Transfer pricing and related parties disclosures

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To ensure the respect of the arm's length principle, Italian Law mandates that companies' financial statements include proper disclosures regarding transactions with related parties. Piergiorgio Valente, managing partner of Valente Associati GEB Partners explains the logistics of the Italian rules.

As of November 21 2008, Legislative Decree No. 173/2008 modified Art. 2427 of the Italian Civil Code by adding paragraph 22-*bis* on related party disclosures.

For every relevant transaction with related parties, the amounts involved, the relationship between the parties and any other information necessary to understand such transactions, must be disclosed.

The definition of "related party" is provided by the international accounting standards adopted by the EU (accounting principle "IAS 24").

With reference to the arm's-length conditions, the government report on Legislative Decree No. 173/2008 explains that the circumstances leading to transactions with related parties rather than with third parties need to be evaluated and all criteria supporting such a decision must be provided.

Regarding the relevance of related parties' transactions, the 2010 "Regulation on Disclosures Regarding Related Parties Transactions" by the Italian Companies and Stock Exchange Commission (*Consob*) defines a transaction as "relevant" if its value exceeds 5% of the net assets or the total assets/liabilities, depending on the type of transaction.

Relations with related entities must also be described in the companies' management report attached to the financial statements, as per Art. 2428 of the Italian Civil Code.

Additionally, Arts. 3 and 4 of Legislative Decree No. 74/2000 establish criminal consequences for the incorrect application of transaction evaluation criteria.

Nevertheless, Art. 7 of the above-mentioned Decree excludes a wilful tax-evasion attempt if the financial statements describe the criteria applied in transfer pricing evaluations, since their explicit disclosure does not have a misleading connotation and seems incompatible with the intent to evade taxes.

Pursuant to Art. 2427, par. 1 of the Italian Civil Code, those criteria must be included in the explicatory note to the financial statements.

The law, however, does not clarify whether it is sufficient to state the transfer pricing methods or if more information (comparability analysis, prices and margins data, etcetera) is needed.

If interpreted too strictly, the law could entail revealing industrial and commercial secrets. Further, the explanatory note's role and function are those of an accounting document that does not lend itself to bear the weight of complex tax considerations.

Yet, a generic reference to the criteria followed is not sufficient to rule out a tax-evasion attempt.

It is preferable to choose an intermediate solution, namely a detailed description of the steps leading to the determination of transfer prices. The Criminal Court will then verify the degree of specificity of each explanation; the greater the degree of specificity, the lower the risk of the Criminal Court challenging the adopted criteria for being vague.

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