



## Italian Revenue Agency issues clarifications on the use of an “arm’s length range”

The Italian Revenue Agency, with Circular Letter No. 16/E (the “Circular”), issued on 24 May 2022 operating instructions regarding the correct definition and use of the “arm’s length range”.

In the Circular, it is confirmed that the range of indicators to be used in compliance with the arm’s length principle must be identified based on the OECD Guidelines and confirmed by the Decree of the Italian Ministry of Economy and Finance of 14 May 2018 (that sets out the general guidance for the correct application of transfer pricing rules).

More in detail, the Circular provides that:

- i. if it can be maintained that all independent entities are equally comparable to the controlled transaction, any point within the entire range (so-called “full range”) can be taken into account;
- ii. if not all companies included in the set have the same degree of comparability with the controlled transaction, the range should be narrowed using statistical tools that take account of central tendency (e.g., interquartile range), provided that a sizeable number of observations is available.

In either case (i.e., the use of the full range or the use of the interquartile range), all the points included within the range must be considered compliant with the arm’s length principle. Therefore, if the relevant indicator of a controlled transaction (i.e., price or margin) falls within such range, no adjustment should be made. If instead the price or margin of the controlled transaction falls outside such range, it is up to the taxpayer to provide suitable documentation to demonstrate that the arm’s length principle is satisfied in any event due to exceptional reasons. Otherwise, the tax administration must make an adjustment by determining the point within the range that best satisfies the arm’s length principle.

In determining such point, tax authorities have to consider that, in a range that includes results that have a high and equal degree of comparability, each point should be considered at arm’s length. Therefore, tax authorities will have to limit the adjustment to the minimum or at the maximum value of the “full range”, depending on which is closer to the value applied by the taxpayer. If the set comprises entities that do not have a high and equal degree of comparability, the tax administration can use the interquartile range but still limit the adjustment to the 25th or 75th percentile, depending on which is closer to the value applied by the taxpayer.

The Circular also states that the selection of a central value within the range (e.g., the median) must be limited to cases in which the range does not show a sufficient degree of comparability of the identified transactions, even after having narrowed the range by using statistical tools. The use of a central value must, in any case, be specifically justified by tax authorities in their assessment.

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For further information: **Maisto e Associati**

**Milan**

Piazza F. Meda 5  
20121  
T: +39.02.776931

**Rome**

Piazza d'Aracoeli 1  
00186  
T: +39.06.45441410

**London**

2, Throgmorton Avenue  
EC2N 2DG  
T: +44.207.3740299

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