

TRANSFER PRICING **DETERMINATION OF THE TRANSFER PRICES AND THEIR DOCUMENTATION**

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THE GENERAL FRAMEWORK

- ❑ When several companies belonging to a corporate group are **fiscally resident in different countries**, from a tax point of view it is required that the transfer prices, or the fees applied to the exchange of goods and services between subsidiaries, are defined in such a way as **not to excessively transfer profits to foreign countries** (especially if with reduced taxation).
- ❑ In fact, the determination of **cross-border** transfer prices can be oriented not only by economic evaluations, but also by elusive purposes: this is because the transfer pricing policies can have a more or less significant impact on the quantification of net income, taxable amount of the companies concerned.
- ❑ To combat such behavior, the international transfer pricing fees provide:
 - ❑ a **principle** underlying the definition of prices applied to intra-group exchanges: the **free competition price** (so-called "Arm's length principle");
 - ❑ **methods** for determining intra-group trading prices aimed at satisfying this principle;
 - ❑ **formal method** of documentation procedures aimed at making clear and explicit the process of choosing the methods by the taxpayer and the results (prices) deriving from their effective application.

MODULE 1

ITALIAN LAW ON

TRANSFER PRICES

THE REFERENCE STANDARD

- ❑ Article 110, paragraph 7 of the T.U.I.R. provides that exchanges with group companies resident abroad are valued, for tax purposes, at the so-called "**Fair value**", ie the *"average price or consideration charged for goods and services of the same or similar type, under conditions of free exchange and at the same stage of marketing, in the time and place in which the goods or services were acquired or lent and, failing that, in the closest time and place"* (art. 9 T.U.I.R.).
- ❑ *"The components of income deriving from transactions with companies not resident in the territory of the State, which directly or indirectly control the company, are controlled by it or are controlled by the same company that controls the company, are determined with reference to the conditions and prices that would have been agreed between independent parties operating under conditions of free exchange and in comparable circumstances, resulting in an increase in income. The same provision is also applied if there is a decrease in income, according to the methods and conditions set out in article 31-quater of the Presidential Decree of 29 September 1973, n. 600. By decree of the Minister of Economy and Finance, the guidelines for the application of this paragraph can be determined on the basis of international best practices"*

THE SUBJECTIVE CONDITION

☐ Italian subject: “**company**”

Extensive interpretation (Circ. Min. 32/1980).

The definition of "company" includes:

- corporation
- partnership
- sole proprietorships
- permanent organizations of foreign companies operating in Italy belonging to a "multinational" group.

☐ Foreign subject: "**company**"

Extensive interpretation (Circ. Min. 32/1980).

All sorts of corporate bodies legally recognized in the foreign State fall within the definition of "company". For example:

- Groupement d’Interet economique French
- Trusts of Anglo-Saxon derivation
- German Stiftung and Anstalten

THE SUBJECTIVE CONDITION

❑ The concept of "control" is not limited to the provisions of art. 2359 of the Civil Code. It is extended to any hypothesis of potential or current economic influence that can be inferred from individual circumstances (Ministerial Decree 32/1980).

For example:

- common members of the board of directors;
- family relations between the parties;
- right to appoint members of the board of directors or management bodies of the company;
- granting large loans or prevalent financial dependence;
- exclusive sale of products manufactured by the other company;
- impossibility of functioning of the enterprise without the capital, products and technical cooperation of the other company.

❑ The existence of **only one** of the aforementioned factual elements **does not always allow** to reach an affirmative conclusion on the existence of the control required by Article 110 paragraph 7 of the T.U.I.R.

❑ On the other hand, **several elements** combined together can constitute **sufficient proof** of the existence of the dependence link.

THE OBJECTIVE CONDITION

- ❑ Upon the occurrence of the subjective assumption, all cross-border transactions between counterparties are subject to evaluation at "**fair value**".
- ❑ Therefore, the following fall within the scope of the transfer pricing rules:
 - supplies of tangible assets
 - transfer of intangible assets: rights for the use of industrial (industrial patents, know-how, designs and projects, formulas and models necessary for the production of a good or the provision of a service) or commercial (trademarks);
 - provision of services
 - intra-group loans

MODULE 2

THE DETERMINATION OF

TRANSFER PRICES

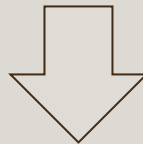
THE BASIC REFERENCES

- ❑ In the determination of intra-group transfer prices, the first interpretative and supplementary tool of current legislation is given by the **OCSE Guidelines** (*Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*), the latest revision of which was approved in July 2017, which incorporates the changes made in the framework of the BEPS (Base Erosion and profit shifting).
- ❑ In the OCSE model, the determination of transfer prices between parties belonging to a Group must replicate the pricing methodologies applied between independent counterparties.
- ❑ The determination of transfer prices cannot therefore ignore:
 - ❑ an analysis of the company characteristics in order to recognize similar counterparties operating on the free market;
 - ❑ an analysis of the economic magnitudes of the so-called "*Comparables*" for the purpose of determining (directly or indirectly) the "fair value" of the goods / services exchanged.

THE DEFINITION PROCESS OF THE TRANSFER PRICES

- ❑ The OCSE Guidelines recognize how the determination of transfer prices is the result of a logical deductive process.
- ❑ This process is typically composed of the following phases:

1. Analysis of the reference sector
2. Comparability analysis
3. Identification of internal comparables
4. Analysis of information sources
5. Selection of the method for determining the price and identification of the relevant economic data
6. Identification of external comparables
7. Determination of corrective measures



Determination of the transfer price

COMPARABILITY ANALYSIS

- ❑ The comparability analysis represents the "heart" of the transfer pricing process.
- ❑ It consists of **five sub-phases**, which aim to identify the five key factors for the qualification of the intragroup transaction:

1. Characteristics of the goods and services exchanged
2. Functional analysis of the corporate group
 - Functions performed
 - Risks assumed
 - Assets employed
3. Contractual conditions
4. Economic conditions
5. Commercial strategies

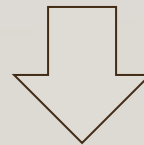


FUNCTIONAL ANALYSIS

Company	Activities performed	Risks assumed	Assets employed
Alfa	Design	Market research	Materials
	Purchase of materials	and development	
	Production	Warehouse	Intangible
	Warehouse	Exchange	
Beta	Commercial	Credit	
	Marketing	Transport	
	Distribution	Guarantee	
	...		

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Determination of the transfer price

THE SELECTION OF THE METHOD

❑ The OCSE defines 5 applicable methods

❑ **Traditional** transactional methods

- Comparable Uncontrolled Price method (CUP)
- Resale Price method
- Cost Plus method

❑ **Income** transactional methods

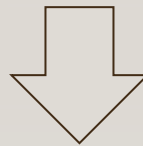
- Transactional Net Margin method
- Profit sharing method (Transactional Profit Split method)

❑ ***Best method rule:***

Choice of the method that ensures the greatest reliability of the result

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Determination of the transfer price

THE IDENTIFICATION OF EXTERNAL *COMPARABLES*

- ❑ For the research of comparable subjects from which to obtain the prices or the useful margins for the definition of intra-group transfer prices, the OCSE Guidelines provide as follows:
 - quantity should not be privileged over the quality of information;
 - a maximally exhaustive research is not necessary (costly in terms of time and resources).
- ❑ Basically, the taxpayer must adopt a "pragmatic" approach, based on which:
 - matches don't necessarily have to be perfect;
 - if necessary, it is possible to broaden the field of research: it is possible to identify third parties with strategies, business models or geographic markets that do not perfectly coincide.
- ❑ In the impossibility of identifying comparable subjects, the use of public **data bancs** and **sample surveys** represents the best solution for determining the "**arm's length range**", or rather the range of price values or margins relating to transactions between independent counterparties considered representative.

MODULE 3

THE DOCUMENTATION OF THE TRANSFER PRICES

THE REFERENCE STANDARD

- ❑ Article 26 of Legislative Decree 78/2010 added the new paragraph 2 to Article 1 of Legislative Decree 471/1997 concerning tax penalties in the field of direct taxes.
- ❑ Under the new rule, a reward system is envisaged in terms of penalties for taxpayers who demonstrate transparency and willingness to collaborate with the tax authorities in the context of the verification of transfer prices.
- ❑ The sanction referred to in paragraph 2 [**from one hundred to two hundred percent of the higher tax or of the credit difference**] does not apply if, during the access, inspection or verification or other preliminary activity, the taxpayer delivers to the tax authorities the **documentation** indicated in a specific provision of the Director of the Revenue Agency suitable to allow the verification of compliance with the normal value of the transfer prices applied. The taxpayer who holds the documentation required by the provision referred to in the previous period, must specifically notify the tax authorities according to the procedures and terms indicated therein. In the absence of such **communication**, paragraph 2 becomes applicable (Article 1 paragraph 2-ter of Legislative Decree 471/1997).

THE ESSENTIAL CONDITIONS

- ❑ Access to the bonus scheme is subject to the joint occurrence of **3 formal conditions**:
 1. Preparation of suitable documentation;
 2. Communication of the possession of the documentation to the Revenue Agency;
 3. Presentation of the documentation to the financial administration within certain delivery terms.

- ❑ There are also certain **substantial prerequisites**, aimed at qualifying the suitability of the documentation referred to in point 1:
 - a. The documentation must comply with the formal requirements established by the provision of the Director of the Revenue Agency;
 - b. The documentation must present complete information contents and comply with the provisions of the provision of the Director of the Revenue Agency;
 - c. The information contained in the documentation must be true.

THE SUITABLE DOCUMENTATION

- The suitable documentation required by the Provision of the Director of the Revenue Agency n. 2010/137654 complies with the documentation required by the Code of Conduct relating to the documentation of transfer pricing for associated companies in the European Union (EU DPT), approved with a Resolution of 27 June 2006.
- These are standardized documents provided as basic information on which to base the contradiction when ascertaining the transfer prices.
- The documentation is divided into:

Master File

Documentation containing common standardized information valid for all subjects belonging to the group.

National Documentation (Country File)

Documentation containing information relating to the individual group company.

THE MASTERFILE

- ❑ The Masterfile is a set of common information for all companies in the group.
- ❑ The Masterfile is divided into **9 points**:
 1. General description of the multinational group;
 2. Group structure;
 3. General strategies pursued by the group;
 4. Flows of operations;
 5. Intragroup transactions;
 6. Functions performed, capital goods used and risks assumed;
 7. Intangible assets;
 8. Transfer Pricing Policy;
 9. Relations with the tax administrations of the member countries of the European Union concerning "Advance Price Arrangements" (APA) and "rulings" on transfer pricing.

THE NATIONAL DOCUMENTATION (COUNTRY FILE)

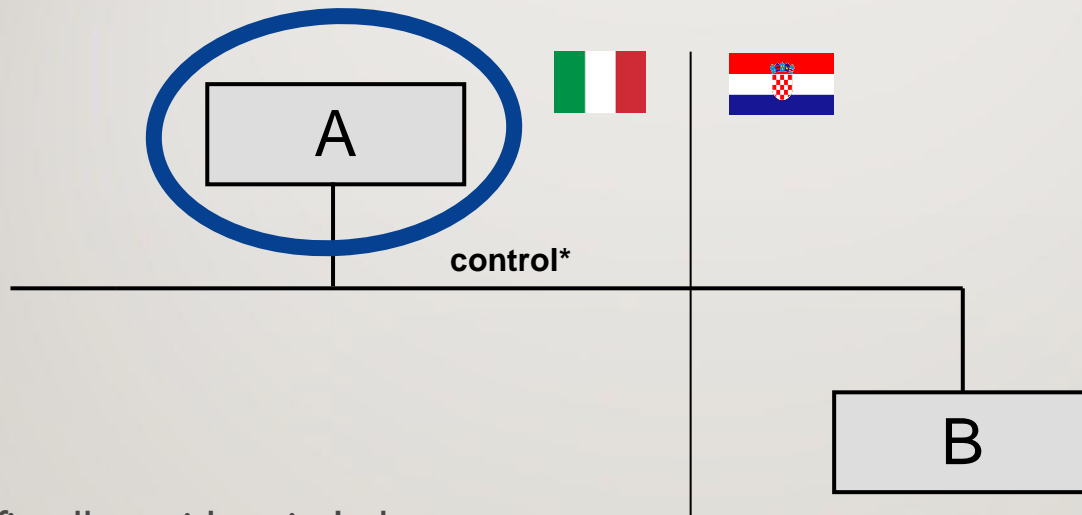
- ❑ The National Documentation ("Country File") is a specific documentation for each taxpayer, aimed at highlighting:
 - the methods for determining the transfer prices practiced in cross-border transactions conducted by the taxpayer;
 - the correspondence of these prices to the "fair value".

- ❑ The National Documentation is divided into **6 points**:
 1. General description of the company;
 2. Sectors in which the company operates;
 3. Operational structure of the company;
 4. General strategies pursued by the company;
 5. Intragroup transactions;
 6. Presence of Cost Contribution Agreement (CCA).

THE MODULATION OF THE DOCUMENTAL CHARGE

- ❑ The Provision no. 2010/137654 provides for different modulations of the documentary burden depending on the type of taxpayer who has intragroup transactions with foreign affiliates.
- ❑ For the purpose of diversifying the burden, **3 types** of subjects are recognized:
 - Holding company
 - Sub-Holding Company
 - Subsidiary company
- ❑ Even **permanent establishments** of non-resident companies in Italy can fulfill the documentary burden. For these categories of subjects, the requirements vary according to whether the non-resident subject of which the permanent establishment is a part qualifies, respectively, as a holding company, sub-holding or subsidiary company belonging to a multinational group.

HOLDING COMPANY



- Company fiscally resident in Italy;
- not controlled by another person with legal personality and carrying out commercial activity, wherever resident;
- which controls (also through sub-holding) at least one non-resident company.

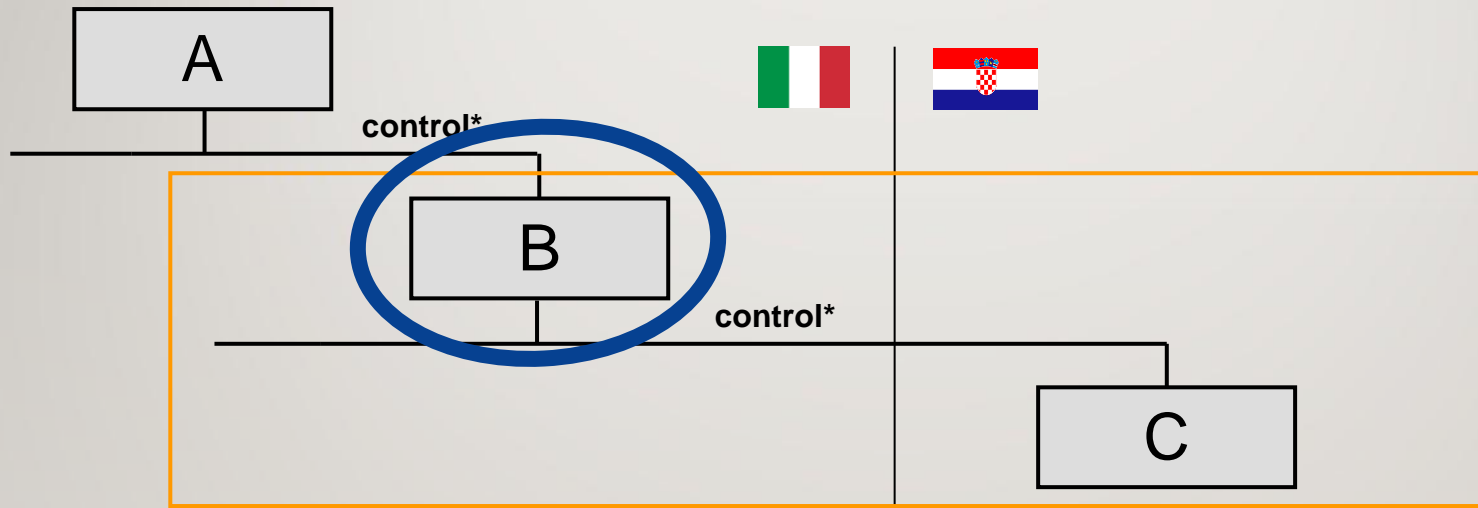
Suitable documentation:

- Masterfile
- National Documentation

Please note

* The control relationship must be defined based on the interpretations of the Min.Fin Circular n. 32 of 22/9/1980.

SUB-HOLDING COMPANY

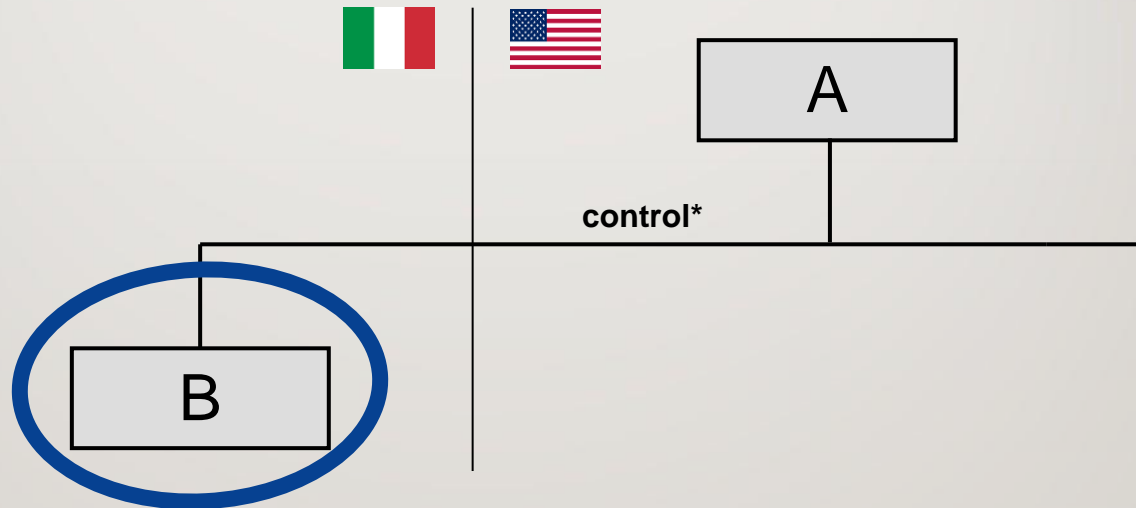


- Company fiscally resident in Italy;
- controlled by another person with legal personality and carrying out commercial activity wherever resident;
- which in turn controls at least one non-resident company.

Suitable documentation:

- Masterfile (sub-group information only)
- National Documentation

SUBSIDIARY COMPANY



- Company fiscally resident in Italy;
- controlled by another person with legal personality and carrying out commercial activity, wherever resident;
- it does not control other non-resident companies.

Suitable documentation:

- National Documentation

THE TIMING OF UPDATE

- ❑ The documentation must be drafted on an annual basis..

Specific rules for SMEs

- ❑ SMEs have the right not to update the selection procedures for comparable transactions referred to in point 5.1.3 ("Method adopted for determining the transfer prices of transactions) of the National Documentation **for two tax periods subsequent** to the one to which it refers the documentation provided that:
 - The comparability analysis is based on publicly available information (eg: financial statements filed or available through databases);
 - The factors determining the comparability analysis (referred to in point 5.1.2 of the National Documentation) do not undergo significant changes in these tax periods.

Specific definition of SMEs

- ❑ Subjects who achieve a turnover or revenues not exceeding **50 million euros**. Subjects that directly or indirectly control subjects that cannot be classified as "small and medium-sized enterprises" are not included

THE MODULATION OF THE CHARGE DOCUMENTAL

- The preparation of the documentation is an indispensable but not sufficient requirement.
- In order to access the facility for a specific tax period, companies in possession of the necessary documentation are required to notify the Revenue Agency.
- Different methods depending on the annuities involved

Tax period 2010 and subsequent

Communication when submitting the annual tax return. The deadline is therefore set at **30 September of the following year.**

Prezzi di trasferimento	RS106	Tipo controllo			Possesso documentazione	Componenti positivi	Componenti negativi
		A	B	C	4	5	6
		✗			✗	,00	,00
						1.000.000	500.000

Tax periods prior to 2010

Communication transmitted electronically by the deadline of 28.12.2010. In any case, any communications subsequent to this deadline are considered valid, provided that they are sent prior to the beginning of access, inspections, verifications or other verification activities of which the taxpayer has had formal knowledge.

TERMS OF DELIVERY

- ❑ The non-application of the sanction regime is subject to compliance with certain delivery times to the tax authorities.
- ❑ The taxpayer is required to deliver the documentation **within 10 days** of the request by the tax authorities.
- ❑ Failure to deliver within this deadline may integrate **cause for forfeiture** of the benefit.

- ❑ The financial administration has the right to request any additional information other than that contained in the documentation.
- ❑ The taxpayer is required to provide such supplements **within 7 days**.
- ❑ A longer term may be provided depending on the request.
- ❑ Failure to deliver within the deadline may integrate **cause for forfeiture** of the benefit.
- ❑ *Once the aforementioned terms have elapsed, the financial administration is not bound by the application of art. 1, paragraph 2-ter, legislative decree 18 December 1997, n. 471. (Provision 20/0/137654, § 8.2)*

SUMMARY SCHEME

The reward scheme is granted upon the joint occurrence of the 3 conditions.

- Documentazione idonea
- Comunicazione in UNICO
- Consegna entro 10 giorni
- Integrazioni entro 7 giorni



PREMIUM SYSTEM

- Documentazione idonea
- Comunicazione in UNICO
- Consegna entro 10 giorni
- Integrazioni entro 7 giorni



ORDINARY PENALTY REGIME

- Documentazione idonea
- Comunicazione in UNICO
- Consegna entro 10 giorni
- Integrazioni entro 7 giorni



**PREMIUM SYSTEM or
ORDINARY PENALTY REGIME**

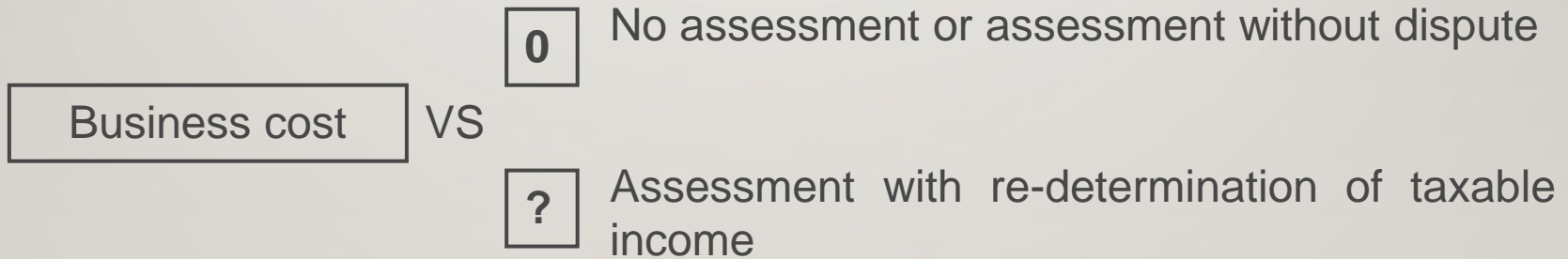
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* At the discretion of the tax administration

VALUATIONS OF CONVENIENCE

- ❑ The choice of whether or not to fulfill this documentary burden is subject to entrepreneurial assessments linked, essentially, to the risk profile that the taxpayer independently attributes and to the estimate of any tax recovery (and related penalties).



- ❑ However, the valuation cannot be limited only to group companies resident in Italy.



In the case of an Italian parent company, it is crucial to assess compliance at the level of group compliance.

MODULE 4

TRIBUTARY OFFENSES

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FORM OF "SUITABLE DOCUMENTATION"

Documentation in electronic format authenticated by electronic signature;

➤ Documentation in paper format is also accepted, signed by the legal representative (or his / her delegate) and initialed on each page, provided that a copy of the documentation in electronic format is also provided within a reasonable time limit assigned by the inspectors (article 8.1 of the provision);

➤ Documentation written in Italian;

UPDATING THE "SUITABLE DOCUMENTATION"

Annual update.

➤ SME exception: right NOT to update paragraph 5.1.3 of the National Documentation (Method adopted for the determination of transfer prices) with reference to two tax periods if the comparability analysis (referred to in paragraph 5.1.2) is based on information available to the public and provided that the information contained therein is not significant

modification during these tax periods.

Note: companies with a turnover or revenues not exceeding € 50,000,000 are qualified as SMEs, provided that they do not control (directly or indirectly) other companies that exceed the aforementioned limit (article I, letter d), of the provision).

PRESERVATION OF "SUITABLE DOCUMENTATION"

- Preservation of documentation relating to previous years for the assessment period.
- The place where the taxpayer keeps the documentation in question should be irrelevant, provided that, upon request, it can be promptly made available to the tax authorities. Taxpayers should therefore be free to keep Masterfile and National Documentation also in a "centralized" way, as long as they are promptly produced to the verifying bodies.

TIMELY DELIVERY OF "SUITABLE DOCUMENTATION"

- Condition for access to the facilitated sanction regime ex-

- Article 1, paragraph 2, Legislative Decree 471/1997:
 1. Delivery of the documentation within 10 days of the request from the financial administration;
 2. During accesses, audits, inspections or other preliminary activities, the Financial Administration may need additional information:
 - Delivery of the same within 7 days of the request (further);
 - That is, within a longer period granted by the verifiers depending on the complexity of the information itself.

PREVENTIVE COMMUNICATION

➤ Condition to access the facilitated sanction regime pursuant to Article 1 paragraph 2-ter, Legislative Decree 471/1997:

1. Tax periods prior to the one in progress on May 31, 2010 (first application)
 - Within 90 days of the publication of the provision;
 - Late communications are also valid as long as they are prior to accesses, inspections, controls or other preliminary activities;
 - Use of the Entratel electronic channel.
2. Current period as of May 31, 2010 and subsequent:
 - Included in the annual tax return.

CONSTRAINTS OF THE FINANCIAL ADMINISTRATION

- There are restrictions on the non-application of sanctions if:
 - Incomplete documentation;
 - Documentation not compliant with the content of the provision;
 - Documentation containing (totally or partially) untruthful information.
- Prohibition for the financial administration to use the information for purposes other than those related to the control activity during which the documentation is exhibited (Article 8.3 of the provision).

NON-OBSTATIVE CAUSES TO THE DISAPPLICATION OF SANCTIONS

Pursuant to Article 8.3 of the provision, the following DO NOT constitute an impediment to the non-application of sanctions for unfaithful declaration:

1. "Omissions or partial inaccuracies and such as not to prejudice the analysis of the verifiers and the correctness of the results of said analysis";
2. Omission of attachments

TP DOCUMENTATION AND TAX OFFENSES

The new paragraph 2 of Article 1 of Legislative Decree 471/1997 allows the administrative sanction provided for unfaithful declaration to be set aside; however, it should offer companies an important opportunity also in order to significantly reduce the area of possible disputes in criminal-tax matters, given the "transparency" of the procedures adopted when setting intra-group transfer prices, with the important consequence of allowing easier access to what is also known as "Friendly procedures" between states (in the matter of removing double taxation phenomena), explicitly precluded by the multilateral convention of the European Union in the case of "severe sanctions" (understood, in Italy, as tax offenses).

**THANK YOU FOR YOUR
ATTENTION**

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