

Italian Revenue Agency issues clarifications on arm’s-length range

By **Federico Vincenti, Alessandro Valente** July 19, 2022



Federico Vincenti and Alessandro Valente of Valente Associati GEB Partners/Crowe Valente explain how Circular Letter No. 16/E will affect transfer pricing (TP) calculation in Italy.

On May 24 2022, the Italian Revenue Agency published Circular Letter No. 16/E (referred to hereafter as the Circular), clarifying the correct definition of the arm’s-length range for TP purposes.

The arm’s-length range concept was covered in Article 6 of the Decree of the Italian Ministry of Economy and Finance, dated May 14 2018 (hereafter referred to as the Decree). The Decree sets out the general guidance for the correct application of TP rules. According to Article 6:

- The range of values resulting from the financial indicator selected in applying the most appropriate method is deemed to be in conformity with the arm's-length principle if those values can be referred to a number of transactions carried out between two independent parties (non-controlled transactions), each of which is equally comparable to the controlled transaction; and
- A controlled transaction, or a set of controlled transactions, is deemed to be carried out in accordance with the arm's-length principle if the financial indicator applied is within the arm’s-length range.

Determining the arm’s-length range

The Circular confirms that the arm’s-length range must be identified on the basis of OECD guidelines. In particular, it states that:

- If the analysis carried out proves to be reliable, and all the transactions identified have the same level or degree of comparability, the entire range of values resulting from the application of the financial indicator selected in the application of the most appropriate method (the so-called "full range") must be taken into consideration.
- Otherwise, the range should be narrowed using “statistical tools”, provided that a sizeable number of transactions is available.

In both cases – whether the “full range” or the narrowed range is used – all the points included within the range must be deemed compliant with the arm’s-length principle.

Should the financial indicator fall outside the arm’s-length range, the company must provide appropriate documentation to prove that the indicator used complies with the arm’s-length principle. If the company does not provide any evidence, or if the evidence provided is not satisfactory, the tax administration will make an adjustment by identifying the point that best satisfies the arm’s-length principle within the range.

In cases where the range includes highly comparable values

If the arm’s-length range determined by the tax administration includes values characterised by a high and homogenous degree of comparability, each of them must be considered in conformity with the arm’s-length principle.

Consequently, it would be the tax administration’s responsibility to place the financial indicator identified by the company on the 'minimum' or 'maximum' value of the arm’s-length range that first intersects the one identified.

In this respect the Circular provides the following examples:

- With reference to sales of goods, in cases where the enterprise determines a range between 80 and 120 and places the financial indicator at 80, while the tax administration puts the valid arm’s-length range at between 100 and 120, the adjustment would be made by repositioning the transaction price to 100 (the minimum value). Consequently, the tax recovery that the administration could ascertain would only be equal to 20.
- With reference to purchases of goods, in cases where the enterprise determines the same range as above (between 80 and 120) and places the financial indicator at 120, while the tax administration puts the valid arm’s-length range as between 80 and 100, the adjustment would be made by repositioning the transaction price to 100 (the maximum value). Consequently, the tax recovery that the administration could ascertain would only be equal to 20.

Other potential cases

Likewise, in cases where the arm’s-length range determined by the tax administration comprises entities that do not have a high and equal degree of comparability, the interquartile range can be used to narrow it. In this case, the adjustment must be limited to the 25th or 75th percentile of the arm’s-length range that first intersects the identified range.

It may also be the case that an enterprise adopts the "full range", considering all identified transactions to be equally comparable with the controlled transaction, while the tax administration finds flaws of comparability within the range by excluding certain transactions considered comparable by the enterprise.


In such cases, the tax administration may disregard the application of the "full range" by making proper arguments. It can thereafter consider the range based on the "statistical instruments" to be the arm’s-length range.

Finally, the Circular points out that:

- The use of a central value within the range (e.g. the median) must be limited to cases in which the range does not show a sufficient degree of comparability with the identified transactions, and must be specifically justified;
- It is the responsibility of the tax administration to use the "full range" method only in those cases in which a perfect comparability of all parties in the set with the "tested party" can be discerned;
- It is recommended that the adjustments that result in the identification of the point that best satisfies the arm’s-length principle within the range be argued in detail.



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CROWE VALENTE/VALENTE ASSOCIATI GEB PARTNERS



Federico Vincenti
SENIOR TAX MANAGER Crowe Valente/Valente Associati GEB Partners

Contact





Alessandro Valente
ASSOCIATE Crowe Valente/Valente Associati GEB Partners

Contact

