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Italian Transfer Pricing Rules Aligned with OECD Standards

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Italian transfer pricing rules have been aligned with current international standards: explicit reference to the "arm's length" principle aligns the transfer pricing rules to the OECD Model Convention and to international best practice, in accordance with the OECD BEPS project.

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Article 59 of the Law Decree April 24, 2017, n. 50 aligns Italian transfer pricing rules to current international standards, as established by the Organisation for Economic Co-operation and Development ("OECD"), and provides resident companies with new ways and means, other than the Mutual Agreement Procedure ("MAP"), for the corresponding downward adjustments of their taxable income.

Italian Transfer Pricing Rules up to April 24, 2017

Article 110 comma 7 and Article 9 comma 3, DPR 917/1986, contained the Italian transfer pricing rules. Pursuant to Article 110 comma 7, first indent, items of income deriving to domestic companies from intra-group transactions were priced according to their "normal value" (*valore normale*).

In the case of corresponding downward adjustments of taxable income, taxpayers could only rely on MAPs, pursuant to Article 25 of the OECD Model Tax Convention on Income and on Capital ("OECD Model Convention") (OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing) to obtain relief from double taxation.

Article 9 comma 3 of DPR 917/1986 defines the "normal value" as the average sum paid or received for the same kind of goods and services, under conditions of free competition and at the same stage of marketing, at the time and in the place that the goods or ser-

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vices were acquired or provided, or, if this is not possible, the time and place nearest thereto.

According to *Circolare* n. 32 September 22, 1980—*Ministero delle Finanze*, concerning "The transfer price in the determination of the taxable income of companies subject to foreign control" ("*Circolare* n. 32/1980"), both the personal scope and the control requirement must be interpreted in an extensive sense. As regards foreign companies, the dispositions at stake apply to any social entity recognized by a foreign legislation and to permanent establishments of foreign companies located abroad. The Italian company must be intended in the more general meaning of "anyone who professionally exercises an organized economic activity for the purposes of production or exchange of goods or services" (Article 2082 *Codice Civile*).

In addition, the notion of control must be interpreted in an extensive sense. To this end, the provision of Article 2359 *Codice Civile* is inadequate. In fact, in commercial transactions, prices are very often established by the counterpart having dominant bargaining power. Accordingly, in administrative practice, the situation of control is met in any potential or current economic influence, depending on specific circumstances.

In its sentence n. 8130 April 22, 2016, the *Suprema Corte di Cassazione* ("*Suprema Corte*") endorses the administrative position and strengthens its conclusions with legal and teleological arguments. The *Suprema Corte* affirms that transfer pricing rules, given their anti-abuse purposes, cannot adopt a concept of "control" limited to contractual conditions or to the percentage of equity shares or voting rights. Transfer pricing rules derogate from the general rules underlying the taxable income rules according to which parties can freely agree on prices when those prices can be manipulated in a tax avoidance perspective, as could happen in cross-border transactions among related parties. On these grounds, the *Suprema Corte* reaffirms the correctness of the position already expressed in *Circolare* n. 32/1980, and explicitly refers to it.

Current Italian Transfer Pricing Rules

Article 59 of the Law Decree April 24, 2017, n. 50 changes Italian transfer pricing rules in form, substance and procedure.

Article 59 comma 1 amends the content of Article 110 comma 7 first indent. In its current wording, this provision states that the items of income arising from transactions entered into between associated enterprises (parent and subsidiary companies and companies under common control) must be priced taking into account conditions and prices as if the enterprises were independent, operating at arm's length and in comparable circumstances.

According to *Circolare* n. 32/1980, the concept of normal value as defined in Article 9 DPR 917/1986, because of its reference to "*condizioni di libera concorrenza*," was already a transposition in the Italian tax law of the arm's length principle recommended by the OECD.

In legal theory, the deemed coincidence between "normal value" and "arm's length" is controversial. Scholars correctly point out that, according to the normal value principle, as stated in Article 9 comma 3 DPR 917/1986, transfer prices are based on the comparison of prices in transactions carried out with third parties. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration ("OECD Guidelines") provide for various methods based on different criteria. Thus, the *resale price method* is "based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise;" the *cost plus method* considers the costs incurred in the production of goods or in the supply of services.

More significantly, the arm's length principle, when determining the transfer prices, considers not only prices but even conditions under which the transaction are carried out (OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing, Article 9—Associated enterprises, Article 7 comma 2—Business profits).

The amended version of Article 110 comma 7, first indent, explicitly refers to both the arm's length principle, fully replacing the normal value principle, and to "conditions and prices" which independent parties, in comparable circumstances, would have agreed on.

Therefore, the updated transfer pricing domestic rules are compliant with Article 9 and Article 7 of the OECD Model Convention and with the current OECD Guidelines, as recently updated in the framework of the OECD Base Erosion and Profit Shifting ("BEPS") project (OECD (2015), *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris).

In the explanatory memorandum of the Law Decree April 24, 2017, n. 50, the Italian legislator does not attribute economic effects to this amendment. The change would simply align the wording of the domestic transfer pricing rules to the most recent OECD Guidelines, as last reviewed in the framework of the BEPS project (Explanatory Memorandum to the Law Decree April 24, 2017, n. 50, Comments to Article 59—Transfer pricing).

The Director of the Revenue Agency, during his hearing before the responsible Parliamentary Committees, held on May 4, 2017, points out that the OECD Model Convention and the OECD Guidelines were already widely considered a reference point, both in the existing case law and in the administrative practice (The Director of the Revenue Agency's hearing before the responsible Parliamentary Committees, May 4, 2017, p. 40.)

In its sentences n. 22023 October 13, 2006, n. 11226 May 16, 2007, and n. 8130 April 22, 2016, the *Suprema Corte* explicitly refers to the OECD Guidelines and to Article 9 of the OECD Model Convention.

The *Provvedimento del Direttore dell'Agenzia delle Entrate September 29, 2010, prot. 2010/137654*, in providing proper guidance on transfer pricing documentation requirements, bases its recommendations on the OECD Guidelines.

Circolare n. 32/1980, to the end of determining transfer price in the determination of the taxable income of companies subject to foreign control, considers the experience already gained in foreign coun-

tries, and the guidelines provided by different international organizations, particularly by the OECD.

In conclusion, and in the light of the considerations above, Article 59 comma 1 has not introduced a new principle in Italian transfer pricing practice. In fact, before the Law Decree 50/2017, the arm's length principle was already considered a reference point for any transfer pricing issue, involving business entities, legal proceedings, or administrative practice.

Nonetheless, the restatement of Article 110 comma 7, first indent, is very welcome. Indeed, the explicit reference to the arm's length principle aligns the Italian transfer pricing rules with the OECD Model Convention and with international best practice, according to the findings of the OECD BEPS project. Furthermore, the restated provision is consistent with the existing case law and administrative practice. Finally, it provides for a certain legal basis in disputes concerning transfer pricing issues.

Article 59 comma 2 modifies Article 110 comma 7, second indent, introducing the new Article 31-*quater*, DPR 600/1973.

In detail, Article 31-*quater* establishes that a taxpayer requesting in Italy a downward adjustment of its taxable income corresponding to an international transfer pricing review, can rely on:

a) MAPs, according to either Article 25 OECD Model Convention or the Directive 90/436/CEE July 23, 1990;

b) the results of transfer pricing audits, carried out in the context of international cooperation procedures, whose findings are shared by all the acceding contracting states;

c) a formal application to the tax authorities, when a definitive transfer pricing upward adjustment has been carried out, in compliance with the arm's length principle, by a foreign state with which Italy has concluded a bilateral tax agreement ensuring an appropriate exchange of information. The Italian tax authorities will give instructions to set up terms and formal requirements for filing the application.

The new instruments, when duly implemented and applied, could be highly beneficial for different reasons, depending on the stakeholders involved.

The new procedures will reduce the overall number of MAPs—whose effectiveness is highly controversial (OECD (2015), *Making Dispute Resolution Mechanisms More Effective, Action 14—2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. The document points out the importance of MAPs for an effective and timely resolution of disputes regarding the interpretation of tax treaties and the consequent double taxation. To this end, it provides for "Minimum standard, best practices and monitoring process", aimed at strengthening the effectiveness and efficiency of MAPs. However, these measures have not been implemented yet. Therefore, for the time being, MAPs remain an inadequate instrument in pursuing the purposes for which it was conceived.)—with a consequent relevant improvement in the efficiency of the administrative activity (Explanatory Memorandum to the Law Decree April 24, 2017, n. 50, Comments to Article 59—Transfer pricing).

Long-term Commitment

The procedure described under point b) above expresses the Italian long-term commitment to actively participating in international cooperation among tax jurisdictions, as the OECD recommends in the Final Reports of the BEPS project (OECD (2015), *Mandatory Disclosure Rules, Action 12—2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris; OECD (2015), *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris).

The formal application under point c) above allows tax authorities to give relief from economic double taxation in a prompt and effective way while ensuring to both multinational enterprises and tax jurisdictions transfer pricing adjustments compliant with the arm's length principle (The Director of the Revenue Agency's hearing before the responsible Parliamentary Committees, May 4, 2017, p. 41).

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