

TRANSFER PRICING

Avv. Marco Cerrato

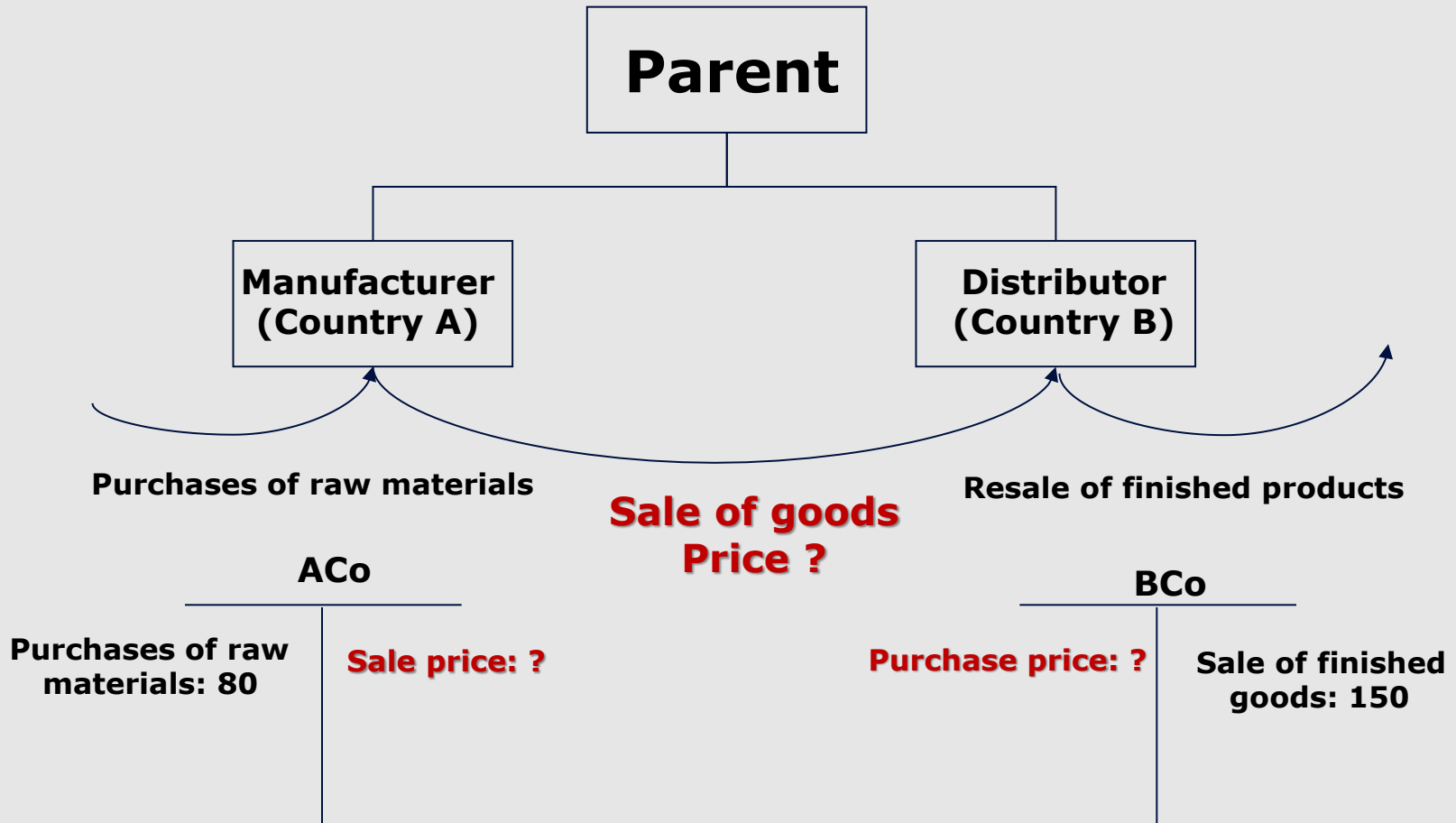
Table of contents

1. The issue;
2. The Arm's length principle (ALP)
 - Italian legal framework
 - International legal framework
3. Transfer pricing methods
4. Application of the ALP: Comparability analysis
5. TP Documentation
6. Administrative approaches to avoiding and resolving transfer pricing disputes:
 - a) Advanced Price Agreement (APA)
 - b) Mutual Agreement Procedure (MAP) and the Arbitration Convention
6. OECD/G20 BEPS Project

Transfer Pricing

THE ISSUE

Transfer Pricing



Transfer Pricing

THE ARM'S LENGTH PRINCIPLE (ALP)

The Italian legal framework

- **Legal basis:**

- Art. 110(7) of Presidential Decree n. 917/1986 (TUIR);
- Art. 9(3) of Presidential Decree n. 917/1986 (TUIR).

- **Regulations and Circulars:**

- Ruling 9/2555 of 31 January 1981, Ministry of Finance;
- Circular 32/9/2267 of 22 September 1980, Revenue Agency;
- Circular 42/12/1587 of 12 December 1981, Revenue Agency;
- Ruling 9/281 of 29 September 1990, Ministry of Finance;
- Circular 98/E/2000/107570 of 17 May 2000, Ministry of Finance;
- Ruling 18/E of 15 February 2005, Revenue Agency;
- Circular 58/E of 15 December 2010, Revenue Agency;
- Circular 21/E of 5 June 2012, Revenue Agency.

Art. 110(7) TUIR

- **General remarks:**

- Business income of a resident enterprise arising:
 - i. from transactions with non-residents that, either directly or indirectly, **exercise a dominant influence**;
 - ii. from transactions where the resident enterprise (directly or indirectly) **controls** non-resident companies and ;
 - iii. from transactions between resident and non-resident companies that are under the **common control** of a third company;
- is assessed on the basis of the **"normal value"** of the goods transferred, services rendered or services received if an **increase in taxable income** derives therefrom (articles 9 and 110 of the TUIR). The provision also applies if a **decrease in taxable income** derives therefrom, but only if the **mutual agreement procedure** provided in double tax treaties is used.

Art. 110(7) TUIR

- **Subjective requirements:**
 - **Resident enterprises** that (directly or indirectly) **control non-resident companies** and;
 - **Non-Resident companies** that (directly or indirectly) **control** resident **enterprises** and;
 - **Resident** and **non-resident** companies that are under the **common control** of a **third company**.

Notion of Control

- ***De Jure control:***
 - Art. 2359 c.c.;
- ***De Facto control:***
 - According to the case law, any hypothesis of economic influence, potential or actual. In general, whenever one company influences the business decisions of the other a stable manner. E.g.:
 - exclusive sale of products
 - economic dependence from products or technical cooperation of another enterprise
 - right to appoint the members of the board of directors or management bodies of the company
 - common members of the board of directors
 - financial dependence
 - monopolistic situation

Notion of Control

- Italian Supreme Court, decision No. 8130 of 22 April 2016:
 - *"Hence, **the concept of "control" must be extended to all hypotheses of economic influence – whether currently effective or potential – that may be inferred from the single circumstances** (i.e., the exclusive sale of goods produced by the other enterprise, the enterprise's impossibility to function without capital, the other enterprise's products and technical cooperation, the control of supplies or the opening of new markets, and in general, all such cases in which any influence might be currently or potentially exercised on entrepreneurial decisions)."*

Art. 110(7) TUIR

- **Objective requirements:**
 - **Business income** (revenues, losses, gains, etc.) arising from:
 - Transfer of goods;
 - Transfer of shares;
 - Provision of services;
 - Loans;
 - Licensing;
 - **Business restructuring;**
 - Etc.

Art. 9(3) TUIR

- **Definition of Normal value:**

- Average price or consideration paid for goods and services of the same or similar type, carried on at market conditions and at the same level of business, at the time and place in which the goods were purchased or the services were performed

- **Determination of Normal value:**

- Reference should be made to the extent possible to the price list of the provider of goods or services. In the absence of the provider's price list, reference should be made to the price lists issued by the Chamber of Commerce and to professional tariffs, taking into account usual discounts



Link between **Art. 9** and **OECD Transfer Pricing Guidelines (TPG)** → the Italian tax authorities confirmed that the **2010 OECD TPG are a primary source of interpretation**

The ALP according to the TPG

- **Arm's Length Principle (OECD Glossary):**
 - *"This valuation principle is commonly applied to commercial and financial transactions between related companies. It says that **transactions should be valued as if they had been carried out between unrelated parties, each acting in his own best interest.**"*
- The Arm's length principle is the international TP standard that OECD members have agreed should be used for tax purposes by MNE Group and Tax Administrations (TPG Para. 1.1);
- Arm's length principle follows the approach of treating the members of an MNE group as if they were independent entities (TPG Para. 1.6);
- The authoritative statement of the arm's length principle can be found at art. 9(1) of the OECD MC (TPG Para. 1.6).

International legal framework

- **International Legal framework:**
 - Article 9(1) and (2) of the OECD Model Convention;
 - Article 9 (1) and (2) of the OECD Model Convention Commentary;
 - 2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and tax Administrations (TPG);
 - 1979: “Transfer Pricing for Multinational Enterprises”;
 - 1984: “Transfer Pricing and Multinational Enterprises: Three Taxation Issues”;
 - 1995: “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations”;
 - 2016: approval of the amendments to the TPG set out in the 2015 BEPS Report on Actions 8-10 and 13 (final text of the TPG not yet published).

Art. 9(1) OECD MC

Article 9

Associated Enterprise

(1). Where:

- a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
- b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case **conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises**, then **any profits which would, but for those conditions, have accrued to one of the enterprises**, but, by reason of those conditions, **have not so accrued, may be included in the profits of that enterprise and taxed accordingly**.

Art. 9(2) OECD MC

Article 9

Associated Enterprise

- (2). *Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State **if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits.** In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.*

Interpretation of art. 9

Para. 1, OECD Commentary on Art. 9

1. *This Article deals with **adjustments** to profits that may be made for tax purposes where transactions have been entered into between **associated enterprises** (parent and subsidiary companies and companies under common control) **on other than arm's length terms**. [...] conclusions (of the Committee) are set out in the report entitled *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, which is periodically updated to reflect the progress of the work of the Committee in this area. **That report represents internationally agreed principles and provides guidelines for the application of the arm's length principle of which the Article is the authoritative statement.***



No adjustments can be made in the hands of the enterprise if the transactions have been concluded following the arm's length principle

Interpretation of Art. 9(2)

Para. 5 and 6, OECD Commentary to Art.9(2):

Price adjustment (Art. 9(1) MC)

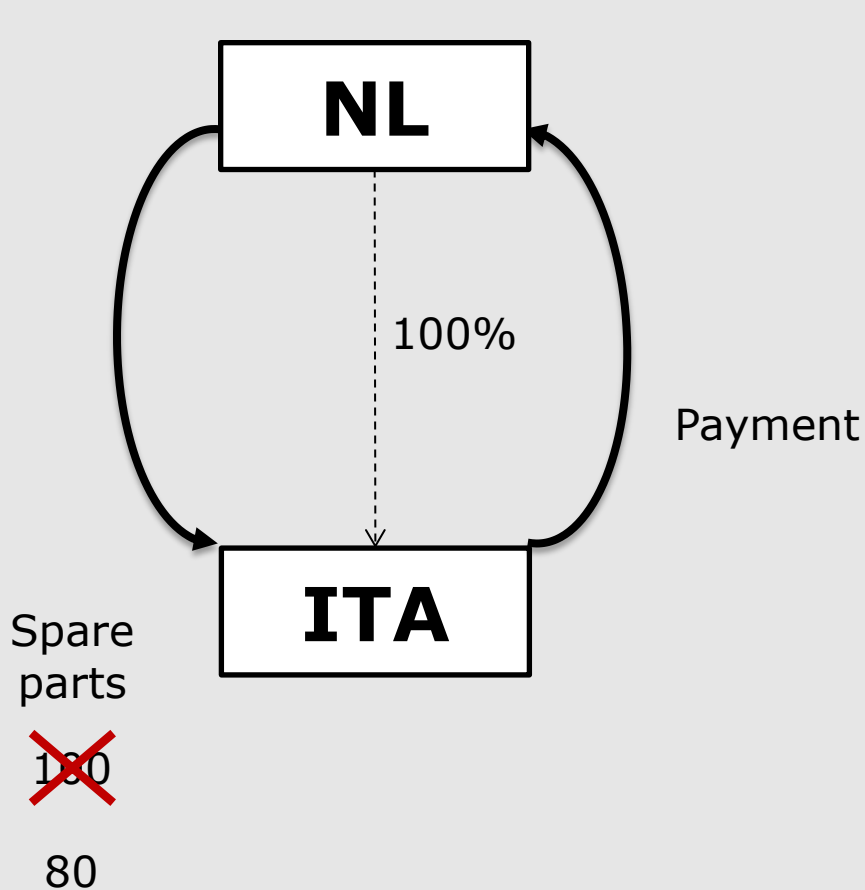


Economic Double Taxation



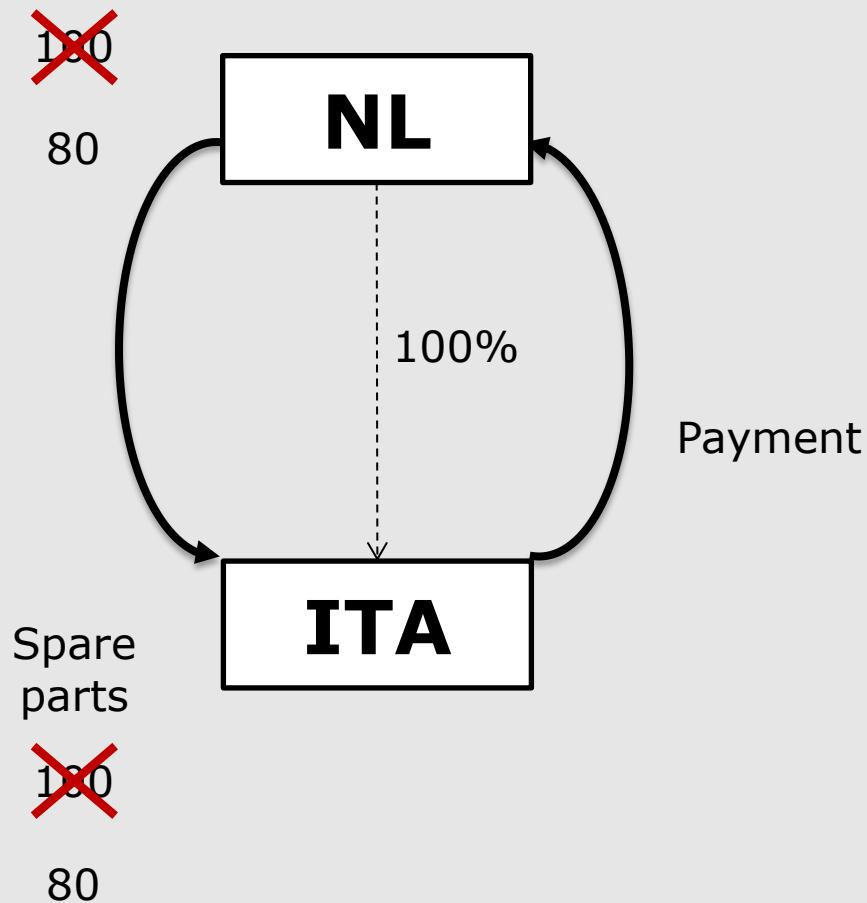
Possible solution: Corresponding Adjustment

Primary Adjustment



- NL sells spare parts to ITA
- Italian Revenue Agency claims that the transfer pricing adopted by ITA was too high

Corresponding Adjustment



- The taxpayer **claims for a corresponding adjustment in NL to avoid the double taxation**