Francesca Manuela Comis, Alessia Giglio, Gianluca Di Maria

THE DISCIPLINE OF TRANSFER PRICING IN THE ITALIAN AND ROMANIAN LEGAL ORDERS

1. INTRODUCTION

The theme of Transfer Pricing is gaining more and more importance in the current economic and legislative context.

Increasingly, in fact, in the various intercompany transactions affiliated companies carry out between them operations that result in a transfer of income to those companies located in countries with low taxation.

In doing so, in the research for maximum operating and structural efficiency, under certain circumstances, companies of a group can put into practice abusive and sometimes elusive behaviors, that the national and international legal orders attempts to eliminate.

The term "*transfer pricing*" describes the process through which companies associated together determine the prices of transactions within the group so as to minimize the "cost" for tax purposes.

There's a transfer pricing, therefore, when in a transaction between parties linked by a relationship of legal and/or economic dependency, the price of a good or a service is set at a different level from that which had been formed in a transaction between independent parties, under conditions of free competition.

The tax legislator of each country intervened by caring to identify the principles to which intra-group transactions must be subjected in order to avoid that the overall tax burden is minimized or redistributed.

In particular, the matter is to determine whether the intercompany trading transactions are carried out respecting the principle of free competition, so that there is a correspondence between the price set in commercial transactions between associated enterprises and the one which would be agreed between independent enterprises, under similar conditions, on the open market.

The issue of transfer pricing, apart from calling the attention of the tax laws of each country, has also been examined by supranational organizations , which in recent years have devoted energy to find instruments for cooperation and exchange of information.

In order to preserve their taxing authority, the individual states adopted special legislation on transfer pricing, which reflects the principle of valuation at fair value of the intercompany transactions contained in the OECD Model Convention.

On end it is analyzed the discipline of Transfer Pricing in the context of Italian and Romanian legal orders.

2. TRANSFER PRICING BY ITALIAN LAW

2.1. The Italian regulation

The national regulation of transfer pricing is contained in the co. 7 of Art. 110 and Art. 9 of Presidential Decree December 22, 1986 , n° 917 (Tax Code) .

Following the changes caused to the Tax Code by DL 12 December 2003, n° 344 , the former article. Art. 76 Tax Code was transfused in Art. 110, paragraph 7 of the Tax Code, which provides that "*the components of the income arising from transactions with companies not residing in the territory of the State which, directly or indirectly, controls the enterprise, are controlled by the enterprise or by the same company that controls the enterprise are valued on the basis of the normal value of goods sold, services rendered and goods and services received, are determined in accordance with paragraph 2, if it results in an increase in income; the same shall apply even if it results in a decrease in income, but only in execution of agreements concluded with the competent authorities of foreign states as a result of special mutual agreement procedures provided for by the international conventions against double taxation on income. This provision shall also apply to goods supplied and services rendered by companies not residing in the State on behalf of which the company carries out activities of selling and placement of raw materials or goods or activities of manufacturing or processing of products.*"

In summary, the Italian legislature, with the above regulation , has sought to establish that, for the purpose of determining the business income of a company resident in Italy, the income components of the transactions entered into with companies of the same group, residing abroad for tax, must be evaluated according to the normal value of the goods and services covered by the same transaction, as defined by Art. 9, paragraph 3 of the Tax Code .

Therefore, the transfer price charged in a transaction between affiliated companies, one of which is tax resident in Italy, the other tax resident abroad, will be determined according to the normal or market value of goods or services which are the subject of the transaction.

Moreover, re of extreme importance, in the area of transfer pricing, the following interpretative sources. the Circular September 22, 1980, n° 32 (protocol n° 9/2267) and the Circular December 12, 1981, n° 42 (protocol n° 12/1587), which provide an interpretation of the concept of control and give the basic criteria for the determination of normal value.

In order to give a correct assessment of the discipline in the field of Transfer Pricing, the following identifies the legal conditions required for the application of the Framework .

2.2. Subjective requirements

Pursuant to Art. 110, paragraph 7 of the Income Tax Code, transfer pricing rules apply to commercial transactions between a resident enterprise and a non-resident company which directly or indirectly:

- control the Italian enterprise;
- are controlled by the Italian enterprise;
- are controlled by the same parent company of the Italian enterprise.

Circular n° 32/1980 stepped in on this point, by excluding that the notion of control referred to Art. 110 of the Tax Code is attributable solely to the limits of Art. 2359 of the Italian Civil Code, ascertained as it covers any possibility of potential or current economic influence, derived from individual circumstances .

Indeed, according to the provisions of Art. 2359 of the Italian Civil Code, a relationship of control is identified in cases of:

- a company in which another company holds the majority of voting rights in the ordinary shareholders (sec. 1 , 1);
- a company in which another company has sufficient votes in order to exercise a dominant influence on ordinary shareholders (sec. 1, point 2);
- a company on which another company exercises significant influence (sec. 1, point 3).

However, according to the approach adopted by Circular n° 32/1980, for the purposes of the definition of control, are relevant not only the legal and formal requirements just mentioned, but also mere factual situations ; we are talking about those situations of connection formed by the economic influence of an enterprise on the business decisions of the other enterprise , which allow to reach an alteration of transfer pricing .

The above-mentioned Circular made manifest the anti-avoidance character of art. 76 (now art. 110 Income Tax Code), clarifying that: "*for the purposes intended by the tax legislator (...) the control in question must be marked by flexibility needs and must find a place in a dynamic environment , bearing in mind , namely , that price changes in commercial transactions often find their fundamental assumption in the power of one part to affect the other one's will (come ti pare?) not basing on the market mechanism but depending on the interests of one of the Contracting Parties or of a group* ."

In particular, the Financial Administration notes that the findings emerging from practice show that the connecting factor which determines the alteration of transfer pricing is often composed by a firm influence on business decisions of the other firm, which goes far beyond contractual or equity obligations, encroaching on factual statement of purely economic nature. In this sense, the Circular n° 2/1980 lists a number of circumstances in which potential or current

economic influence is likely to lead to supervisory positions:

1. The exclusive sale of products manufactured from the other firm;

2. Impossibility of operation, without capital , products and technical cooperation of the other entity (including the case of joint ventures);

3 . Right to appoint members of the board or the governing bodies of the company;

4 . Members of the board in common;

5 . Family relationships between parties;

6 . Granting of huge loans or prevailing financial dependence;

7 . Companies Participation in supply or sale stations;

8 . Companies Participation in cartels or consortia of companies , particularly those aimed at price fixing;

9 . Monitoring of supply or outlets;

10 . Series of contracts that model a monopolistic situation;

11 . Generally all the cases in which is exercised (currently or potentially) an influence on business decisions.

It follows that rules on transfer pricing are used not only in the cases of supervision laid down by Article 2359, but whenever there are commingling of interests such as to assume the uniqueness of the government of the undertakings concerned.

On the other hand, it is worth remembering that jurisprudence sometimes interpreted the concept of control in the statutory sense; In fact, according to a judgment of the C.T.P. Alexandria 11 December 1995 *"the concept of relevant control at last of the application of the rules of Art. 76 , paragraph 5, of the Tax Code (now Art. 110, paragraph 7), must be interpreted in the light of Article 2359 of the Italian Civil Code and then correlated to the distinct circumstances provided for by this rule."*

2.3. Objective requirements

The principle of free competition (so-called arm's length principle), inferable from Art. 110, paragraph 2, and Art. 9 co. 3 , of the Tax Code, as well as Art. 9, par. 1 of the OECD Model, is the basis of the rules on transfer pricing .

According to this principle, the price agreed in commercial transactions between associated enterprises should match the price that would have been agreed between independent enterprises for the same or similar transactions on the open market, to be identified in the normal value of goods or services transferred .

It follows that companies bound together by legal or economic relations and autonomous enterprises are subject to a tax levy uniformly determined. The parameter for the assessment of intra-group transactions is therefore the ''normal value'' under co. 3 of Art . 9 of the Income Tax Code, defined as :

"*Average price or consideration charged for goods or services of the same or similar kind under conditions of free competition and at the same marketing stage, at the moment and in the place where the goods or services were*

purchased or provided, and failing that, at the nearest moment and place. For the determination of normal value we refer, to the greatest extent possible , to the prices or rates of the individual who provided the goods or services and , failing that, to the chambers of commerce "mercuriali" *and price lists and to professional rates , taking into account exchanges of Use*."

The transaction relevant to the application of the rules on transfer pricing can be represented by:

- Intercompany sale of material or semi-finished goods, or finished products;
- Intercompany sale of intangible assets, related to the research and development activity, such as, for example, trademarks and trade, intellectual property, industrial inventions , know- how, etc.;
- Provision of services , both of administrative (including planning, coordination, accounting and auditing of financial statements, etc.). and commercial nature (such as production control, quality control, marketing) or related to personnel (such as planning, recruitment and training).

3. DETERMINING THE VALUE OF INTERCOMPANY TRANSACTIONS

The OECD (Organization for Economic Cooperation and Development) identifies the principle of free competition, the fundamental criterion for determining the transfer pricing .

This standard requires that the commercial transactions of goods and services between companies belonging to the same group, must occur at the same price charged between independent enterprises under conditions of free competition.

Are provided for different types of analysis to make more effective assessment of the compatibility between the intercompany sales and those between independent enterprises:

• analysis of the characteristics of the products and services being traded: are taken into account the physical characteristics , quality and reliability of products, the nature of the services;

• Functional analysis : analyzes the various functions performed by the companies of the Group and the shareholders' equity for the performance of those functions;

• analysis of contract terms : analyzing the effects of various contractual clauses on those parties that sign;

• analysis of the economic conditions are examined geographic location , the amplitude of the markets, the level of demand and supply on the market , the nature and impact of government intervention;

• analysis of business strategies adopted by multinational group : geographic location are analyzed, the extent of competition , the balance of power between seller and buyer , the availability of other assets, the levels of supply and demand, the quality of consumer spending.

In order , therefore, to make an effective comparison of the price , product features , functions performed by the distributor,

contractual conditions , markets, business strategies must be as homogeneous as possible.

The methods used to perform the comparison of the price according to the principle of free competition are mainly methods based on transactions of products (comparison of the price, the resale price method, cost plus method), and alternative methods based on the allocation of earnings (net margin method or transaction Transactional Net margin Method and method of distribution of overall profits or profit Split).

The method recommended by the OECD report is the comparison of the price, which provides a comparison between the price of goods and services transferred in a transaction concluded between associated enterprises and the price charged for goods and services transferred between independent operators (external comparison).

If it is not applicable, the comparison is with the price for which the property was purchased from an associated enterprise and resold to independent firms (internal comparison). This method is valid only in the presence of objective similarity between the subjects are compared (Regional Tax Commission of Piedmont Judgment 25/2010).

The main alternative to the comparison of the price is the resale price method in which normal value is considered the price at which the goods are purchased by a group enterprise , is resold by a distributor , reduced by a margin considered reasonable on the market reference, and possibly reduced distribution costs in excess of the normal market practice. This method is effective in the presence of relationships involving a manufacturer and distributor essentially a subsidiary that do not assume a particular risk and does not particular treatment.

Another alternative is using the cost plus method, in which we consider normal value the cost of production plus a reasonable mark-up considered in the relevant market. This method is more suitable for long-term contracts for raw products

4. TAX AND OPERATING OF TRANSFER PRICING

Transfer pricing is the fiscal discipline and operational measures in the implementation of the Revenue by 29 September 2010. Such a measure, in the Art. 26 of D.L. n° 78/2010 contains rules to escape the penalties of the infidel statement and sets the pattern of communication to be made via computer and for the preparation of transfer pricing documentation on transfer pricing between companies belonging to the same group holding and sub-holding.

Since 2010, the electronic communication of the possession of the Transfer pricing documentation must be carried out with the submission of the tax return.

Failure to notify will not have consequences if transmitted late, but before they have access, inspections, audits or other administrative tasks

such as investigation of the subject has had formal knowledge.

The documentation will be made by a Masterfile and the National Documentation, designed to collect information about the group and the individual company.

Both the National Documentation Masterfile collect information that must be divided into chapters, sections and subsections , each containing the data taken from its titration and by any additional indications set out in detail in the measure.

The documentation to be drawn up annually for all operations within the transfer pricing must be provided in electronic format and made available to the tax authority within 10 days of the request or in the case of additional information within seven days.

The documentation is different depending on whether it's holding, sub-holding company, subsidiaries, permanent establishments. It is determined that the subsidiaries belonging to a multinational group must prepare the only National Documentation .

Small and medium-sized enterprises with a turnover or revenues not exceeding EUR 50 million can update the documentation with intervals of more than a year.

5. THE TRANSFER PRICING BY ROMANIAN LAW

Romania has not set the theme of "*transfer pricing*" within its legal system, nor the same country joined the OECD .

There are, however, of the practices that are applied by the tax authorities for both transactions at the national level and for those at the international level involving a Romanian legal entity.

These practices generally involve the need to dispose of an asset at a price not less than the cost of production or the time of purchase, without imposing any limit to margin in the transaction.

It provides for the possibility that this principle be waived in the case of sales made at values lower than the above parameters only if the transferor is able to provide arguments in support of the transaction.

An example of atypical justifiable transaction can be represented by the liquidation of a stock of material.

Given the above, it can be said, therefore, as to date there are no Romanian order under regulations governing the issue of transfer pricing.