

# EU Legal Entity Subject to Transfer Pricing Rules, Italy Says

**by Luigi Perin**

Reprinted from *Tax Notes Int'l*, March 21, 2005, p. 1036

## TAX NOTES INTERNATIONAL

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ISSN 1048-3306

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## EU Legal Entity Subject to Transfer Pricing Rules, Italy Says

by *Luigi Perin*

Italian tax authorities, in Ministerial Resolution 18/E (Feb. 15, 2005), ruled that the contributions made by a European Economic Interest Grouping's (EEIG's) members to its Italian permanent establishment constitute remuneration for services rendered by the EEIG to its members and must be determined in accordance with the arm's-length principle.

### Background

Established on July 25, 1985, by EC Regulation 2137/85, an EEIG is an international legal entity specifically designed to encourage business cooperation within the EU market.

An EEIG is not to be confused with the European company (or *Societas Europaea*), a new corporate entity that on October 8, 2004, became available to companies with operations in more than one EU member state (see European Council Regulation 2157/2001).

The main objective behind the development of EEIGs was to provide a flexible way for EU businesses to conduct auxiliary or support activities jointly across the European Union. For example, Belgian and French trappist monks — producers of beer and cheese, respectively — might form an EEIG to jointly market their products. Among the activities typically carried out by EEIGs are research and development, training, market research, purchasing, and sales. EEIGs also have been formed to run a common sales or purchasing office outside the European Union — for example, in the United States or Japan.

An EEIG must have at least two members based in different EU member states. To be eligible for membership, companies and other legal entities must have been formed according to the laws of one of the member states and must have their place of central management and control, as well as their registered or statutory office, within the European Union.

One of the advantages of forming EEIGs is that there are no minimum capital requirements. Members may vary their funding methods according to their specific needs. For example, when smaller firms or nonprofit organizations are involved, their contribution may be in the form of the services and skills that they can provide. Likewise, members of an EEIG are subject to unlimited joint and individual liability.

### Taxation of EEIGs in General

From an income tax perspective, EEIGs are analogous to partnerships. An EEIG is not itself subject to income taxes; rather, its profits or losses are passed through to its members.

It follows that EEIG members that are Italian residents are subject to Italian income tax on the worldwide income of the EEIG. However, EEIG members that are not Italian residents are subject to Italian income tax on the Italian-source income of the EEIG.

### The Ruling Request

Ministerial Resolution 18/E addressed issues raised by an Italian PE of an EEIG headquartered in

London (the taxpayer). The EEIG in question was established to provide technical assistance and marketing services to EU independent distributors and final customers for the sale of cables and other transmission devices manufactured by a U.S. company.

The questions raised by the taxpayer concerned the Italian income taxes and VAT applicable to contributions made directly by the EEIG's members to the EEIG's Italian PE.

In the ruling request, the taxpayer argued that because by statute EEIGs are not organized for the purpose of making profits for themselves but rather for their members, EEIGs are nonprofit entities. Also by statute, EEIGs have no control over the activities of their members. For those reasons, the taxpayer argued that EEIGs are not subject to transfer pricing rules.

The taxpayer also argued that the EEIG members' contributions to the EEIG's Italian PE should be treated for tax purposes as mere cost contributions and not as payments for services rendered.

As a subordinate argument, the taxpayer contended that — in the event that the transfer pricing rules do apply to the EEIG — the cost-plus method should be employed to determine the arm's-length fee for services rendered.

### Italian Transfer Pricing Rules

Italy's transfer pricing rules are contained in paragraph 7, article 110 of the Italian Tax Code. In the early 1980s, the Finance Ministry released two documents — Ministerial Circular 32 (Prot. 9/2267), Sept. 22, 1980, and Ministerial Circular 42 (Prot. 12/1587), Dec. 12, 1981 — containing guidelines on the criteria for applying the transfer pricing rules.

The guidelines contain definitional standards for the various types of business entities that are subject to the transfer pricing rules. In addition to corporations, partnerships, and trusts, the Finance Ministry makes explicit reference to several foreign entities, including the French *Groupement d'intérêt économique*, which somewhat represents the precursor of the EEIG.

According to the guidelines, the determination of an arm's-length charge for intercompany services should be made with reference, whenever possible, to internal or external comparables. Also, the party

performing the services should earn a profit only if the services are conducted as part of its principal activity. That test is narrower in scope than the one provided under U.S. Treas. reg. section 1.482-2(b)(7), which references the "integral part of the business activity" standard. Under that standard, a service is considered to be an integral part of a party's business if it meets the similar service test, the principal activity test, the "peculiarly capable of rendering the services" test, or the "substantial services from related parties" test.

### The Ruling Determination

In their reply to the taxpayer, the Italian authorities held that an EEIG is a for-profit entity; that its members exercise, by statute, control over its activities; and that, accordingly, EEIGs and their PEs are subject to transfer pricing rules. As a result, contributions made by the EEIG's members to its Italian PE constitute remuneration for services rendered by the EEIG to its members and must be determined in accordance with the arm's-length principle.

The ruling also stated that the appropriate forum to determine which method should be employed in determining the arm's-length fee is the recently established international ruling program (article 8 of the Law Decree of Sept. 30, 2003, converted into Law 326 (Nov. 24, 2003)).

### Conclusion

Resolution 18/E confirms the need for Italian and EU tax authorities to issue clear guidelines on the taxation of both old and new EU legal entities. Indeed, commentators have noted that a significant obstacle to the European company becoming popular for investments within the European Union is the lack of corresponding tax rules. (For related commentary, see *Tax Notes Int'l*, Jan. 31, 2005, p. 375.)

Also, because the Italian transfer pricing guidelines are about 25 years old and have been, in part, superseded by the OECD transfer pricing guidelines, it will be interesting to monitor the outcomes and developments of the newly introduced international ruling program, which will test Italian tax authorities' ability to deliver up-to-date, effective transfer pricing guidance. ♦

♦ *Luigi Perin is a partner with Funaro & Co., P.C. in New York.*