



Italy refines transfer pricing methodology

A new decree replaces Italy's previously established hierarchy of transfer pricing methods, and aligns the country further with the OECD's guidelines. TP Week's correspondents in Italy, Antonella Della Rovere and Federico Vincenti of Crowe Valente/Valente Associati GEB Partners, explain the new provisions.

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On May 14 2018, the Italian Ministry of Economy and Finance issued a decree providing guidelines for the application of the Italian transfer pricing provisions, following relevant public consultation (the decree).

The Italian transfer pricing provisions, art. 110 para. 7 of the Italian Income Tax Code, had been amended in 2017 in line with the OECD Guidelines, as updated in July 2017 following the BEPS project.

The decree is composed of nine articles and in line with the OECD Guidelines on transfer pricing – these have been explicitly taken into account, according to the preamble. Further implementing provisions are expected to be issued by the Italian Revenue Agency, in particular with regards to updates of the OECD Guidelines.

In more detail, concerning the concept of control, the decree confirms the approach of the tax administration requiring verification of legal as well as economic control for the application of transfer pricing regulations.

The decree also adopts the notion of comparability as provided in the OECD Guidelines. For the assessment of comparability, it affirms the need to proceed with the analysis of the economically significant characteristics of the transactions (contractual terms, functional analysis, characteristics of goods and services, economic circumstances, company strategies).

As for the selection of the applicable transfer pricing method, the decree, in line with the OECD Guidelines, favours the most appropriate method on the basis of the specific circumstances of each case. Such method shall hence be determined ad hoc, taking into account the strengths and weaknesses of the various methods, the appropriateness of the method in consideration of the economically relevant characteristics and the availability of reliable information.

Thus, the aforementioned provision allows to disregard, in principle, the previously established hierarchy of transfer pricing methods. Such hierarchy implied that certain methods, so-called traditional methods, were to be prioritised over so-called transactional methods. The latter could be applied only in case of application of the former was not possible.

Nevertheless, this is not absolute. In particular, the decree, following the OECD, provides that if a traditional and a transactional method can be applied with the same degree of reliability, the application of the traditional method is preferable. To the same effect, if the comparable price method and any other transfer pricing method can be applied with the same degree of reliability, the application of the first is preferable.

The decree also provides that in case of audit, the tax administration must verify the correct application of the arm's-length principle by reference to the method applied by the taxpayer, provided that the decree has been complied with.

Moreover, the decree introduces so-called "low value-adding services" in Italian transfer pricing. For such services, a simplified approach can be adopted as follows: "Following preparation of specific documentation, the value of the service is determined by adding a profit margin of 5% on the sum of all the direct and indirect costs related to the supply of the service".

Low value-adding services are deemed to be services:

- of a supportive nature;
- that are not part of the core business of the multinational group;
- not requiring the use of unique and highly valuable intangible assets, and not contributing to creation of such assets;
- not involving the assumption or control of a significant risk by the service provider and not generating the occurrence of such risk to such person.

Finally, the decree authorises the Italian Revenue Agency to update the rules on transfer pricing documentation and more specifically the requirements for such documentation to be considered suitable (pre-requisite for exclusion of penalty or so-called penalty protection). In any case, as per the decree, transfer pricing documentation must be considered suitable where it provides the auditors with the data and information necessary to analyse the transfer prices applied, regardless of:

(i) whether or not the transfer pricing method or the selection of transactions or comparable subjects differ from those identified by the auditors; and

(ii) any omissions or partial inaccuracies that are not likely to compromise the auditors' analysis.



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