Italian Supreme Court ruling maintains arm's-length principle must apply to related companies within Italy

June 4, 2014

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The Italian Supreme Court ruled, on April 16, that all transactions carried out between companies belonging to the same group, and all of which have offices in Italy, are subject to the arm's-length principle.

Ruling No. 8869 confirmed once more the Supreme Court's position already expressed through Ruling No. 17955/13, on the arm's-length principle, applying to companies of the same group within Italy.

The stance is deemed "an anti-avoidance clause, representing the exercise of the general prohibition of law abuse in tax matters, in view of the fact that the taxpayer is precluded from achieving any tax advantages – such as the shifting of taxable matter to associated enterprises which, in the territory, enjoy exemptions or lower taxation – through the distorted use, even if not in conflict with any given law provision, of instruments designed to secure advantages, given the absence of any reasons other than the attainment of the said benefits".

Background

Italian transfer pricing rules, pursuant to paragraph 7 of Article 110 of the *Testo Unico delle Imposte sui Redditi* (Italian Income Tax Code, hereinafter (TUIR)), state that transactions carried out between an entity residing in Italy and another entity belonging to the same multinational group, but not residing in the state's territory, be assessed on an arm's-length basis.

Circular No. 32/1980 on transfer pricing explicitly establishes that it is necessary to "(…) ascertain, *a priori*, whether or not, in a transaction, a foreign entity, an Italian entity, the control of a foreign entity over an Italian entity may be identified: in the absence of any of the said assumptions the application of the rule is to be excluded".

In standard practice, the tax authorities frequently impugn the inaccuracy of prices applied, focusing rather on the non-profitability of entrepreneurial choices made within a group.

The theory maintained by the Tax Authorities was further – albeit only partially – upheld by the Supreme Court, which, in a number of rulings, declared its being in favour of the opportunity, during audit, to apply the arm's-length principle, also for assessing the accuracy of prices applied between/among resident companies.

The ruling

In the case at issue, an Italian cooperative company applied a 1.2% mark-up to its sales,in to an Italian limited liability company (which it wholly owns) compared to the prices that it generally applies to its own shareholders.

In accordance with the tax authorities, the above mark-up could not possibly have any other purpose except the intent to secure – by channeling profits through an intercompany transfer – a tax advantage for the group itself, deemed the most favourable special tax legislation on cooperative companies.

A further, and particularly significant, statement was made by the Supreme Court in which it asserted that there is no doubt that the burden of proof, pursuant to ordinary rules, rests with taxpayer, as the latter must provide evidence that the said transactions were carried out on the basis of market values deemed to be at arm's-length, along the same lines provided by Article 9 of the previously mentioned TUIR.

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