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## Transfer pricing guidance for the implementation of the Italian investment management exemption

On 28 February 2024, the Director of the Italian Revenue Agency released the implementing transfer pricing guidance (the “TP Guidance”) relating to the Italian investment management exemption (“IME”)<sup>1</sup> regulations.

### 1. Background

Article 1, para. 255, of Budget Law for 2023 amended the definition of permanent establishment (“PE”) set forth by Article 162 of the Income Tax Code<sup>2</sup> (“ITC”) providing for that - subject to conditions being met - an entity (also in the form of a branch) operating in Italy in the name and on behalf of a “foreign investment vehicle”, or of its controlled entities, and habitually concluding, or in any way contributing to the conclusion of, purchases, sales and/or trading of financial instruments (including derivatives, equity interests and receivables) does not qualify as a PE of the foreign investment vehicle, even if it exercises discretionary powers.

The main conditions are:

- a) the establishment of the foreign investment vehicle and its controlled companies in a white-list country<sup>3</sup>;
- b) certain independency conditions to be complied with by the foreign investment vehicle with respect to investors and investment manager;
- c) limitation in the roles assumed by the entity into management or supervisory bodies of the foreign investment vehicle (and any of its direct or indirect subsidiaries) (including any persons of the entity acting on its behalf) and maximum thresholds of participation (as determined on a cumulative basis with other companies of the same group) to the economic results of the foreign investment vehicle, and
- d) drafting and keeping transfer pricing documentation supporting the arm’s length remuneration for the services rendered by the entity or the branch operating in Italy with related parties.

Details of the independency condition and of other conditions under b) and c) above are provided in the Decree of the Minister of Finance issued on 24 February 2024<sup>4</sup>.

### 2. The TP Guidance

#### 2.1. The content

With regard to the above condition under d), the TP Guidance reports transfer pricing criteria to assess the arm’s length remuneration of services in the investment management industry.

More specifically, the TP Guidance provides for criteria to select the most appropriate transfer pricing method

<sup>1</sup> See our previous tax alerts of 20 December 2022 and 1 March 2024.

<sup>2</sup> Attached to Presidential Decree no. 917 of 22 December 1986.

<sup>3</sup> I.e., a country allowing a satisfactory exchange of information with Italy, listed in the Ministerial Decree of 4 September 1996, issued in accordance with Article 11, para. 4, let. c), of Legislative Decree No. 239 of 1 April 1996.

<sup>4</sup> See GOP’s tax alert on 1 March 2024.

to be applied by investment managers and advisors for the purposes of IME. The relevant services encompass two categories:

- i. investment management services such as:
  - a. management of investments, such as the purchase, sale or trading of financial assets (including derivatives, equity instruments and debt instruments) based on a pre-determined investment policy;
  - b. funds administration, such as legal and accounting services related to the capital raised, investors relations (e.g., clients' reporting, valuation and pricing of the assets under management (including tax ones), keeping investors' registries, distribution of proceeds and quota issuance/redemption, settlements) and control of regulatory compliance;
  - c. marketing and distribution of the products, including any offering, solicitation or promotion of the subscription or distribution of units/quotas/shares to investors (in any manner and whether direct or indirect);
- ii. services related and instrumental to investment management such as:
  - a. promotion and development of the investment management, like investment advisory and consulting services;
  - b. ancillary activities, e.g., economic and financial research and analysis, financial and economic data/information processing, transmission and disclosure, setup and management of IT and data processing services, management of real estate properties, administrative/accounting services.

## 2.2. The proposed methodologies

Regarding the investment management services (*sub* 2.1, i. above), the TP Guidance identifies the following transfer pricing methods (each a "**TP method**"): the Comparable Uncontrolled Price ("**CUP**") method as the appropriate TP method. However, to the extent:

- a) the CUP cannot be applied with the same reliability and
- b) the parties involved in the transaction share the assumption of the same economically significant risks or assume separately economically significant risks, which are strictly interconnected,

the most appropriate TP method is the transactional profit split ("**Profit Split**") method based on the contributions rendered by each of the parties.

Where neither the CUP nor the Profit Split can be applied in a reliable way, one of the other TP methodologies provided by the transfer pricing guidelines issued in 2022 by the OECD (the "**OECD TP Guidelines**") and the Italian regulations contained in a Decree issued in 2019 ("**TP Decree**") shall be selected with the express exclusion of those featuring a profit level indicator based on costs.

The selecting method guidance depicted above does not apply for those investment management services which do not imply an assumption of economically significant risks. In those circumstances, the most appropriate TP method shall be selected among those enumerated by and following the criteria set by the OECD TP Guidelines and the TP Decree (hence, no exclusion of the methods featuring costs as denominator of the profit level indicator).

Regarding the services related and instrumental to investment management (*sub* 2.1, ii. above), the TP Guidance indicates that, as general rule, the most appropriate TP method shall be selected among those provided by the

OECD TP Guidelines and the TP Decree (hence, no exclusion of the methods featuring costs as denominator of the profit level indicator).

However, if the transaction involves the assumption of economically significant risks, the same order based on CUP, Profit Split and, subsequently, the other methods (excluding those featuring costs as denominator of the profit level indicator) shall apply as in standard case for investment management services (*sub. i* above).

The TP Guidance sets a preference for CUP, Profit Split and, subsequently, the other methods (excluding those based on costs) for the determination of the arm's length remuneration of those service transactions implying the assumption of economically significant risks (regardless of whether they fall within categories *sub* 2.1, i. or 2.1, ii. above). Conversely, the arm's length remuneration for the service transactions not implying the assumption of economically significant risks is determined by applying the most appropriate TP method among those provided by the OECD TP Guidelines and the TP Decree.

Finally, the TP Guidance clarifies that investment management services and services related and instrumental to investment management shall be assessed together to the extent they are strictly interconnected and cannot be separated in a reliable way. The same hierarchical preference among CUP, Profit Split and the other methods (excluding those featuring costs as denominator of the profit level indicator) applies.

### **2.3. Compliance of transfer pricing documentation for IME purposes**

To comply with the above IME condition set forth in letter d) of Article 162, para. 7-*quater* ITC, the transfer pricing documentation of the entity (or its PE) operating in Italy shall duly analyse the transactions related to services listed in the TP Guidance (i.e., the investment management services and the services related and instrumental to investment management). The documentation shall comply with the Provision of the Director of the Revenue Agency ref. 2020/360494, of 23 November 2020. Further intercompany transactions / dealings that the entity (or its PE) may enter into should not be required to be included in the transfer pricing documentation for IME purposes. In any case, their inclusion is required to be granted penalty protection in case of TP adjustments on those transactions.

## **3. Preliminary comments**

The introduction of the TP Guidance is related to the implementation of the IME, addressing the arm's length requirement for the certain specific controlled transactions (i.e. provision of services in the investment management) as regulated by Article 110, para. 7 of ITC. Nevertheless, it may be the case that the Italian Tax Authorities rely on those principles to analyze the intercompany transactions and dealings within the investment management industry also in context other than the IME. Investment management companies, advisory companies and other entities operating in the investment management market might consider to assess the implications of the TP Guidance on their current or future operations in Italy and, potentially, review the transfer pricing policies.

Foreign investment vehicles and their direct and indirect controlled entities are excluded from the definition of "group" which is relevant for the IME arm's length remuneration according to the TP Decree. In principle, this may lead to maintain that IME may apply even when the arm's length remuneration of the transactions between foreign investment vehicles (and controlled entities) and the investment managers or advisors is not specifically verified.

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