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ARM'S LENGTH CHRONICLE

OECD and Transfer Pricing rules: the role of OECD guidelines in the hierarchy of sources of law

A recent Italian Supreme Court judgment (No. 26432 of 10 October 2024) clarified the role of OECD transfer pricing guidelines in the Italian hierarchy of sources of law. The outcome in itself is not surprising; however it is interesting reading the straight principle on such matter.

Facts

An Italian manufacturing company underwent a transfer pricing audit with reference to fiscal year 2008. Tax authorities contested the arm's length nature of prices charged to the foreign subsidiaries, operating as limited-risk distributors. The company applied the Comparable Uncontrolled Price (CUP) method, but tax authorities rejected this approach in favour of the Transactional Net Margin Method (TNMM), which they deemed more appropriate given the facts and circumstances of the transactions.

The case and the decision of the Court

The Supreme Court upheld the use of the TNMM, favouring it over the CUP method, affirming that the specific economic setup of the group, where the production process was centralized and the distribution was operated by related entities at low risk, justified the application of a method based on profit margins. In fact, the Court endorsed the use of the TNMM even though the taxpayer believed that conditions justified the use of the CUP method, leveraging on the strict hierarchy established by the OECD transfer pricing guidelines in force at that date (1995 version, being the tax audit – and the decision – related to fiscal year 2008).

The 1995 version of the guidelines indeed emphasized the CUP as the preferred method, considering transactional profit methods as measures of 'last resort'. Such a stringent approach was lifted starting from 2010 with the new versions of the guidelines, which now place greater emphasis on selecting the 'most appropriate method' based on the specifics of each case.
In the decision at stake, the Court ruled that taxpayers cannot rely on the OECD transfer pricing guidelines to assert an automatic preference for one method over another, considering the OECD institutional role. In fact:

(i) the OECD guidelines are not part of the formal hierarchy of legal sources in Italy unless specifically included by legislative provisions;
(ii) the OECD guidelines function as technical support and operational tools to aid in the interpretation of broader legal concepts, such as "arm's length" conditions, but they do not carry normative authority unless incorporated into national law.

Comments and broader implications

Without delving into the merits of the controversy or the suitability of the CUP versus the TNMM for the case in exam, the decision regarding the role of the OECD guidelines is open to criticism and notably diverges from legislation in force and previous case laws.
Firstly, the relevance of the OECD guidelines in the Italian regulations has grown in recent years:

- in 2010, a provision issued by the revenue agency, falling within the secondary legislation perimeter, clearly mentioned the guidelines as "relevant legislation" for transfer pricing aspects;
- a legislative decree in 2017 modified the Italian income tax code further embedding OECD principles into the Italian transfer pricing framework;
- in 2018 a ministerial decree explicitly incorporated the OECD guidelines into Italian legislation, aiming to adopt "best international practices" in the Italian tax contest. The ministerial decree fully embraces the OECD guidelines approach also when dealing with the selection of the methodologies, making clear that the taxpayer must select the most appropriate method based on facts and circumstances of the specific transaction, in line with OECD indications.

The same Supreme Court endorsed the OECD guidelines in specific decisions for transfer pricing cases in 2006 and 2007. In 2021 the judges reaffirmed that the guidelines play a pivotal role, functioning as a soft law instrument in transfer pricing analysis to promote fair taxation. Another more recent decision follows the same principle.

Key takeaways

If it is true that this decision might create uncertainty regarding the role of OECD principles in the Italian framework, the Italian transfer pricing system actually relies on the OECD guidelines. In fact:

- for any transfer pricing analysis, reference must be always made to the OECD guidelines. Italian discipline, even with its peculiarities, reflects – and is based on – best international practices;
- when selecting a method, it is true that traditional methods (such as the CUP) do not have innate precedence. At the same time, however, the technicalities to be adopted must always reflect a tailored approach to transfer pricing analysis;
- the importance of OECD principles is increasing: despite not being binding law, OECD principles keep shaping international, European and domestic tax policies, with real-world impacts on international tax practices. The EU Commission proposal for a Council Directive

aimed at harmonizing transfer pricing rules in the European market seeks both to recognize the essential role of the OECD in all the aspects governing transfer pricing and to elevate their authority to a legislative level;

- The influence of OECD guidelines is undeniable and it continues serving as critical technical references.

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