
Italian Ministerial decree on transfer pricing incorporates latest OECD principles

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In brief

The Italian Ministry of Finance (MEF), on May 14, 2018, published a decree providing key principles to assist implementation of the provisions contained in the revised wording of local transfer pricing law, Article 110 par. 7 of the Italian Tax Code (the Decree). This is an important step in aligning Italian transfer pricing rules with current international standards, taking into account the project initiated by the Organisation for Economic Co-operation and Development (OECD) on Base Erosion and Profit Shifting (BEPS) and the 2017 revision of the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).

The Decree addresses points of principle only. Further guidance in the form of regulation and circular letters will be issued by the Italian Revenue Agency in order to cover matters of an operational and procedural nature.

In detail

Overview

On February 21, 2018, the MEF launched a public consultation on implementation of the new transfer pricing rules set out in Law Decree n. 50/2017 of April 24, 2017. Those rules established the concept of the arm's-length principle as a basis for determining intercompany transfer prices, finally replacing the long-standing Italian legal concept of '*valore normale*' (see our [Tax Insight](#) published on May 15, 2017).

The public consultation ended on March 21, 2018. It was followed on May 8, 2018 by a

roundtable meeting between representatives of the MEF and Italian tax professionals that provided significant input to the consultation process, which discussed the proposed output and next steps.

The Decree was published in final form on May 14, 2018. It contains nine articles and reflects both the BEPS project and the 2017 revision to the OECD Guidelines, to which the Decree specifically refers. The main technical issues included in the Decree are described below.

Definitions

Article 2 introduces a definition of 'associated companies' to which the Italian transfer pricing rules are applicable. These are companies where there is either:

- direct or indirect ownership of more than 50% of the capital or voting rights of a company or entitlement to more than 50% of its profits; or
- dominant influence on its management, either through share ownership or through any other contractual arrangements.

The Decree formally defines ‘unrelated companies,’ ‘controlled transactions,’ and ‘uncontrolled transactions,’ as well as the concept of ‘financial indicator,’ in which reference is made to ‘price’ as well as to the more usual usage of ‘profit percentage.’

Comparability

Article 3 provides clarification on comparability. It incorporates the OECD definition and lists the five comparability factors as set out in the Guidelines.

Transfer pricing methods

Article 4 lists the five OECD-recommended methods and incorporates OECD recommendations on the criteria to be used in selecting the most appropriate method. Taxpayers may select an unspecified other method, provided it can be shown that none of the five OECD methods can be employed in a reliable manner. In line with OECD Guidelines, taxpayers need not employ more than one method.

The Decree reiterates the OECD view that where a profit-based method and a traditional transaction method can be applied with equal reliability, the latter is to be preferred. It also restates local Italian guidance dating back to 1981 that if more than one of the traditional transaction methods can be applied with equal reliability, the Comparable Uncontrolled Price method is to be preferred over the other two methods.

Observation: Article 4 makes clear that where the taxpayer has selected a method and has employed it in a reliable manner, the Italian tax authorities must base their analysis on that method. Although this is a welcome statement of principle, much will depend on local tax authority practice in evaluating whether a method has been reliably applied.

Combined transactions

Article 5 specifically states that the arm’s-length principle must be applied to each transaction individually. However, where one or more transactions are very closely related or can be considered as a ‘unitary complex,’ they must be analyzed together.

Arm’s-length range

Article 6 deals with the arm’s-length range, an issue that is often of some controversy between taxpayers and the Italian tax authorities. The Decree reflects the general rule expressed in Chapter 3 of the OECD Guidelines that an arm’s-length result may lie anywhere in the range of all values derived from independent comparable transactions, all of which respect full comparability with the controlled transaction. The Decree does not enter further into the criteria to be used for assessing whether the level of comparability is sufficient.

If the controlled transaction falls outside the range, this does not automatically mean that an adjustment is required. Taxpayers may bring forward appropriate arguments in support of such a position, although there can be no guarantee that they will be accepted. There is no reference to statistical tools or to criteria for determining the point to which any out-of-range result should be adjusted.

Observation: It is expected that the Italian Revenue Agency will issue detailed further guidance in this area.

Low-value-adding services

Article 7 of the Decree introduces the simplified approach for low-value-adding services developed in the BEPS project and based on a 5% markup on direct and indirect costs. The Decree broadly follows the OECD definition of such services and their treatment.

Observation: Although the Decree does not refer to the supporting documentation the taxpayer may need to provide, it is expected that the Italian Revenue Agency may specify this in more detail, rather than simply relying on the OECD Guidelines recommendations on this matter.

Transfer pricing documentation

Article 8 addresses transfer pricing documentation. It refers to a regulation, still awaited from the Italian Revenue Agency, to reflect international best practice in this area, i.e., the conclusions from BEPS Action 13.

The only specific input provided in Article 8 is some elaboration on the circumstances in which documentation is to be considered acceptable for penalty protection purposes. The Decree repeats existing Revenue Authority guidance that partial inaccuracies or omissions should not invalidate penalty protection and states that documentation should be accepted ‘if it is able to provide the tax authorities with all the information useful in conducting a transfer pricing analysis.’

Observation: It is helpful that Article 8 makes a clear statement that the Italian tax authorities may disagree over the choice of method or the selection of comparable transactions, but this does not constitute a valid reason to withhold penalty protection.

The takeaway

The Decree should be considered an important step in aligning Italian rules and regulations with OECD recommendations and best practice in the post-BEPS environment. However, the Italian Revenue Agency still needs to issue additional regulations to clarify how the OECD

guiding principles will play out within domestic law and to address other areas; such as intercompany

financing, intangible assets, and transfer pricing year-end adjustments, in order to

improve the level of clarity in dealings between taxpayers and the Italian tax authorities.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Transfer Pricing

Ugo Cannavale, *Milan*
+39 02 91605503
ugo.cannavale@pwc.com

Alessandro Caridi, *Milan*
+39 02 91605003
alessandro.caridi@pwc.com

Gianni Colucci
+39 02 91605500
gianni.colucci@pwc.com

Transfer Pricing Global, Americas, and US Leaders

Isabel Verlinden, *Brussels*
Global Transfer Pricing Leader
+32 2 710 44 22
isabel.verlinden@be.pwc.com

Horacio Peña, *New York*
Americas Transfer Pricing Leader
+1 646 471 1957
horacio.pena@pwc.com

Paige Hill, *New York*
US Transfer Pricing Leader
+1 646 471 5192
paige.hill@pwc.com

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