The impact of TP policies on managing a company in crisis

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Companies need to take extra care when choosing their transfer pricing methodology and determining how to apply it, warn tax advisors from Valente Associati GEB Partners/Crowe Valente.

The Italian government, with Legislative Decree No. 14 on January 12 2019, approved the new Code of Business Crisis and Insolvency (the Code).

The novelties of this Decree are the tools and mechanisms included for warning and preventing the crisis. In this way, the Legislator has tried to comply with the guidelines expressed by the European Commission on a new approach to manage business failures and insolvency (2014/135/EU).

According to Article 13 of the Code, any income, equity or financial imbalances, in relation to the specific characteristics of the company and the entrepreneurial activity carried out by the company, are identified as "crisis indicators", taking into account the date of incorporation and the start of the activity.

The connection with transfer pricing

The above mentioned imbalances, in companies belonging to multinational groups, could be caused by the application of incorrect transfer pricing policies, through which they could be generating significant reductions in the margins of companies operating in a specific sector.

Incorrect pricing applied to products or services provided between companies belonging to a multinational group may derive from either choosing the wrong transfer pricing methodology or incorrectly applying the chosen methodology.

In the first hypothesis, when the reduction of the margins of companies belonging to a multinational group can be traced back to choosing the wrong transfer pricing method, it is necessary to focus on two different lines of action:

- In the first instance, it is necessary to carry out a functional analysis of the target company, taking into account a reassessment of the risks and the functions performed in a constantly evolving economic context; and
- In the second instance, it is necessary to carry out a market analysis in relation to the main players in the sector, analysing their performance in a context of a preliminary market crisis, thus revealing the reduction or not of margins also for these companies.

In the second hypothesis, when the incorrect transfer pricing policies are due to the incorrect application of the chosen methodology, it is advisable to consider preparing a benchmark analysis, which should refer to the market considered to be in a state of crisis or which presents important warning signals.

This analysis should include an assessment of the companies identified as comparable to the tested party under consideration and ascertain whether, in the three years prior to the current year, they had already shown signs of crisis, through the use of the following ratios: income, equity and financial.

The preventive analysis of the state of crisis of a company belonging to a multinational group responds to a dual need:

- It allows a timely and effective restructuring of healthy companies facing financial difficulty, thus avoiding the repercussions of such difficulties on the entire group to which the company belongs; and
- Promotes an easier management of the internal market by reducing the barriers that characterise it and promoting greater investment in it.

In conclusion, it can be argued that, in light of recent regulatory changes, it is important that when analysing the transfer pricing policies adopted by multinational groups greater attention must be paid to any signs of crisis and, consequently, to take the necessary measures to prevent it.

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