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**Public consultation concerning Transfer Pricing, concerning the implementation of the regulation included in the article 110, para 7 of the TUIR[1] and in the article 31-quater of the D.P.R.[2] no. 600/1973.**

Copenhagen Economics welcomes this public consultation organised by the Ministry of Economy and Finance concerning Transfer Pricing.

Copenhagen Economics considers such initiative a relevant and positive evolution in the relationships between the Tax Administration and the Taxpayers, and a further improvement of the general trust in the international economic environment.

The following comments focus on the guidelines concerning the application of the rules included in the article 110, para 7 of the TUIR approved with the D.P.R. 22 December 1986, no. 917, concerning Transfer Pricing ("**Guidelines**").

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1 TUIR: *Testo Unico delle Imposte sui Redditi* (Consolidated Tax Act).
2 D.P.R.: *Decreto del Presidente della Repubblica* (Presidential Decree).

## 1 Topic: Control and dominant influence

Art. 2 of the Guidelines, para 1, letter a), sub 2), defines "*associated enterprises*": *the enterprise resident in the territory of the State and the non-resident enterprise when: the same person or more persons partake directly or indirectly, in the management, in the control or in the capital of both the enterprises*.

The following letter b) of the same article, defines "*participation in the management, control or capital*":

a) *The participation which a person or an enterprise holds, directly or indirectly, beyond 50 percent in the capital of another enterprise; or*
b) *The dominant influence which a person or an enterprise has over the commercial or financial decisions of another enterprise.*

### Observations

In this respect, it is worth noting that of the three areas of influence of an enterprise on the other (i.e. management, control and capital), details are only provided with regard to the participation of the capital, when higher than 50 percent, directly or indirectly. On the contrary, the other areas of influence (i.e. management and control) are not clarified in the Guidelines.

### Request

In this respect, **we are of the opinion that it is necessary to provide further clarifications on the concepts of "management" and "control" to understand the level of association between enterprises residing in the territory of the State and non-resident enterprises.**

With regard to the same topic, it is worth underlining that **a definition of "dominant influence" is missing**.

## 2 Topic: Conditions of a transaction

Letter f) of the Art. 2, para 1 defines "*conditions of a transaction*": *those conditions which include, but are not limited to, any element economically relevant, included the related financial indicators used in the application of one of the methods described in the following article 4.*

### Observations

In this respect, we are of the opinion that the inclusion of the financial indicators within the conditions of a transaction may be misleading in the accurate delineation of the transaction. The financial indicators represent, indeed, the result of the application of one of the transfer pricing methods, which is in turn influenced and determined by the economically significant elements of the transaction (or comparability factors), as defined in the following Art. 3, para 2.

The causal nexus between the conditions of the transactions and the financial indicators is indeed referred to in Art. 3, para 1, letter a): "*An uncontrolled transaction is deemed comparable to a controlled transaction [...] when: there are no relevant differences in the related conditions such to significantly affect the financial indicator to be used in the most appropriate method*".

**Request**

In the light of the considerations above, **we are of the opinion that the reference to the financial indicators should be removed from the conditions of the transactions**.

## 3 Topic: Wording used for the financial indicators

Art. 4, para 2, letters from a) to e) defines the methods to be used to determine the transfer prices in compliance with the arm's length principle.

**Observations**

In the article we have found an inconsistent wording used as to the financial indicators.

In particular, in spite of what is described in letters b) and c), where the gross margin[3] is implicitly referred to as a ratio (i.e. gross profit to revenue or costs, respectively), in letter d) the net margin, which *per se* should be referred to as a ratio, is defined as numerator and divided by "*an appropriate base*".

With regard to the same topic, in letter e) there is a reference to the "*share of profit*", without any indication of the type of profit to be taken into account, i.e. gross profit vs. net profit.

**Request**

In this respect, **we are of the opinion that a revision and consistent standardisation of the wording used for, or definition of, the financial indicators related to each of the listed methods is necessary, together with a clarification on the calculations**.

In addition, **we are of the opinion that it is necessary to make an explicit reference to both the gross and the net profit in the application of the transactional profit spit method**.

3 "*Margine lordo*" in the Italian wording.

The figure below provides a suggestion of the wording to be used.

## Figure 1 – Summary of methods and financial indicators

| Method | Reference | Indicator | Notes |
|---|---|---|---|
| Comparable uncontrolled price method | Price | Price | • Royalties and commissions are included in this category |
| Resale price method | Gross margin | • Gross profit / Revenue | • Gross Profit = Revenue – Direct and indirect costs |
| Cost plus method | Gross margin | • Gross profit / Direct and indirect costs | • Gross Profit = Revenue – Direct and indirect costs |
| Transactional net margin method | Net margin | • ROS = Net profit / Revenue<br>• MOTC = Net profit / Total operating costs<br>• ROA = Net profit / Assets<br>• Berry ratio = Gross profit / Opex | • Net profit = Revenue – Total operating costs<br>• Opex = Operating expenses (excl. The cost of the product = COGS) |
| Transactional profit split method | % Gross margin<br>% Net margin | | |

Note: ROS = Return on sales
MOTC = Mark-up on total cost
ROA = Return on assets

## 4 Topic: Aggregation of transactions

Art. 5 of the Guidelines, para 1, regulates the aggregation of transactions. In particular: "*If an associated enterprise puts in place two or more controlled transactions which are economically linked or which constitute an unitary set, such that they could not be separately evaluated in a reliable way, such transactions are to be aggregated in the comparability analysis described in the article 3 and in the method application described in the article 4*".

### Observations

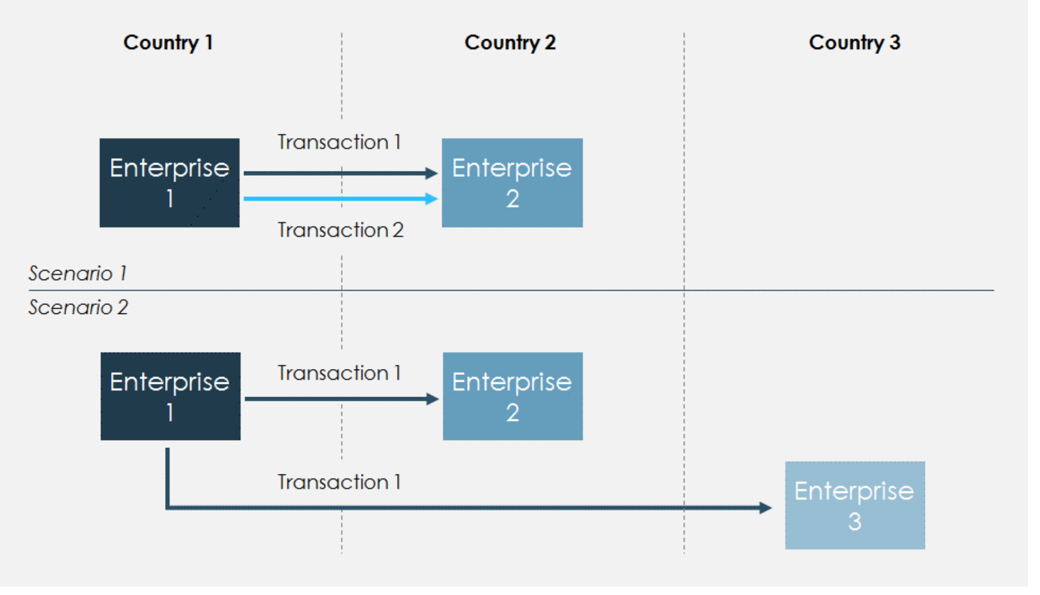
In this respect, it is not clear whether "*two or more controlled transactions"* are those with the same counterparty or with more counterparties with the same functional profile.

### Request

In this respect, we are of the opinion that **further clarifications are necessary to correctly apply the meaning of "aggregation of transactions" in the comparability and economic analysis.**

For clarity, we report below an exemplary figure.

## Figure 2 – Aggregation of transactions




## 5 Topic: Arm's length range

Art. 6 of the Guidelines, para 2, states: "*A controlled transaction, or a pool of controlled transactions aggregated based on the article 5, are considered to be realized at arm's length, where the related financial indicator falls in the range described at para 1 of this article*".

In addition, para 3 of the same Art. 6 states: "*If the financial indicator of a controlled transaction, or a pool of controlled transactions aggregated based on the article 5, falls outside of the arm's length range, the Tax Administration makes an adjustment in order to bring back the aforementioned indicator in the range described at para 1*".

### Observations

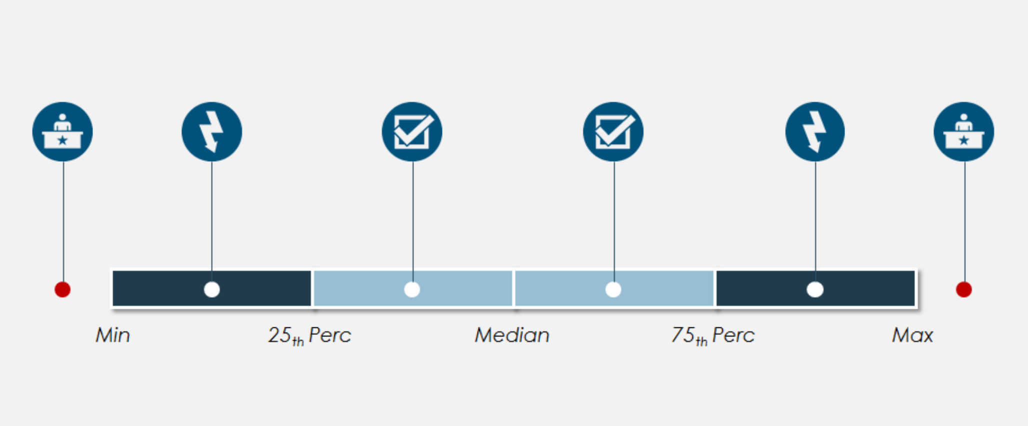
In light of the considerations above, we should also deem the transactions presenting a financial indicator in the upper or lower end of the range (i.e. higher than the $75^{th}$ percentile or lower than the $25^{th}$ percentile, respectively) as realised at arm's length.

On the contrary, if the financial indicator is outside the arm's length range, it is not clear which value within the range ought to be selected by the Tax Administration as the new position.

In addition, the possibility that, in specific circumstances (e.g. economic crisis, exceptional events, imperfect comparability of the sample of comparable companies selected in the economic analysis), the financial indicator of the controlled transaction may fall outside the range, without compromising the arm's length principle, is excluded *a priori*.

For clarity, we report below an exemplary figure.

## Figure 3 – Arm's length range




**Request**

In this respect, considering also the prevalent practice, **we are of the opinion that it is necessary to provide further clarifications on the circumstances which could lead the Tax Administration to challenge the positioning within the arm's length range**.

In addition, **we are of the opinion that it is necessary to provide further clarification on the point in the range where the Tax Administration should reposition the financial indicator** (i.e. mean/median, closest quartile, closes extreme point), **as well as to describe the circumstances which could determine a fair positioning of the financial indicator outside the range.**

For any clarification to the comments above please contact: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