Italy: Guidelines issued for the application of transfer pricing rules

Tax Alert

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After public consultation, on 14 May 2018 the Ministry of Economy and Finance issued a decree laying down Italian transfer pricing guidelines (the 'Italian Guidelines'), in compliance with article 110(7) of the Italian Income Tax Code, as recently modified to incorporate the arm’s length principle.

The decree, consisting of nine articles, sets out certain general and fundamental principles, widely adopted in international practice, and makes express reference to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the 'OECD Guidelines') as periodically updated.

The Italian Guidelines define, first of all, the criteria for establishing that transactions are comparable, i.e. for verifying that none of the possible differences between the transactions could materially affect the financial indicator - price or margin - to be compared or that reasonably accurate adjustments can be made to eliminate the material effects of such differences. They also list the *economically relevant characteristics* or *comparability factors* to be used in order to accurately delineate the controlled transaction and base a judgment on comparability. These characteristics and factors fully match the most recent version of the OECD Guidelines.

The OECD transfer pricing methods (both *traditional transaction methods* and *transactional profit methods*) are listed and accepted, even though traditional transaction methods, and mainly the CUP, are to be preferred in situations where more than one method can be applied in an equally reliable manner. The Italian Guidelines also acknowledge the possibility of adopting an *alternative method*, but only if none of the listed OECD methods can be reliably used and only if the result of the alternative method is compliant with the arm’s length principle.

A combined transactions approach is allowed when transactions are so closely linked or continuous that they cannot be properly evaluated separately.

According to the Italian Guidelines, the arm’s length range is a range of figures for the financial indicator, calculated using the most appropriate transfer pricing method and a number of uncontrolled transactions, all relatively equally reliable. A controlled transaction is in line with the arm’s length principle when the relevant condition of the controlled transaction (i.e. price or margin) falls within the arm’s length range.

The Italian Revenue Agency may adjust the value of the financial indicator if it falls outside the arm's length range, subject to the right of the associated enterprise to present evidence that the conditions of the controlled transaction satisfy the arm's length principle. The tax administration has the power to reject that evidence but has to do so on the basis of appropriate arguments.

Article 7 introduces a definition of low value-adding intra-group services as well as a simplified approach, in line with the OECD Guidelines, for the exclusive purpose of evaluating the arm's length value of those services.

The Director of the Italian Revenue Agency will update the rules on transfer pricing documentation. On this point, the Italian Guidelines state that transfer pricing documentation will be appropriate and grant penalty protection whenever it provides auditors with the information necessary for an accurate analysis of transfer prices, regardless of the choice of method or the selection of the tested party or comparables. This will hold true even if the documentation contains omissions or partial inaccuracies, provided that these do not hamper the work of the tax administration.

Finally, the Italian Guidelines indicate that further implementation rules will be issued, which will take into consideration the OECD Guidelines, as periodically updated.

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