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The Non-Unique Notion of "Control" in Transfer Pricing – Interpretation, Legislative Developments and Problematic Aspects from an Italian and International Perspective

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For their concrete implementation, transfer pricing rules necessarily presuppose a tax-relevant notion of "group", which is built on the concept of "control" among enterprises. The current definition of "control", under Italian tax law, is the result of a long and troubled process of refining the legislative text. Over time, the Italian tax authorities have always adopted a far-reaching interpretation of "control", which went far beyond contractual or shareholding connections (that make relevance for the notion of "control" under Italian Civil Code), resulting in the application of the TP rules even to cases not representing a distortion of the rules of competition, but rather reflecting situations that can be ordinarily found on the market. The notion of "control" has been finally clarified (and circumscribed) by the recent legislative developments, which – despite a number of persistent interpretative doubts – appear also more in line with the international OECD framework, which is briefly discussed in the present article as well.

1. Introduction

Transfer pricing rules ("TP rules") are prominent among the anti-avoidance measures to which the international community – first and foremost the OECD – has recently dedicated more attention. By setting prices in their internal transactions outside the range of the arm's length principle, multinational groups manage to "drain" their taxable base and transfer profits from high-tax jurisdictions to more advantageous ones. In order to restrain these phenomena, most OECD member countries (including Italy) have adopted specific legislation on transfer pricing, according to which the prices applied for the transfer of goods and services between companies belonging to the same group must match up with market prices applied in transactions between third and independent parties. If this does not occur, the relevant tax authorities have the power to adjust such prices for tax purposes.

For their concrete implementation, TP rules necessarily presuppose a tax-relevant notion of "group", which is built on the concept of "control" among enterprises. This article focuses precisely on the analysis of this preliminary aspect.

In the Italian legal system, provisions on transfer pricing are to be found in article 110(7) of Presidential Decree 917 of 22 December 1986 (*Testo unico delle imposte sul reddito* , TUIR), which currently provides that

> income deriving from transactions carried out by companies not resident in the territory of the State which directly or indirectly controls the company are controlled by it or are controlled by the same entity that controls the company are determined with reference to the terms and prices that would be agreed upon between independent parties operating in conditions of free competition and in comparable circumstances.

The wording of the aforementioned provision suggests that the presence of a control relationship between the companies involved in the cross-border transactions not only constitutes the subjective precondition for the application of the TP rules, but ultimately represents its underlying rationale. Indeed, TP rules are aimed at correctly splitting the taxable income arising from the "controlled" transactions among the states involved, neutralizing any profit shifting that might occur when a foreign company exercises control over a resident entity (and vice versa).[1] When transactions between companies linked by a close inter-subjective relationship take place, in fact, the parties may not act according to the market logic, but rather according to mutual

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1. *See* G. Maisto, *Il transfer pricing nel diritto tributario italiano e comparato* p. 61 (CEDAM 1985).

commercial, financial or tax purposes (i.e. focusing on the group's interest). Therefore, the transfer pricing discipline requires, as a prerequisite for its application, a unitary economic strategy on the part of the group that makes it irrelevant whether the financial flows are attributed to one or another party of the relevant controlled transaction.[2]

In the light of the above, it is easy to understand why the current definition of "control" is the result of a long and troubled process of refining the legislative text. Moreover, it is also easy to understand the reasons behind the vibrant debate that has developed on this topic among scholars and in case law, and which only seems to have been unravelled since the enforcement of the 2018 Budget Law and its implementing decree (Ministerial Decree of 18 May 2018).

2. Evolution of the Domestic Interpretation of the Concept of "Control"

The first regulation concerning the subjective nexus for transfer pricing purposes was introduced into the Italian legal system by means of articles 53 and 56 of Presidential Decree 597/1973, in which a wording similar to that of current article 110(7) of the TUIR was adopted, in particular in the use of the expression "direct or indirect control of the enterprise". The first interpretations of such regulation among scholars[3]were strongly influenced by the civil law perspective on tax relationships, according to which the concept of control could only be traced back to article 2359 of the Italian Civil Code. According to this last provision (which we find in the version in force at that time), "controlled companies" are (i) companies subject to the internal de jure control of another company, which holds the majority of the voting rights; or (ii) companies subject to the "dominant influence" of another company by virtue of specific contractual obligations.[4]

According to this interpretation, the fact that the term "control" was not provided with a clear definition in the tax legal framework meant that it was necessary to rely on definitions of such term present in other branches of law, where it was explicitly mentioned.[5]

In sharp contrast to the aforementioned interpretation, the Italian Ministry of Finance declared the inadequacy of the above-mentioned civil law provision by means of Circular Letter 32 of 22 September 1980. According to the Circular Letter, in order to achieve the objectives pursued by the tax legislator, the concept of control in the context of transfer pricing must be characterized by "flexibility and must be placed in a dynamic economic context"; furthermore, it must be interpreted as "the power of one party to influence the will of another party not on the basis of the market mechanism, but on the basis of the interests of one of the contracting parties or of the group".

In this regard, the Ministry of Finance argued that "the influence that an enterprise can exert over the business decisions of the other one goes far beyond contractual or shareholding connections, resulting in factual considerations of a purely economic nature".

Therefore, according to Circular Letter 32/1980, the concept of control must be expanded to "any hypothesis of potential or actual economic influence" that can arise from several factual (as well as legal and economic) circumstances; among them, the presence of common members on the boards of directors, the financial dependence of one company upon the other, the exclusive sale of manufactured products from one company to the other, common participation in cartels or consortia and the existence of family relationships between the parties. All these situations may reveal a "control relationship" (which might also be a "non-qualifying" one, i.e. independent from shareholding or contractual relations). In any event, the dominant influence must be characterized by a certain stability, and a mere fortuitous or accidental relation would be irrelevant.

As a consequence, the wording of article 2359 of the Italian Civil Code (both in its original version and in the version subsequent to the 1974 amendment, which introduced the concept of "indirect control" exercised through another company) would be insufficient by itself to provide us with a full-fledged definition of the term "control". In fact, it only mentions the concept of "corporate" control, without picturing scenarios of control among entities with a different juridical nature (such as individuals, partnerships, permanent establishments (PEs), etc.) which are instead *unequivocally* subject to TP rules as well.

In 1980, domestic rules on transfer pricing were significantly amended: article 38 of Presidential Decree 897 of 30 December 1980 removed the term "control" from the legislative text and only left the concept of "dominant influence", without, however, explaining the exact scope of this revision.

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2. *See* M. Leotta et al., *"Transfer pricing" e presenza di "soci esterni" nella compagine sociale* , Dialoghi Tributari 4 (2012).
3. *See* S. Mayr, *La rettifica dei costi e dei ricavi ex artt. 53 e 56 del D.P.R. n. 597/1953* , Bollettino tributario 17, p. 1245 (1975).
4. The control referenced under (ii) is so-called "external" or "contractual" control, which has been interpreted with reference to contractual relationships that reveal the link of domination – or even constitute it – as the loss of such contracts would endanger the very "survival" of the controlled company (*see* A. Pozzo, *Sui presupposti per l'applicazione della normativa transfer pricing* , III Diritto e Pratica Tributaria, p. 687 (1997), quoting G. Angelici, *La partecipazione azionaria nelle società per azioni* , in *Trattato di diritto privato* vol. II (Colombo & Portale eds., Utet 1985)).
5. *See* Mayr, *supra* n. 3 , at p. 1248.

A few academics,[6] adhering to the argument of the Italian Ministry of Finance, pointed out that the civil law notion of control was not acceptable from a systematic and teleological perspective, as it should also take into account (in addition to the literal data) the far-reaching anti-avoidance purposes that the transfer pricing regulation intends to achieve.[7]

The terminological consistency of the reference to the "dominant influence" is not sufficient to reconcile the 1980 reform of TP rules and the civil notion of control. In fact, if the tax provision had been interpreted according to the Civil Code provision, the tax legislative reform would have lacked the innovative scope it seemed to offer, as the concept of dominant influence was already included in article 2359 of the Civil Code (as amended in 1974) and, therefore, in the civil law notion of control.[8]

In 1986, with the adoption of TUIR, the rule on transfer pricing was revised once again. Compared to the wording of the previous provision, it can be noted that in that revised version (i) any reference to the expression "dominant influence" had disappeared and was replaced by the term "control"; and (ii) the reference to the case of control exercised by an Italian company over a foreign entity was dismissed.

According to some academic interpretations,[9] the elimination of the notion of economic influence and the reintroduction of the concept of control are indicative of the legislative wish to overcome the broader interpretation offered by the above-mentioned Circular 32/1980.

In addition to this, it has been noted that the concept of control referred to in article 76 (now 110) (5) of the TUIR should in any case have been connected with the Civil Code notion for the sake of systematic consistency. Indeed, article 76(5) was inspired by the same purpose as paragraph 7- *bis* of the same article 76. The latter provision affirms that costs arising from transactions concluded with counterparties residing in blacklisted jurisdictions are not deductible for Italian companies, making an explicit reference to article 2359 of the Civil Code. Therefore, it seemed illogical that the tax legislator had chosen to interpret the term "control" according to two different meanings within the same provision.[10]

It is difficult to share this view, since the interpretative position expressed in Circular 32/1980 was based on a legal framework that already referred to the concept of "control" and not to the one of "dominant influence".

Further amendments to transfer pricing rules were introduced into the TUIR of 1986, but they had a mostly marginal impact on the subjective requirement.

Although many academics and tax courts continued to support the hypothesis of the civil law derivation of the notion of control,[11] the voices in favour of an autonomous interpretation of the concept of control for transfer pricing purposes have risen over time.[12]

In fact, it has been observed[13] that an extensive approach enhancing the anti-avoidance rationale of national TP legislation is also supported by a particular interpretation (more widespread than others but not a unique one) of the relevant conventional transfer pricing provision (article 9 of the OECD Model), in which the subjective nexus is defined in even more general and extensive terms.[14]

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6. *See* Maisto, *supra* n. 1 , at p. 63.
7. The reference to the civil law notion of control would therefore be misleading with respect to a provision that "derives from the need to avoid manipulation of income components" and must therefore include within its scope "all cases in which the legal or economic relationship between the parties is of such importance as to presuppose an alteration of the values in trade, with a practical assimilation to the hypothesis of commonality of interests" (*see* Maisto, *supra* n. 1 , at p. 69).
8. *See* Maisto, *supra* n. 1 .
9. *See* S. Mayr, *Valore normale nei rapporti tra società italiane e controllate estere* , Corriere Tributario, p. 1993 et seq. (1990).
10. *See* M. Antonini & P. Ronca, *Il requisito del controllo nei prezzi di trasferimento,* Corriere Tributario 32, p. 2527 (2016), according to which, on the contrary, the lack of reference to IT: Codice civile, 1942 [Civil Code], art. 2359, is the result of a precise choice of the legislator, who expressly mentions the Civil Code when he wants to, as in the case of other tax provisions of IT: Decreto del Presidente della Republica [Presidential Decree] 917 of 22 December 1986 (*Testo unico delle imposto sui redditi* [Income Tax Code], TUIR).
11. *See* IT: CTP [First Instance Tax Court] Alessandria, 28 Nov. 1995, No. 1416/1995; IT: CTP Gorizia, 12 June 2013, No. 83/2013; and IT: CTP Alessandria, 11 Dec. 1995, No. 170/1995. In this last case, the Court denied the existence of a controlling relationship between two entities linked by a 50/50 joint venture, stating that "the two legal entities maintain their autonomy and independence, and in fact, from time to time, problems arise opposite to those hypothesised by the Italian tax authorities and lead to significant corporate conflicts within the joint venture". *See also* IT: CTP Milano, 11 Apr. 2017, No. 2826/2017; IT: CTR [Tax Court of Appeal] Lombardia, 9 July 2015, No. 3165/2015; and IT: CTR Lombardia, 27 June 2019, No. 2771/2019.
12. *See* G. Marino, *La relazione di controllo nel diritto tributario* p. 159 (CEDAM 2008); A. Fantozzi, *La determinazione del reddito imponibile nei rapporti tra società italiane e collegato all'estero* , Rivista notarile, p. 803 (1979); I. Sangiorgio, *La rilevanza fiscale del controllo societario* , Rivista di Diritto Tributario 12, p. 1341 (1993); A. Giovannini, *Soggettività e fattispecie impositiva* p. 377 (CEDAM 1996); Pozzo, *supra* n. 4 , at p. 687; G. Cottani, *Italian Transfer Pricing Legislation: An International Perspective* , 64 Bull. Intl. Taxn. 8/9, p. 463 (2010), Journal Articles & Opinion Pieces IBFD.
13. *See* Pozzo, *supra* n. 4 , at p. 687; C. Rotondaro, *The Application of Transfer Pricing Rules and the Definition of Associated Enterprises* , 6 Intl. Transfer Pricing J. 6 (1999), Journal Articles & Opinion Pieces IBFD; P. Valente, *Documentazione transfer pricing per holding e sub-holding: come valutare il perimetro soggettivo* , Fiscalità e commercio internazionale 3 (2001); Leotta et al., *supra* n. 2 .
14. L. Tosi, *Transfer pricing: disciplina interna e regime convenzionale* , Il Fisco 7 (2011); Cottani, *supra* n. 12 .

However, even after issuing Circular Letter 32/1980, the Italian tax authorities approved a resolution (Resolution 18/E of February 2005) that confirmed their preference for the broader scope of transfer pricing control against the interpretation provided for by civil law.

The concept of control adopted by article 110(7) of the TUIR would then need to incorporate into a unitary concept all those situations in which two or more companies pursue a unitary entrepreneurial strategy or, even better, all those possible connections between companies participating in a substantially unitary production cycle, as they are subject to the presence of a unitary management or a superordinate decision-making centre.

Eventually, the Italian Supreme Court, lacking precise indications from domestic legislation or from article 9 of the OECD Model (*see* section 3.), affirmed in judgment 8130 of 22 April 2016 that the concept of control that is relevant for transfer pricing purposes is broader than the one offered by civil law provisions.[15] This assertion was made on the basis of the following deductions:

– from a literal point of view, the absence of any legislative specification of the concept of "control" (either explicitly or in the form of a reference to another provision) is decisive, given that references to non-tax rules are indeed identifiable in other provisions of the Italian tax system. The absence of such a reference would represent the legislature's clear intention not to bind or limit, in this case, the concept of control to the civil law notion;

– the textual reference to the term "enterprises" used by the tax legislator is indicative of the greater subjective extension of control in transfer pricing. In fact, the Civil Code provision refers only to "companies", excluding therefore some legally recognized entities carrying out business activities to which the transfer pricing regulations undoubtedly have to be applied; and

– finally, the anti-avoidance rationale behind the TP rules excludes per se that the interpreter should reduce the concept of control to mere contractual or shareholding relationships, excluding a priori the tax administration's power to adjust prices in all those situations in which the coercion of the controlled company's will is substantiated in a de facto influence (actual or potential) of a merely economic nature.[16]

The Supreme Court's approach has been agreed with by academics, according to whom the concept of control under article 110(7) of the TUIR encompasses any hypothesis of stable economic influence manifested as the ability of the controlling entity to affect in a non-occasional manner the decisions of the controlled company, placing it in a condition of economic subordination (i.e. dependence) with respect to the former.

For the purposes of article 110(7) of the TUIR, this broad notion of control is only partially consistent with the notion of dominant influence (so-called "external control") in the Civil Code, which occurs when a company is able to exercise over the other "a managerial and strategic influence on the overall business activity"[17] by virtue of particular contractual connexions[18] "whose continuation affects the activity and the entrepreneurial potential of one of them".[19]

Decree-Law 50 of 24 April 2017 modified such legal framework by further amending article 110(7) of the TUIR and by questioning once again the conclusions reached by the majority of Italian scholars and by the aforesaid case law.

As the stated purpose of the Decree-Law was to bring the national TP rules in line with the principles recognized by the OECD and international best practice, it is appropriate to briefly discuss international transfer pricing provisions.

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15. IT: Cass. [Supreme Court], 22 Apr. 2016, No. 8130.
16. The case concerned a distributor of products manufactured by the parent company only. The Supreme Court, moreover, reiterated these conclusions in its subsequent decision: IT: Cass., 15 Nov. 2017, No. 27018.
17. *See Commentario al Codice civile* , Commentary to Art. 2359 of Civil Code , p. 661 (P. Cendon ed., Giuffré 2010).
18. *See* Antonini & Ronca, *supra* n. 10 , at p. 2527. By way of example, the authors cite the doctrine (G. Bei, *Controllo esterno e responsabilità da direzione e coordinamento* , Le Società 1 (2016)) according to which the types of contract that (in the abstract) may entail so-called external control are the following: (i) agency agreements; (ii) exclusive supply agreements; (iii) exclusive sales concession agreements; (iv) licence agreements; (v) know-how agreements; (vi) franchising agreements; (vii) subcontracting agreements; (viii) agreements for the supply of manufactured products under a monopoly regime; (ix) commission agreements; (x) financing agreements (in particular, the granting of financing is considered an indication of dominant influence as it is essential for the business activity of the recipient company and allows the lender to influence the business decisions of the borrower). On this point, *see Commentario del Codice civile: Della Società – Dell'Azienda – Della Concorrenza, vol . I (artt. 2247-2378)* (E. Gabrielli ed., Utet 2014); and Pozzo, *supra* n. 4 , at p. 671.
19. *See* G. Cian & A. Trabucchi, *Commentario breve al Codice civile* p. 2659 (CEDAM 2007). In this regard, Assonime, in its comment on decision No. 8130/2016, affirmed that it is "doubtful whether a purely anti-avoidance interpretation of the transfer pricing rules is correct ...; this is not consistent with the rationale of the legislation in question, which has to be identified in the need to spread the tax burden between different States in order to avoid international double taxation".

3. The Interpretation of the Concept of "Associated Enterprises" – A Brief Comparative Analysis of International Trends

At the international level, the benchmark provision for transfer pricing is to be found in article 9 of the OECD Model, which underlies most of the bilateral conventions ratified by Italy. Like the national provision, the OECD Model grants the tax authorities of the contracting states the power to adjust revenues and costs of transactions between enterprises that are linked by connections influencing one another's decision-making process. However, such an inter-subjective nexus is sometimes surrounded by a degree of uncertainty.

Indeed, the ambiguous concept of "associated enterprises", to which the heading of the provision refers, contemplates two different circumstances with very broad and substantially blurred boundaries: hence, the relevant nexus arises "when (a) an enterprise of the Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or when (b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of the Contracting State and an enterprise of the other Contracting State as well".

Moreover, the association among enterprises exists in any case in which the conditions laid down for commercial or financial transactions between two or more enterprises differ from those that would be agreed between independent parties.

In particular, the meaning of the expression "participation in the control of an enterprise" has generated several interpretative doubts among scholars. The possible forms of association indicated in article 9(1) are apparently three: (i) participation in capital (influence over shareholders' resolutions); (ii) participation in management (influence by virtue of interactions between the respective boards of directors or senior managers); and (iii) participation in control, as a *tertium genus* of uncertain meaning, consisting neither in shareholder's influence nor in interference in management.

Moreover, in the Commentary on Article 9 of the OECD Model we find another ambiguous definition of the notion of control, by which associated enterprises are generically defined as "parent and subsidiary companies and companies under common control".

In short, the term "control" is left without a precise definition, with the result that – as has been widely highlighted by scholars[20]– for its interpretation we should in principle refer to article 3(2) of the OECD Model, according to which any term not defined by the convention, unless the context requires otherwise, shall be interpreted in accordance with the meaning it acquires under the law of the contracting state to which the treaty applies.[21]

However, the definition of the expression "associated enterprises" for transfer pricing purposes varies significantly across OECD member countries. In principle, it is possible to identify at least two different interpretations: the first is based only on the concept of legal control, while the second is supplemented by the concept of de facto control. In Europe, Denmark, the Netherlands and the United Kingdom mainly employ a notion of control based on the existence of qualified legal connections, such as the right to vote in the shareholders' meetings or to participate in the management of the company (the so-called "limited to de jure control" approach); on the contrary, in French and German tax law an approach based on de facto control is privileged, understood as the mere economic influence that drives the entrepreneurial decisions of the associated company ("open-ended" concept of control).

As a result, the reliance on national laws exacerbates uncertainties in the application of conventional rules instead of facilitating the interpretation of the treaty provisions. Moreover, a fragmentary interpretation of the concept of control might lead to cases of double taxation, as a result of misalignments between national systems.[22]Indeed, if a country's tax administration makes a unilateral price adjustment on specific cross-border transactions, the other contracting state would, in principle, be entitled to reject the tax reduction if it considers that the audited transactions have not been "controlled" in accordance with its domestic law.[23]

Therefore, in order to avoid such cases of double taxation, the expressions "associated enterprises" and "participation in control" should be interpreted according to a treaty-autonomous approach. Moreover, it must be emphasized that, in the hierarchy of interpretation criteria, interpretation according to context is generally to be preferred to interpretation according to domestic laws.

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20. C. Rotondaro, *The Notion of "Associated Enterprises": Treaty Issues and Domestic Interpretations – An Overview* , 7 Intl. Transfer Pricing J. 1 (2000), Journal Articles & Opinion Pieces IBFD.
21. R.T. Ainsworth, *Transfer Pricing in VAT/GST v. Direct Taxation: Relations between Associated Companies* , in *Value Added Tax and Direct Taxation: Similarities and Differences* (M. Lang, P. Melz & E. Kristoffersson eds., IBFD 2009), Books IBFD.
22. *See* Rotondaro, *supra* n. 20 ; Cottani, *supra* n. 12 ; and E.M. Bagarotto, *Transfer pricing e rischi di doppia imposizione internazionale alla luce dell'entrata in vigore delle Linee Guida* , Rivista trimestrale di diritto tributario 2 (2019).
23. For an example in relation to the double taxation convention between Denmark and Japan, *see* Rotondaro, *supra* n. 20 .

With the term "context", the Commentary on the OECD Model refers to the intentions of the contracting states at the time of signing the convention. Since the intention of the parties to a double taxation convention would undoubtedly be to avoid any cases of international double taxation, it is clear that the treaty rules must be interpreted in order to avoid the risk that unilateral changes in the prices of cross-border transactions lead to an overlap in tax claims.

For these reasons, some scholars[24]have supported a restrictive interpretation of the concept of "associated enterprises", limiting its meaning to those forms of legal control depending on ownership of voting or administrative rights, while excluding the meanings related to the concept of de facto control. Indeed, in the first version of a provision on TP rules, developed in 1933 by the Fiscal Committee of the League of Nations,[25]the association between enterprises was described as the "dominant participation in the management or capital of an enterprise". The formula used by the Fiscal Committee seems to have been borrowed from UK legislation, which (as mentioned above) recognizes as controlled entities only those enterprises connected by shareholdings or management relations, by means of which the controlling subject is able to "dominate" (i.e. direct according to its own interests) the entrepreneurial activity of the other.[26]Mere economic or contractual influence would not be sufficient to fulfil the subjective requirement of the rule.

The actual wording of the provision (as subsequently revised) did not aim to distance itself from the original conceptual approach.[27]Therefore, the expression "participation in control" is not intended to indicate any additional criterion of "association" beyond the one related to shareholding or management relationships; conversely, it simply aims at emphasizing that the nexus with the associated company must be so significant as to allow one to deeply influence the other's activity and business. In other words, the ambiguous expression "participation in control" currently used by the OECD Model must be interpreted as a mere textual reformulation of the term "dominating" used in the early League of Nations documents on transfer pricing.[28]

Ultimately, the cases of association contemplated by article 9 of the OECD Model would drop from three to just two circumstances: (i) participation in capital and (ii) the exercise of management powers over the subsidiary.[29]Hence, the circumstance related to the concept of de facto control goes beyond the scope of the transfer pricing rules.[30]

In any case, it still remains unclear what threshold of relevant shareholding and what degree of interference in the administration of the associated company should be considered to constitute control; between the domestic laws of each OECD member country, divergences might nevertheless emerge that would inevitably give rise to unilateral adjustments by the corresponding tax authorities.

4. The Legislative Innovations Introduced by Decree-Law 50 of 24 April 2017

As previously mentioned, the Italian legislator has recently changed once again the domestic rules on transfer pricing (by means of Decree-Law 50 of 24 April 2017), pursuing a greater compliance with the principles accepted as international standards.

As far as the relevant inter-subjective nexus is concerned, the only change in the wording of the rule of article 110(7) of the TUIR introduced by the 2017 amendment is the reference to international best practice. However, in spite of the apparent overlap in wording, the new provision takes on a different scope in substantive terms precisely by reason of the reference to international standards and, therefore, to the concept of "associated enterprises".

In fact, article 2 of the Ministerial Decree of 18 May 2018 offers an exhaustive definition of the concept of "associated enterprises", stating that this term refers to

> enterprises that are resident in the territory of the State as well as to non-resident companies when: (1) one of them participates, directly or indirectly, in the management, control or capital of the other, or when (2) the same person participates, directly or indirectly, in the management, control or capital of both companies.

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24. Bagarotto, *supra* n. 22 ; R. Dwarkasing *, The Concept of Associated Enterprises* , 41 Intertax 8/9, p. 412 et seq. (2013).
25. Art. 5 *Draft Convention for the Allocation of Business Income between States for the Purposes of Taxation* , Annex to League of Nations, *Report to the Council on the Fourth Session of the Committee* , doc. C.399.M.204.1933.II.A [F./Fiscal. 76] (1933).
26. *See* Dwarkasing, *supra* n. 24 .
27. According to Dwarkasing, *supra* n. 24 , the Fiscal Committee stressed that it had solely readjusted the basic principles outlined in the Mexico and London Models: the term "participation in control" should therefore have the same function as the term "dominant" used in the drafts of the Model developed in those editions.
28. *See* Dwarkasing, *supra* n. 24 .
29. On this point, *see* G. Kofler, *Article 9. Associated Enterprises* , in *Klaus Vogel On Double Taxation Conventions* , pp. 633-634 (E. Reimer & A Rust eds., Kluwer Law International 2015), according to whom "a participation in the management or capital of an enterprise falls into the scope of Article 9 OECD and UN MC only in connection with control, hence requiring a dominating or controlling participation in capital or management".
30. *See* Dwarkasing, *supra* n. 24 , for whom "a mere 'de facto' control situation is not covered by Article 9(1)(a) OECD Model". *See also* Kofler, *supra* n. 29 , who affirms that "a relationship by 'blood or marriage' or 'any community of interests' cannot by itself constitute an 'association' within the meaning of Art. 9 OECD"; and moreover, that "economic control based on a market position is not to be considered 'control' falling within Art. 9 OECD".

In addition, in order to avoid the same uncertainties arising from article 9 of the OECD Model, the Ministerial Decree clarifies that participation in management, control or capital means "(a) participation of more than 50 per cent in the capital, voting rights or profits of another enterprise; or (b) dominant influence on the management of another enterprise, on the basis of shareholding or contractual connections".

Therefore, the "mere" economic subjection of one enterprise to another (in the absence of contractual or shareholding connections) is outside the scope of the rule: indeed, the application of TP rules to such cases would be likely to include within the category of "controlled transactions" also agreements which – despite the economic subordination – already reflect "market" conditions, albeit quite peculiar ones: for example, this is the case of a person who only purchases products from a monopoly or from an enterprise holding a dominant position on a specific market.[31]

It should also be highlighted that the current wording is the result of the development of draft legislation made available for public consultation. In the draft, only a stake representing more than 50% of the share capital (but not of the voting rights or profits) was considered relevant for control, and a dominant influence on the commercial or financial decisions of the associated enterprises was assumed to be relevant without precisely qualifying the connection that had to exist between the enterprises. In addition, the term "person or company" was used to indicate the persons included in the scope of the transfer pricing regulation, whereas in the final version of the rule the word "person" was dismissed.

Despite the significant efforts at clarification, the current provision of the TUIR still presents some critical issues giving rise to several interpretative doubts, to which a response is attempted in section 5.[32]

5. Concluding Remarks and Persistent Issues Regarding the Interpretation of the Subjective Nexus Required by Transfer Pricing Rules

The most critical issue concerns the persistence, in the legislative provision, of the deliberately undefined concept of "dominant influence".

In this respect, it is established that the dominant influence must assume the nature of a stake in the share capital or of contractual influence. Thus, while the previous wording of the rule seemed to admit that any influence over the commercial or financial decisions of the associated company was sufficient to constitute control, the current text makes it clear that a qualifying connection is required. This prevents "control" in the context of transfer pricing from assuming an excessively broad and pervasive meaning. In light of the current definition of "dominant influence", therefore, the scope of article 110(7) of the TUIR undoubtedly includes shareholders with a relative majority (provided that they are able to effectively manage the business decisions of the controlled companies) and entities which, by virtue of particular contracts, are able to influence their business partners' management and strategic guidance; this is especially the case when the termination of the contractual relationships irreversibly affects the business activity of the counterparty.[33]

Thus, the current wording of the law no longer allows transactions between associated companies linked by a significant (but not dominant) influence to fall within the scope of TP rules,[34] as was argued in the past.[35] The relevant shareholding connection is represented by voting power in the subsidiary corresponding to more than one fifth (one tenth in the case of companies listed on stock exchange); a shareholding equal to, or lower than, this threshold should not be considered as an adequate link to meet the requirement of control as mentioned in article 110(7) of the TUIR, as – by express provision of the Civil Code – it constitutes merely a "significant" influence.

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31. In such cases, several centres of economic interest can be distinguished, but the economic power of a counterparty prevails over the others. This form of control should not be relevant for the purposes of transfer pricing legislation, as there is a genuine clash of interests between the parties which is resolved by one party prevailing over the other in their mutual relations of economic strength. *See* Leotta et al., *supra* n. 2 .
32. M. Leo, *Le imposte sui redditi nel Testo Unico* (Giuffrè 2018); and D. Avolio, E. de Angelis & B. Santacroce, *Per il transfer pricing servono direttive chiare da parte dell'Agenzia delle Entrate* , Corriere Tributario 5, p. 461 (2019).
33. Consider the case of a company which, although not linked by a shareholding relationship to its customers, exclusively supplies another company with semi-finished products with high added value and which are essential to the latter's production process. In this case, the supplying company, although it does not hold shares in the counterparty, is able to exercise a decisive influence on it, conditioning its "survival". *See* Chiomenti Studio Legale, comments on the draft of the Ministerial Decree, submitted 21 Mar. 2018, available at https://www.mef.gov.it/focus/documenti/transfer-pricing/Osservazioni_su_schema_di_Decreto_TP_e_Bozza_di_Provvedimento_-_Chiomenti_CHIOM_6796054_v1.pdf (accessed 16 June 2021).
34. According to art. 2359 Civil Code, as amended by IT: Decreto Legislativo [Legislative Decree] 310 of 28 December 2004, art. 8, associated companies are those entities over which another company exercises a significant influence and "influence is presumed when the shareholder can exercise at least one fifth of votes in the ordinary shareholders' meeting, or one tenth of votes if the company has shares listed on stock exchange".
35. *See* P. Valente, *Manuale del Transfer pricing* (IPSOA 2016); and Leo, *supra* n. 32 , who takes into account the existence of such an interpretative approach, but rejects the conclusions reached through such an approach, considering them outdated.

By circumscribing the relevant economic influence within the shareholding or contractual relationships, the actual provision highlights the smaller extension of the notion of control endorsed by the current system compared to the one emerging from the indications of Circular 32/1980 and from the Supreme Court case law.[36]

In other words, the mere economic subordination of one company to another, in the absence of contractual or shareholding connections, is no longer sufficient to trigger the tax administration's power of adjustment.[37]In fact, in the light of a renewed vision of the market and its mechanisms, economic subordination between independent enterprises has come to be considered as an intrinsic part of the modern liberal economy. For example, the case of the distributor who exclusively sells the manufactured products of its single supplier (which, in the Circular of 1982, was, on the contrary, reported as an example of the existence of control) falls outside the scope of the current article 110(7): indeed, a company that purchases the products of a monopoly or of an enterprise that holds a dominant position in a particular economic sector represents a common and everyday situation in the market. In such a case, the exclusive sale, and therefore the economic subordination of the distributor, does not represent a distortion of the rules of competition, but rather reflects a situation that can be ordinarily found on the market. Extending the subjective nexus assumed for transfer pricing purposes to the aforesaid cases would lead to the application of the arm's length principle to transactions that already reflect competitive market conditions.[38]

This approach also appears to be more in line with international practice, since (as mentioned) the alignment with the principles accepted by the OECD constituted the main purpose of the legislative reform. In fact, if we accept the theoretical framework that considers the reference to "participation in control" as a mere periphrasis of the term "dominating" used in the first OECD papers, economic dependence between enterprises would not be a sufficient condition for the application of value adjustments in transfer prices: as a matter of fact, in OECD publications, the relevance of control is never referred to as exclusively based on economic relationships.

Despite the legislator's effort at clarification, some interpretative doubts still persist, concerning particular cases contemplated by neither case law nor the Italian tax authorities.

Firstly, it is not clear whether transactions between two enterprises under the direct or indirect control of the same individual can be considered "controlled". The ambiguity arises because of the elimination of the term "person" from the final text of article 2 of the Ministerial Decree of 2018. However, a careful examination of the regulatory text allows the observation that, when defining associated enterprises, article 2(a) generically refers to enterprises in which "the same person" participates in the management, control or capital, and it may be assumed that this "person" can also be an individual.[39]According to several interpreters, the inclusion of such cases, among others, in the scope of TP rules is an abuse of the legislative delegation entrusted to the Italian Ministry of Economy and Finance, as article 110(7) of the TUIR refers only to "companies" for situations of common control.[40]

In this respect,[41]the rule does not clarify whether the control or dominant influence may or may not be exercised by two or more subjects acting in concert (e.g. persons related "by blood and marriage").[42]In such a case, as none of the natural persons, separately considered, would have a stake of more than 50% in the capital, voting rights or profits of the associated enterprises, or a dominant influence over them, it should be concluded that this specific context would remain outside the scope of the tax authorities' right of price adjustment.[43]However, the anti-avoidance purpose which characterizes the TP rules might lead, on this point, to a prudently broad interpretation of the letter of the law.

Moreover, the Ministerial Decree does not address the case of 50/50 joint ventures between independent parties in which management and administrative powers are equally distributed between the partners (e.g. the partners have the right to appoint the same number of directors). In such a case, it seems that not only civil law control, but also – as recognized by the case-law

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36. *See* the research paper on transfer pricing published by the Chartered Accountants Association on 19 Dec. 2018 available at https://www.mef.gov.it/focus/documenti/transfer-pricing/20180320_CNDCEC_Consultazione_pubblica_MEF_su_TP.pdf (accessed 16 June 2021).
37. E.A. Palmitessa, *L'influenza economica quale causa sintomatica del controllo ai fini della disciplina sui prezzi di trasferimento* , Il Sole24Ore – Diritto24 (25 Mar. 2020).
38. Another clue as to the context is the absence of the authority to make adjustments in the case of "normal open market commercial terms", as stated in *OECD Model Taxation Convention on Income and on Capital: Commentary on Article 9* para. 1 (21 Nov. 2017), Treaties & Models IBFD.
39. In Circular 28/E of 2011 (answer 4.1), the administration stated that companies subject to common control by a resident individual fall under art. 110(7) TUIR; this view is shared by Avolio, de Angelis & Santacroce, *supra* n. 32 , at p. 461.
40. Comments to draft decree by Maisto e Associati, available at https://www.mef.gov.it/focus/documenti/transfer-pricing/Maisto_e_Associati-commenti_Consultazione_Pubblica_TP.pdf (accessed 16 June 2021). *See* Dwarkasing, *supra* n. 24 , according to which "associated enterprises" in art. 9 is intended to refer only to companies. *See also* K. Vogel, *Klaus Vogel on Double Taxation Conventions – A Commentary to the OECD, UN and US Model Conventions for the Avoidance of Double Taxation of Income and Capital. With Particular Reference to German Tax Treaty Practice* p. 524 (3rd ed., Kluwer Law International 1997).
41. Comments to draft decree by Ernst & Young Studio Legale Tributario, available at https://www.mef.gov.it/focus/documenti/transfer-pricing/EY_Studio_Legale_Tributario_-_Public_consultation_MEF_TP_21_marzo_2018.pdf (accessed 16 June 2021).
42. Thus Dwarkasing, *supra* n. 24 , who states that "[t]he Commentary on Articles 11 and 12 OECD Model indicates that Article 9 OECD Model does not cover relationships by blood or marriage".
43. *See* IT: CTP Milano, 15 Oct. 2012, No. 272.

– de facto control can be ruled out.[44] Specific considerations would be necessary when dissimilarities in the influence exercised by each of the partners arise (e.g. in a commercial joint venture in which one of the venturers contributes the right to use and exploit trademarks or intangibles while the other party merely contributes cash and commercial expertise). If we take into consideration the narrower meaning of the term "control", the majority view that emerged under the previous provision can be confirmed: in joint ventures in which two potentially different and conflicting interests are involved, there is no such indifference in the allocation of resources as that which characterizes the relationship between the subsidiary and the parent company, and, therefore, these situations fall outside the scope of the TP rules.[45]

Another interpretation issue[46] regards the exact scope of control resulting from "contractual connections", and whether it can also include cases of economic influence exercised by virtue of contracts having an object other than the management of the company or the regulation of voting rights. This is the case, for example, of agency, franchising and exclusive supply contracts; indeed, although they do not directly affect the management or the strategic direction of the contracting parties, they can certainly influence the survival of the economically subordinated company. In such cases, however, the prices fixed by the parties may diverge from the hypothetical values considered appropriate by reason of the exercise of a strong bargaining power by one party over the other and not as a result of profit shifting strategies of the group. Therefore, this "influence" on the contractual terms of reciprocal transactions is a result of the competitive positions of buyers and sellers, and not the consequence of an intentional violation of the arm's length principle aimed at tax avoidance. Thus, in such cases, the economic subordination existing between the companies shall not need to be tampered with, as it reflects the market positions of counterparties freely operating on the market.[47]

Finally, it should be noted that the debate on the application of the TP rules to relations between resident parent companies and PEs abroad also remains open. It is not clear, in fact, whether or not a PE of a resident company can be assimilated to a non-resident company. In the literature[48] it has been generally affirmed that TP rules do not apply to PEs, except when the resident company has opted for the branch exemption regime.[49] On the other hand, it has been also pointed out[50] that, notwithstanding the fact that the acts performed by the PE fall directly within the legal sphere of the parent company, from a tax point of view the PE is an autonomous legal entity; therefore, it should be subject to TP rules.[51] In this respect, it must be noted that, for the purpose of the correct allocation of taxable income between the parent company and the PE, the OECD's 2010 Report on the Attribution of Profits to Permanent Establishments (22 July 2010) (from which the current version of article 7 of the OECD Model derives) requires considering the PE and the company to which it belongs as independent entities in their mutual relationships, taking into account the functions performed, the assets used and the risks attributed to each of them. This implies the application by analogy (in view of the legal unity of the PE and the enterprise) of article 9 of the OECD Model and, consequently, of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017).

In conclusion, the persistence of a certain degree of ambiguity in the notion of control generates uncertainty in the evaluation of cross-border transactions. In this context, the new definition provided for by Decree-Law 50 of 24 April 2017 represents a turning point in the actions taken by the Italian legislator in the complex matter of transfer pricing, and contributes to legal certainty in alignment with the provisions contained in the OECD Model and the OECD Guidelines. The new domestic notion of "control" leads to an application of the TP rules more complaint with their rationale. They indeed should not merely aim at preventing the abuses but should pursue the proper reallocation of profits and corresponding taxing rights to countries and jurisdictions in order to avoid international double taxation. In the international field, the best policy answers are boosting cooperation on tax matters between OECD jurisdictions (by enhancing mutual agreement and cooperation procedures in carrying out TP audits across jurisdictions) and developing common approaches to the notion of control. This would support interpreters to solve the doubtful cases analysed in this article. In fact, as mentioned before, the mechanism of corresponding adjustments may be effective only to the extent that the notion of "associated enterprises" is met by both of the contracting states applying the relevant treaty. In other words, the rule contained in double taxation conventions as regards associated parties' transactions can be effective only to the extent that the concept of control applicable under domestic law is consistent with a unitary definition of associated enterprises under the applicable tax treaty. This does not, in any case, constrict the power of tax authorities to challenge cases of tax fraud and tax avoidance.

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44. M. Monaldi, *Transfer pricing, serve il collegamento* , Italia Oggi (8 Dec. 2015).
45. *See* Leotta et al., *supra* n. 2 .
46. Bagarotto, *supra* n. 22 .
47. However, for the opposite opinion, *see* Chiomenti Studio Legale, *supra* n. 33 .
48. S. Mayr & B. Santacroce, *La stabile organizzazione delle imprese industriali e commerciali* p. 373 (IPSOA 2016).
49. In just such a case, in fact, art. 168- *ter* TUIR (entitled "Exemption of profits and losses of permanent establishments of resident companies") expressly refers to art. 152 TUIR which, in para. 3, regulating the relationships between a foreign company and an Italian branch, explicitly provides that they are subject to art. 110(7) TUIR.
50. *See* G. Garbarino, *Manuale di tassazione internazionale* pp. 1138-1139 (2nd ed., IPSOA 2008).
51. The same opinion is expressed by A. Fantozzi & A. Manganelli, *Qualificazione e determinazione dei redditi prodotti da imprese estere in Italia: applicabilità della normativa dei prezzi di trasferimento nei rapport tra stabile organizzazione e casa madre* , in *Studi in onore di V. Uckmar* vol. I, p. 428 (CEDAM 1997).