to gain legitimacy. The requirement to determine procedural legitimacy may be greater among organisations whose processes have a high degree of arbitrariness, which makes them more prone to challenges on their work arrangements and procedures according to Scott (1987).

Isomorphism

Organisations adapt to what they believe society expects of them, which leads to institutional isomorphism; this is a useful platform for comprehending the politics and ceremony that permeates modern economies (DiMaggio and Powell, 1991b). Isomorphism is a 'constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions' (DiMaggio and Powell, 1991b, p. 66). Dillard et al. (2004, p. 509) describe isomorphism as the 'adoption of an institutional practice by an organization'. Scott (2001) identifies the three pillars of new institutional theory as regulative, normative and cultural cognitive. Each is associated with a particular institutional isomorphism, namely coercive, normative and mimetic, upon which DiMaggio and Powell (1991b) expound. Coercive isomorphism 'stems from political influence and the problem of legitimacy' (DiMaggio and Powell, 1991b, p. 67); this manifests when 'powerful bodies' in an organisation's field, through both formal and informal pressures, exercise authority or power to adopt specific structures or practices or else face sanctions (Hopper and

Major, 2007). Normative isomorphism occurs when demands from institutions with moral legitimacy are perceived as binding. It represents the ingredient that 'promotes the success and survival of organizations' (Meyer and Rowan, 1991, p. 49). Mimetic isomorphism often results from standard responses to uncertainty, i.e. under pressures of uncertainty organisations often imitate peers that are perceived to be successful or influential (Haveman, 1993).

Decoupling

Due to conflicting tension between institutional pressures and internal efficiency requirements, organisations claim to adapt institutional practices, whereas in reality they may not have done so in order to safeguard organisational efficiency (Mulligan, 2008).⁸ Decoupling refers to circumstances where the formal organisational structure or practice (Ireland's light touch transfer pricing policies) is separate or distinct from actual organisational practice (in this study's context the OECD transfer pricing policies) (Dillard et al., 2004). Meyer and Rowan (1991, p. 58) posit that 'decoupling enables organizations to maintain standardized, legitimating, formal structures while their activities vary in response to practical considerations'. A classic example of this applying in this study was the exclusion of non-trading income from the transfer pricing rules. From the primary research it was evident that the practical considerations which were taken into account were the impact that such an extension would have had on the powerful FDI community, which led to strong coercive pressure to implement a 'light touch' transfer pricing regime (Seidman, 1983).

Research undertaken by Westphal and Zajac (1994, 1997) indicate that decoupling is most likely among reluctant (later) adopters that respond to normative pressure (Eden et al., 2001). A later study by Fiss and Zajac (2006) suggests that organisations that actively declare their conformity to demands for strategic change are less likely to be the ones that implement structural changes. These views were in evidence in our research findings.

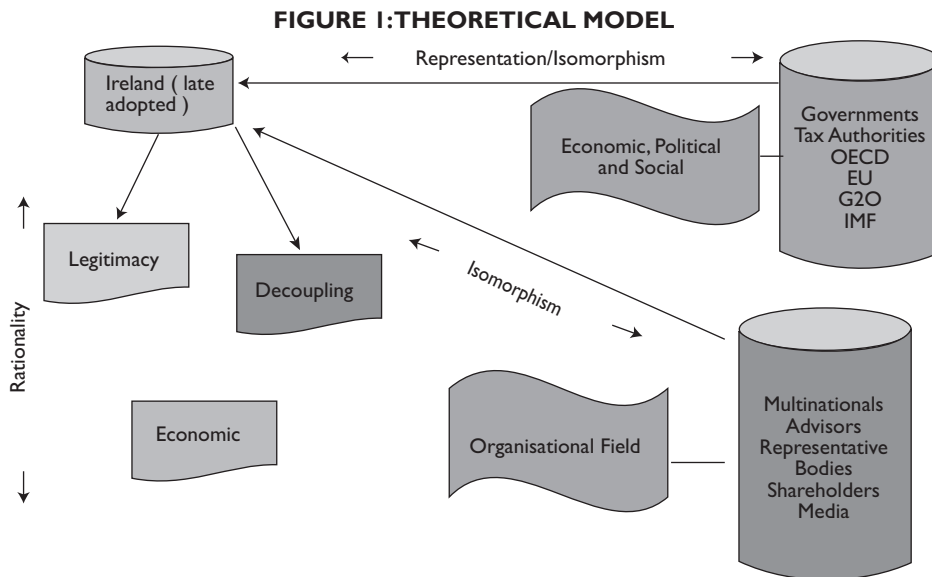
Further support of the rationale for introducing a modified version of the OECD regulations can be seen from the views of George, Chattopadhyay and Sitkin (2006), who posit that decision makers resort to decoupling when they encounter ambiguity in their reading of the environment. In response to institutional pressure for conformity, the organisation may selectively conform to institutional pressures. This is consistent with the views of Oliver (1991), who found that the propensity to decouple was strongest when an organisation was dependent on key influencers (e.g. the FDI community in Ireland). It also resonates with the views of Quirke (2013, p. 1677), who posits that 'the notion that institutional environments impose structural uniformity upon passive organizations has given way to the recognition that fields may be fragmented.'

Decoupling carries a significant health warning, which Meyer and Rowan (1977, p. 357) refer to as the 'logic of confidence and good faith', i.e. that people trust that the organisation does what it says it will. Organisations that decouple must avoid close inspection or else they are exposed as frauds. Ireland's continuing facilitation of certain hybrid structures and the manner in which its transfer pricing legislation

is framed will be influenced by the outcomes of the base erosion and profit-shifting (BEPS)⁹ initiative (Dutton and Dukerich, 1991; Fiss and Zajac, 2006).

THEORETICAL MODEL

The research uniquely draws on aspects of NIS in establishing a theoretical framework (illustrated in Figure 1) of the context and processes connected with designing, endorsing and diffusing transfer pricing policies. It draws on the work of Dillard et al. (2004) and Mulligan (2008, 2012) in developing the framework.



Representation refers to the way reality is framed or symbolically described. Rationality provides the legitimating conditions for evaluating criteria and practices. The theoretical model uses a number of theoretical constructs which emanate from NIS, namely legitimacy, decoupling and isomorphism. All three strands of isomorphism (coercive, normative and mimetic) were in evidence from the field research. In the model the powerful influence of other governments, tax authorities, the OECD, G20 and the IMF are included in the set of influencers at the economic, political and social level – the ‘institutional demands’ (Pache and Santos, 2010, p. 457). This group creates coercive isomorphism, which ‘stems from political influence and the problem of legitimacy’ (DiMaggio and Powell, 1991b, p. 67). This construct manifests when powerful bodies in an organisation’s field, through both formal and informal pressures, exercise authority or power to adopt specific structures or practices or else face sanctions. Within the model, actors and lobbyists at each level are operating in different contexts and have different interests, different sources of power and different audiences to whom their claims for legitimacy must be presented (Perrow, 1985). Consequently, there will be an abundance of tension

and controversy between the different levels around the framing and timing of legislation.

RESEARCH METHODOLOGY AND METHODS

The research question 'What was the rationale for Ireland introducing transfer pricing in 2010?' was considered in the context of a number of discrete objectives, which were arrived at after a detailed consideration of the research question itself, findings from a pilot interview and the literature informing the theoretical framework. The pilot interview was conducted with a tax director with one of the Big 4 firms specialising in transfer pricing. The interviewee previously worked as a transfer pricing specialist outside of Ireland (within the same firm), which provided an interesting perspective on the topic and helped to refine the line of enquiry in the final interview process and to refine the theoretical framework.

Having refined the questionnaire and theoretical model, semi-structured in-depth personal interviews were conducted with thirteen senior tax consultants who have held senior tax positions within their organisations for ten years or more. The personal interview schedule was developed from research questions arising from reviewing the prior literature on NIS. The primary objective of these interviews was to obtain detailed insights into transfer pricing. The interviews were guided by a number of broad open-ended questions and were conducted on the interviewees' firms' premises. The philosophical approach taken is an anti-positivism or interpretation perspective, recognising the 'need to get inside the worlds of those involved in meaning construction, which is viewed as context dependent and also time dependent' (Oats, 2012, p. 11).

There were three primary reasons for selecting senior tax consultants for interview. First, all interviewees have significant years of experience in international tax and transfer pricing. Second, individuals at a senior level could be expected to have a broad perspective on their firms' and clients' operations and may thus be viewed as being able to address questions investigating views on transfer pricing. Third, the interviewees' vast experience of dealing with tax authorities (both domestic and foreign) provides a richness of content in evaluating the role played by the respective authorities. Prior to conducting the interviews, ethics approval was sought and received from the relevant institution.

The list of potential interviewees was researched by examining all of the Big 4 firms (plus two other mid-tier firms, both of which are international firms) and the leading legal firms' websites to establish their designated specialists in international tax consultancy/transfer pricing. The interviewees were selected using 'purposeful sampling' to provide 'a great deal about issues of central importance to the purpose of the research' (Patton, 1990, p. 169). The justification for this approach was to choose information-rich cases whose study would enlighten the question under investigation.

In the interviews, it was agreed that the individuals' names and firms' names would remain anonymous. The interview schedule is shown in Table 1.

TABLE I: INTERVIEW SCHEDULE

Title	Designation	Firm Type (all Irish-based unless stated otherwise)	Specialism	Duration of Interview
Partner	IT2	Mid-tier firm (based in Canada)	Transfer pricing	1 hour
Partner	IT3	Legal firm	International tax	1.5 hours
Partner	IT4	Legal firm	International tax	1.25 hours
Consultant	IT5	Legal firm	International tax	2.5 hours
Partner	IT6	Legal firm	International tax	2 hours
Director	IT7	Big 4	International tax	1 hour
Partner	IT8	Big 4	International tax/ transfer pricing	2 hours
Consultant	IT9	Legal firm	International tax	1.25 hours
Partner	IT10	Big 4	Transfer pricing	1.25 hours
Partner	IT11	Big 4	International tax	1.5 hours
Partner	IT12	Big 4	Transfer pricing	1.25 hours
Partner	IT13	Big 4	International tax	1.25 hours
Partner	IT14	Big 4	International tax	1.25 hours

Note: The designation IT1 was not used, to avoid any possible confusion with the commonly used acronym for the Institute of Taxation in Ireland (ITI).

All thirteen interviews were recorded by tape and subsequently professionally transcribed. Each transcription was sent to the interviewee for confirmation of accuracy. The interview analysis constituted a pervasive activity throughout the life of the study. For example, throughout the interview collection phase, ongoing analysis was aided by extensive notes taken during and immediately after interviews, listening to interview tapes while travelling and dog walking, and the taking of additional notes and use of mind maps. This, in effect, provided a provisional running record of analysis and interpretation. Initial readings of early transcripts throughout the interview collection phase also meant that in subsequent interviews (the total interview schedule spanned a three-week period) certain issues that appeared to be arising from these readings could be probed more deeply. In conducting the post-interview analysis, the broad areas addressed in the interview guide provided a framework/template from which a more detailed analysis of transcripts could proceed.

In total, the transcripts were read on seven separate occasions after data collection had ceased. The first and second in-depth reading of each transcript was undertaken with the tape of the interview running 'as emphasis, mood, intonation and so on can crucially elaborate meaning' (Jones, 1985, p. 58). Each transcript was subsequently re-read and any themes emerging at this stage within this framework were recorded beside the relevant 'chunks' of the interview transcript intuitively coloured-coded for each apparent theme (Miles and Huberman, 1994, p. 56).

A detailed summary of all of the interviews was also prepared after the third reading highlighting emerging themes and providing general observations on the conduct of each interview. The process of coding facilitated the reduction of the transcript evidence, and also provided a means of interacting with and thinking about the evidence, thereby encouraging processes of reflection.

Simple mind (cognitive) maps were also prepared for each interview in order to support or, in some cases, challenge the themes identified. These also helped in the search for any apparent contradictions in the initial themes derived from the transcript evidence. Detailed matrices summarising the themes/codes identified in each transcript (Miles and Huberman, 1994) were then developed in order to visually display the themes emerging when the initial codes were developed. These displays aided in identifying patterns in the interview evidence as a whole (Huberman and Miles, 1994; Miles and Huberman, 1994) with the predominant codes/themes becoming evident partially by mapping the relative incidence of different codes.

Examining the matrices enabled the recognition of regularities, patterns and explanations in the evidence collected. It is important to recognise that while the most common recurring themes in the data were easily determined using the matrices, the authors were careful to avoid presenting a 'smoothed set of generalizations that may not apply to a single interview' (Huberman and Miles, 1994, p. 435) and made strenuous efforts to preserve the uniqueness of certain individual interviews. With their permission, the next section of this article includes quotes from some of these individuals, since their own words often best describes specific features or problems of this research area.

The theoretical approaches addressed in this article primarily draw on insights from NIS. These insights were subsequently used to interpret the empirical evidence, which enabled the writers to encapsulate the core issues emanating from the analysis in a coherent narrative.

Limitations

The qualitative approach adopted in this study, involving interviews with tax consultants from ten professional firms, means the findings are not statistically generalisable. To achieve the latter however was not the researchers' objective. Rather, it was, to explain and enhance the understanding of transfer pricing in practice and to form the basis for theoretical development, which it does.

For the most part, this study sought the perspective of tax professionals and as such provides only one perspective. It could be argued, for example, that obtaining the perspective of tax/finance personnel working in industry or the perspective of the government/tax legislators on tax policy/lobbying aspects would provide further information and enhance our understanding of transfer pricing in practice even more. This broader perspective could form the basis for further research (see below).

FINDINGS AND DISCUSSIONS

The key findings and implications are presented here, drawing on the major themes which emerged in the course of addressing the research question and associated objectives. The interviews were undertaken during a period (the first three months of 2011) in which there was blanket political focus on Ireland's tax competition, which added an 'extra bite' to the richness of the conversations held. In the lead up to the German by-elections, Chancellor Angela Merkel's debate with the new Irish government concerning Ireland's 12.5 per cent rate was being played out in the media, highlighting her dilemma of trying, as suggested by IT6 'to convince the German people that it's okay to bail Ireland out while Ireland has a 12.5 per cent rate of corporation tax.'

The findings are presented in line with the different stages of Irish tax policy for the FDI sector discussed earlier, as the evidence suggested a direct linkage between the introduction of transfer pricing and the maturity of tax legislation. Indeed this evolution was a constant theme referred to by the interviewees. The interviewees' views on the overall evaluation of the Irish regime are then presented.

Early Days of FDI to 2003

The levels of profits reported in Ireland during the early days of FDI in the late 1950s and 1960s in Ireland was highlighted by IT11 noting that Ireland did not experience the 'multiplicity of profits that we've had in the past 15 years in terms of being reported here'. IT3 alluded to the fact that the level of FDI in Ireland was 'comparatively insignificant in terms of global economy'. At a micro level, reflecting on the state of the Irish economy during this period, IT4 believes that Ireland was considered 'almost a developing country,¹⁰ and if you look at a lot of developing countries, people give them tax breaks' – the tax break in this instance being the toleration of the absence of transfer pricing. In contrast on the international stage, transfer pricing as a strategy, as an 'anti-avoidance tax measure, was only really getting up and running during the period of the ESR' was noted by IT5.

IT6 referred to the global transparency aspects, noting that 'in the 1950s and 1960s communications weren't as instant, financial reporting standards were not harmonised and I think a lot of the activities that went on throughout the world just weren't identified.' The evolution of transfer pricing as a discipline was referred to by many of the interviewees, IT9 noting that 'everyone has come up the knowledge curve ... I guess all the tax administrations have more muscle now in terms of ability to look at issues more closely.' Noting the increased level of reported profits in Ireland as a result of the growth of the information and communications technology (ICT) sector, IT9 surmised that it took the 'Microsofts, Googles and Intels' to prompt both international and domestic attention on the level of reported profits in Ireland and the lack of transfer pricing legislation.

Introduction of 12.5 per cent Rate in 2003

The consensus amongst the interviewees was that 2003 was a game changer; IT11 attributes the increased focus and pressure on Ireland to introduce transfer pricing to the greater range of activities that qualified for the 12.5 per cent rate compared

to the narrower scope of the previous low-tax rates/exemptions, which had been largely confined to manufacturing activities. IT12 noted the extent of transfer pricing legislation in place across the globe when it was first being considered by his firm in 2003, highlighting that there were numerous countries in Europe and worldwide which did not have transfer pricing legislation. He recalled that pre-1990¹¹ only the OECD top 10 countries had transfer pricing and Ireland was 'nowhere even near that'. At the time that the 12.5 per cent rate of corporation tax was introduced in Ireland in 2003, the possibility of transfer pricing being introduced was very much on the agenda. The rationale for the proposed introduction at the time was, as described by IT5, that '... every Tom, Dick and Harry would set up an operation here and seek to drop profits in [to] Ireland.'

IT6 understood at the time there was 'pressure in the Counsel of Finance Ministers for Ireland to do a number of things, one of which was transfer pricing' (Hopper and Major, 2007). The draft legislation/regulations were kept 'under the radar' but were seen by a number of relevant stakeholders. However, IT6 believes that a number of negative responses came back advocating that the introduction of such detailed rules would be 'just disastrous for Ireland'. Specifically, as noted by IT13, the introduction would have had an 'adverse impact on the future investment plans' – inter alia the extension of the rules to interest-free loans at the time was particularly sensitive. Coincidentally, the same sensitivity was evident when the rules were eventually introduced in 2010. IT11 recalls that the 'business sector lobbied heavily against it in terms of costs and compliance' and was of the opinion that the priority of Revenue in terms of their resources swung to the then current dilemma of the 'various DIRT¹² tribunals and enquiries'.

In lieu of transfer pricing provisions in 2003, IT5 noted that the Revenue took an alternative approach with the FDI community, by adopting a rigorous approach in examining applications for rulings as to the application of the 12.5 per cent rate, alluding to the fact that 'they started giving some rulings ... trying to restrict the application of the 12.5 per cent.' It was concerning to note the observations of some of the interviewees (IT10 and IT11) who believed that this initial rigor may have been diminished in later years.

Introduction of Transfer Pricing – 2010

Post-2003 increasing pressure (all three strands of isomorphism in evidence) from a number of sources resulted in the introduction of transfer pricing in 2010. IT6 referred to the combined pressures of the 'OECD, the black list, our treaty partners and the G20 summits as being important in influencing their decision to succumb to the pressure' to introduce the new rules (DiMaggio and Powell, 1991b; Scott, 2001). Furthermore, IT3 argues that the absence of transfer pricing 'became less acceptable when Ireland became a more economically viable jurisdiction and a real source of investment from the USA' (Martinez and Dacin, 1999). IT13 agrees, attributing this focus in the main to the increasing prevalence of aggressive tax reduction policies by MNCs: '... there was a greater chance now than there was in 2003 of Ireland's reputation being impacted by the absence of transfer pricing' (see Carpenter and Feroz, 2001). IT5 describes the global fiscal context, noting that whilst companies have expanded their overseas operations, 'the domestic tax base has shrunk while

at the same time the demand for government expenditure in all sorts of areas has gone up.'

By the end of 2009 the international tax environment was changing such that pressures emanating from various sources led to the introduction of transfer pricing. The changing environment is consistent with institutional theorists who argue that the power and potency of the various institutional pressures for change may vary over time (DiMaggio and Powell, 1991b). As noted by IT13, in 2010 'it was much more inevitable that transfer pricing rules would come in now, than any time previously.'

Against a backdrop of global tax reduction strategies by MNCs and tax base erosion caused by these phenomena and the emerging global recession, IT13 believes that Ireland was 'keen not to be seen as in the same light as some of the offshore locations and wanted to be seen as a mature economy and mature in relation to its tax approach' (Dillard's rationality construct, Dillard et al., 2004). A similar view was expounded by IT8, who emphasised that the new rules were introduced to 'underpin the integrity of the Irish tax system' (Meyer and Rowan, 1977; Carpenter and Feroz, 2001) and in a manner perceived as acceptable to the actors in that field (Dillard et al., 2004). Homogeneity often fosters legitimacy, helping to support Ireland's cause (Scott, 2001).

There was a broad consensus that Ireland's tax system required an injection of legitimacy to make Ireland 'look more respectable or more aligned with other members of those groupings' (IT3) (Dillard's rationality construct, Dillard et al., 2004). The importance of legitimacy in the international tax arena was alluded to by IT3, emphasising that Ireland Inc. 'needs to be very careful that it remains on the right side of the rather vague line as to what is internationally acceptable and what is not acceptable'. IT13 concurs arguing that the rules' introduction were motivated by Ireland's desire to demonstrate to the international community that Ireland had a 'mature tax environment and that we weren't a predatory tax nation'.

IT8 referred to the institutional pressures, noting that OECD countries (which belong to the economic and political level in the theoretical model) are expected to have transfer pricing regimes which are embedded within the terms of double taxation treaties. This was also commented upon by IT10, who opined that Ireland had to be 'seen to align ourselves with international best practice'.

IT5 considered that the introduction of transfer pricing would help in defending against an accusation of Ireland being labelled a tax haven. Whilst IT8 dismissed this possibility, he cautioned that Ireland cannot 'be overly careful as our multinational base is so important and we need just to keep our tax regime as robust as possible'. This appears to address the need to establish procedural legitimacy as Ireland may have been perceived as a jurisdiction whose tax policies had a high degree of arbitrariness, which may make it more vulnerable to attacks on its policies (Scott, 1987). IT6 alluded to the post IMF bailout era as one where there will be 'even heightened concern over how Ireland's tax policies are seen on the world's stage in a bigger picture'.

IT10 argues that not having transfer pricing was 'perceived as a blot on our copybook' and that Ireland needed to align itself with international best practice, illustrating normative isomorphism at play (DiMaggio and Powell, 1991b). IT4 alluded to the need to make Ireland an 'acceptable jurisdiction that can take a seat with the big boys', albeit recognising that the exercise was 'more cosmetics' from an Irish Revenue/Department of Finance perspective insofar as being able to say to their counterparts at various multilateral and bilateral negotiations that 'yes Ireland also has a transfer pricing regime' (Dillard's representation construct, Dillard et al., 2004). Does this rationale satisfy Suchman's view that 'legitimacy is possessed objectively, yet created subjectively'? (Suchman, 1995, p. 574). IT3 supported this view, advocating that Ireland had to be perceived as being 'members of the club' (evidence of mimetic isomorphism in action, whereby the club's members have become homogenous). The desire for conformity resonates with what Fligstein (1990) describes as the stability function of organisational fields.

IT13 noted that Ireland was preoccupied with defending the 12.5 per cent tax rate, a key attribute of Irish tax policy which IT13 referred to as the 'holy grail'. From this perspective, the absence of transfer pricing was described by IT10 as 'the big elephant in the room'. From a timing perspective, IT12 noted that in the context of the various tax agendas, it was the 'thing to do to introduce it at that point in time'. In the context of trying to defend the 12.5 per cent rate, IT13 alluded to the dilemma which Ireland is facing in trying to defend the low rate of corporate tax and concurrently being regarded as 'not mature in relation to other aspects of the tax regime'. IT5 reinforces this view, advocating that when Irish Revenue/Department of Finance officials attend international tax fora and engage in discussions defending the 12.5 per cent rate, they have one more 'weapon in their armoury' (see also Suchman, 1995).

IT2 spoke of the need for a country like Ireland to have a transfer pricing system in place to negotiate double tax treaties, a process which IT11 described as being 'tough, very political and point scoring'. IT2 also alluded to similar difficulties in the processing of MAPs. IT6 accepts this critique, highlighting that Irish Revenue would have found it difficult to 'come to the negotiation table and fight your case for Ireland's profit share'. IT7 concurs, advocating that Irish Revenue 'didn't really have a leg to stand on because they didn't have transfer pricing legislation'. IT11 similarly believes that the defence of the existing tax base was relevant, noting a concerning increase in the level of tax refunds¹³ to Irish corporates arising from foreign tax authority challenges - 'the fear level was increased when the claims were increased'. IT2 agreed, noting that a transfer pricing regime was necessary to 'protect the tax base' and referred to the international pressure to have a system and an administrative apparatus to 'counter some of the actions of the Treaty partners' (see also North, 1990).

Evaluation of the Irish Transfer Pricing Rules

There were a number of insightful observations made by the interviewees. IT3 opined that it was 'a defensive measure rather than anything that would raise any significant revenue'. IT4 highlighted that 'any reasonable commentator will look at

what was being brought in as being mainly cosmetic' to make Ireland a more legitimate place for locating business. He surmised that the international community expectation was not exclaiming 'my God, Ireland want to seriously say to US multinationals "you're not paying half enough in terms of royalty fees to the US or you're not paying back enough of the profits that are coming into Ireland for products" or whatever'. This aspect was affirmed by IT5 who spoke of the 'devil in the detail' insofar as 'in reality the Irish transfer pricing rules only kick in if you seek to shift profit out of Ireland, so we're not necessarily objecting if you shift a lot of profit into Ireland.' In this regard, IT10 notes that in reality an MNC in preparing their global transfer pricing strategy would have 'set it up to optimize the 12.5 per cent tax rate' whilst minimising the risk on the counterparty side of the transaction.

Ireland's transfer pricing rules do not extend to non-trading transactions, which has preserved a number of widely used hybrid financing structures using a non-resident related party intermediary, typically resident in Luxembourg (as described earlier). IT3 noted that such structures are used on a 'large-scale basis'. IT10 alluded to the attractiveness of both the low corporate tax rate and the ability to lend the post-tax income on a tax-efficient basis. Indeed IT6 highlights that such hybrid structures are under examination by the OECD and the European Union (EU), suggesting that Ireland's facilitation of such structures will come under the microscope. He graphically illustrates his view by stating that 'no matter how much fake tan you put on, the pimples will show through under the microscope' (IT6). IT8 would be less concerned, noting that in other jurisdictions such as Luxembourg, there are 'a lot of more objectionable areas which would be further up the food chain'. Indeed, IT14 conceded that any change to the Irish rules would be as part of a broader European drive, which would involve the targeting of other hybrid mechanisms facilitated under the fiscal regimes in countries such as Malta and Luxembourg.

According to IT13, this carve out (non-application to non-trading transactions) is illustrative of the 'under the radar FDI lobby' who, through a range of lobbyists (citing the Big 4 and American Chamber of Commerce as examples), lobby for a tax regime that is 'friendly to FDI' (see Tuttle and Dillard, 2007). In this context, IT13 argues that Revenue/Department of Finance had 'to balance two things, trying to balance the reputational issue that Ireland is seen as being responsible in terms of its tax regime, that it has good relationships with the tax treaty neighbours as well as with the EU, but at the same time facilitating the FDI community and further FDI investment'.

Extensive discussions centred on the perceived capability of Irish Revenue, their approach to transfer pricing in the past, and their fire power (Markham, 2012) in dealing with foreign tax authorities, etc. IT2 highlights the importance of Irish Revenue administering and enforcing the new legislation in a responsible and even-handed way. Indeed, IT8 advocates it will be necessary for Revenue to have a large transfer pricing team in light of the 'expedient growth' or 'tsunami' of transfer pricing disputes in the future. He acknowledges that existing personnel are proactive and helpful and that 'Ireland's competent authority is superb' but bemoans the limited amount of capacity. The capacity issue was concurred with by IT9, who expressed concern as to whether Revenue has the 'breadth of resources here to adequately defend our tax base'. Notwithstanding the capacity concern, IT9 has been

'incredibly impressed' with the manner in which Revenue has dealt with the IRS and would not regard Revenue as a 'soft touch by any stretch of the imagination' (see Li, 2002). The predicament in dealing with a well-established transfer pricing tax authority such as the IRS was succinctly described by IT3 as not so much intimidation but that Revenue are 'aware of their power and strength and their resources, so yes, there is a sort of Samson and Goliath feel about it' (see Dillard's power construct, Dillard et al., 2004).

Most of the interviewees emphasised that there has been an evident change in approach by Revenue following a realisation that there was a knowledge deficit. IT11 noted that this became axiomatic when Revenue became enthralled in very detailed and complex transfer pricing MAPs and competent authority claims. During this learning curve, IT14 conceded that there was generally a 'more sophisticated tax regime on the other side of the transaction'. IT11 noted in the past Revenue were acting more as the 'good guys' but 'I think less so now.' He attributed this to financial and political pressure within Revenue.

CONCLUSIONS

This paper has addressed the question as to the rationale for Ireland introducing transfer pricing in 2010. The introduction of the transfer pricing rules in Ireland were primarily underpinned by the legitimacy construct; the factors that would have been of concern included the need to demonstrate that Ireland has a mature fiscal framework. The primary research elucidated a number of economic issues including protecting the tax base, defending the 12.5 per cent corporate tax rate and giving Irish Revenue additional armoury in dealing with transfer pricing disputes. Based on the evidence gathered, there was a concern expressed that had Ireland not introduced transfer pricing, it may have resulted in it appearing on a 'black list', which could discourage foreign direct investment into Ireland. Coercive isomorphism was evidenced by the powerful role of (sometimes competing) stakeholders at the economic, political and social levels. The whole field of international tax is changing and, in an era of uncertainty, having normative tax provisions in the tax legislation infrastructure can be regarded as an example of mimetic isomorphism at play.

Ireland was a late adopter of transfer pricing in 2010, at which stage it was very much in the minority of developed countries which did not have transfer pricing on its statute books. This contrasts with the original proposed (but mothballed) introduction in 2003 when Ireland was one of many developed countries which did not have transfer pricing legislation.

It was clear that the 'carve out' (or decoupling) of non-trading income from the transfer pricing regime reflects the powerful role of the FDI community in Ireland. Revenue's indication of adopting a 'light touch' approach to monitoring transfer pricing may also be considered under the decoupling construct. As a late adopter of transfer pricing, such approaches are not unexpected (Westphal and Zajac, 1994, 1997; Eden et al., 2001; Fiss and Zajac, 2006).

Ireland faces many challenges as it grapples with the introduction of transfer pricing. A notable finding which emerged during the interview process was that at an operational level, Revenue faces the challenge of upskilling its staff on the intricacies and nuances of transfer pricing, and then retaining these staff members, i.e. possibly losing them to Big 4 firms who face similar human resources issues. Markham (2012) highlights the challenges the IRS faces in staff retention with transfer pricing specialism. The requirement for specialist training, particularly in the valuation of intellectual property transactions, will need to be addressed, as it is in this area where disputes are likely to be most prevalent. This may require the recruitment of transfer pricing specialists from overseas professional practices and the IRS or Her Majesty's Revenue and Customs (HMRC). The absence of personnel to administer and police the system may bring into question – by those at the economic, political and social level – the legitimacy of the actions undertaken and perhaps the authority itself.

The ability and the need to successfully defend potential transfer pricing adjustments are sacrosanct, not alone from a tax policy legitimisation perspective but equally importantly in defending Ireland's tax base at a time when Ireland's sovereignty has been exposed. There are upsides to rigorously enforcing the new rules, against the backdrop of sea changes in the international tax arena. If Ireland can continue to demonstrate to the international tax spectators that it upholds internationally acceptable tax policies, then the opportunities to attract FDI may be enhanced.

Future research in this area could draw on alternative theoretical perspectives to enhance our understanding further, such as corporate social responsibility theory (Gray, Kouhy and Lavers, 1995), legitimacy theory (Deegan, Michaela and Tobin, 2002; Dowling and Pfeffer, 1975; Johnson, 2004; Lindblom, 1994) or political economy theory (Armstrong, 1998; Benson, 1975; Wamsley and Zald, 1973; Zald, 1970).

ENDNOTES

- ¹ Christians (2014, p. 43) describes the OECD as a 'transnational network, and its tax division is a tightly knit epistemic community whose main purpose is to create spaces for government officials to collaborate with business and industry leaders to frame issues of international tax policy, formulate norms, and syndicate these norms globally through domestic law making procedures.'
- ² To encourage exports and generate jobs in manufacturing, export sales relief (ESR) was introduced in 1956. This provided relief from income tax and corporation profits tax on the profits from the export of certain manufactured goods.
- ³ The Customs Free Airport (Amendment) Act 1958 allowed special tax and duty concessions to industries and services operating within the Shannon Free Airport. These included exemptions from income tax and corporation profits tax for profits derived from trading operations within the area. Under customs control, raw materials could be imported, without payment of duty and taxes, manufactured and then exported. Duty became payable only if the goods entered home consumption. Shannon was the first free zone in the world in which manufacturing operations were carried out.
- ⁴ For a fuller discussion on profit-shifting see Scholes, Wolfson, Erickson, Maydew and Shevlin (2005).
- ⁵ As part of the 2010 Finance Act, enacted in April 2010, Ireland introduced broad-based transfer pricing legislation. The legislation endorses the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and adopts the arm's length principle. There are, of course, institutional transfer pricing regulations in play such as the United Nations regulations – see www.un.org/esa/ffd/documents/

UN_Manual_TransferPricing.pdf. Other tax regimes which do not conform necessarily to the arm's length principle, such as Argentina, Brazil and Mexico, also exist. Such regimes are of course relevant in the context of Irish resident companies dealing with these jurisdictions; however this paper does not address these issues due to scoping constraints.

- ⁶ Passive income for the purposes of the new regime may include interest, royalties, dividends and rents from property where the income arising is not derived from an active trade. In practice, each transaction must be examined in the context of the company and its business to determine if it will constitute trading or passive income.
- ⁷ The role that the corporate lobby played in mummifying the Stop the Tax Haven legislation in the US and reducing the scope of Ireland's transfer pricing rules are evidential of this applying in practice.
- ⁸ This is consistent with international law theorists who suggest that a state may 'act out of self-interest' (Goldsmith and Posner, 2005, p. 3).
- ⁹ The OECD's Action Plan on BEPS was published in July 2013 with a view to addressing perceived flaws in international tax rules. The 40-page action plan, which was negotiated and drafted with the active participation of its member states, contains 15 separate action points or work streams, some of which are further split into specific actions or outputs. The plan is squarely focused on addressing these issues in a coordinated, comprehensive manner, and was endorsed by G20 leaders and finance ministers at their summit in St Petersburg in September 2013.
- ¹⁰ Supported by the Marshall Aid Plan, Western Europe was experiencing a significant degree of post-War prosperity. The economy of Ireland was stagnating with living standards increasing at much lower rates than those in continental Europe. Ireland was primarily an agricultural country with about half of those employed working in that sector and exports mostly consisted of live cattle for the British market.
- ¹¹ Both ESR and Shannon relief exemptions expired in April 1990.
- ¹² Investigation into widespread tax evasion which occurred during the 1990s through the use of non-resident accounts from which deposit interest retention tax (DIRT) was not deducted.
- ¹³ Pre-1990 refunds to multinationals was a non-event, simply as they paid no corporation tax in Ireland due to ESR and Shannon reliefs. Any transfer pricing adjustments only gave rise to additional tax liabilities in the home country. Post-1990 this all changed.

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