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Consalter
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recent case law in respect
to free interest
intercompany loans and
how taxpayers can support
said agreements under
domestic transfer pricing
principles

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The treatment of interest-free intercompany loans under Italian transfer pricing practice evolved with conflicting interpretations. Recent case law stated that non-interest-bearing intercompany loans are not consistent with the ALP, but said agreement can be justified by business reasons and are acceptable under transfer pricing regulations, should the taxpayer be able to demonstrate that it responds to group needs and not to a strategy of transferring taxable income abroad.

Lombardy Tax Court of Justice, with decision no. 1633/4/2024, recently confirmed that transfer pricing provisions are applicable to intercompany loans granted within a group; nevertheless, non-interest-bearing loans could be consistent with the arm's length principles (also "ALP"), provided that the taxpayer demonstrates the existence of sound business reasons that justify the absence of an interest rate. The decision provides useful arguments to support the consistency of such transactions with transfer pricing regulations.

The Revenue Agency ("ITA") disputed the failure to account for interest income on loans granted to two foreign related companies by the Italian parent entity, deeming it a violation of Art. 110, par. 7, of CTA. The assessed interest income was established based on the statistical bulletin of the Bank of Italy, without taking into consideration OECD practice (actually not yet implemented under Italian domestic transfer pricing provisions).

The Tax Court accepted taxpayer's appeal, recognizing the existence of sound business reasons for the free financing. The judges identified seven key issues

supporting the transaction from a tax perspective.

Firstly, the parent company (lender) had a strategic interest in supporting the subsidiaries in order to facilitate their development and commercial success, with potential indirect economic benefits. Furthermore, the lack of a repayment term excluded comparability with a bank loan, which would have been subject to market conditions. The growing trend of credit balances and the absence of specific deadlines made the operation look like a capital contribution (see in this respect par. 10.o4 and following of the OECD Guidelines). The borrower companies recorded recurring losses, and the application of an interest rate would have worsened their financial situation.

The borrowers could not obtain credit lines from third parties due to their net financial position, making financing from the parent company the only available source of liquidity. The group was also in a difficult financial situation, with a debt restructuring agreement pursuant to art. 67 of the Italian Bankruptcy Law. Finally, for one of the two subsidiaries, the interest-free loan was part of a negotiation involving third-party credit institutions, confirming that the absence of interest was in line with the ALP and consistent with market conditions.

Also the Supreme Court, with decision no. 3223/2025, confirmed the application of the transfer pricing regulations to intercompany interest-free loans and general principles described above. According to art. 110, par. 7, of the TUIR, income deriving from transactions between related parties must be determined according to ALP, i.e. under the same conditions that would be agreed between independent parties. The Tax Agency assessed the non-recognition of interest income on loans granted by an Italian company to its foreign subsidiary, adjusting the taxable income for deemed interest income. The Tax Court of first and second instance cancelled the assessment on the grounds that ITA had not provided adequate proof of the violation of the transfer pricing regulations.

However, the Supreme Court upheld ITA's appeal, clarifying that the ALP also applies to non-interest-bearing loans. The Court referred to previous decision no. 13387/2016, that confirmed that a free loan between a resident parent company and a foreign subsidiary also falls under transfer pricing regulations, as it involves a transfer of taxable income to a foreign State.

The Supreme Court specified the criterion for allocating the burden of proof in disputes relating to intercompany financing. ITA must demonstrate that the transaction took place at a rate lower than the market rate, and the taxpayer has the burden of proving that the free interest loan was granted for sound economic reasons consistent with the group's strategy, justifying the lack of payment with business arguments.

The debate over the application of transfer pricing regulations to non interest-bearing loans has been the subject of several past Supreme Court decisions; in some cases, the Supreme Court excluded the application of TP regulations when there are no taxable incomes or undue tax savings.

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