THE TRANSFER PRICING LAW REVIEW

Editors
Steve Edge and Dominic Robertson

THE LAWREVIEWS

THE TRANSFER PRICING REVIEW

The Transfer Pricing Review
Reproduced with permission from Law Business Research Ltd.

This article was first published in The Transfer Pricing Review, - Edition 3
(published in June 2017 – editors Steve Edge and Dominic Robertson)

For further information please email
Nick.Barette@thelawreviews.co.uk

THE TRANSFER PRICING LAW REVIEW

Editors
Steve Edge and Dominic Robertson

THE LAWREVIEWS

PUBLISHER
Gideon Roberton

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
Thomas Lee, Joel Woods

ACCOUNT MANAGERS
Pere Aspinall, Sophie Emberson,
Laura Lynas, Jack Bagnall

MARKETING AND READERSHIP COORDINATOR
Rebecca Mogridge

RESEARCHER
Arthur Hunter

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Caroline Herbert

SUBEDITOR
Janina Godowska

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-910813-38-6

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

THE ENERGY REGULATION AND MARKETS REVIEW

THE INTELLECTUAL PROPERTY REVIEW

THE ASSET MANAGEMENT REVIEW

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

THE CARTELS AND LENIENCY REVIEW

THE TAX DISPUTES AND LITIGATION REVIEW

THE LIFE SCIENCES LAW REVIEW

THE INSURANCE AND REINSURANCE LAW REVIEW

THE GOVERNMENT PROCUREMENT REVIEW

THE DOMINANCE AND MONOPOLIES REVIEW

THE AVIATION LAW REVIEW

THE FOREIGN INVESTMENT REGULATION REVIEW

THE ASSET TRACING AND RECOVERY REVIEW

THE INSOLVENCY REVIEW

THE OIL AND GAS LAW REVIEW

THE FRANCHISE LAW REVIEW

THE PRODUCT REGULATION AND LIABILITY REVIEW

THE SHIPPING LAW REVIEW

THE ACQUISITION AND LEVERAGED FINANCE REVIEW

THE PRIVACY, DATA PROTECTION AND CYBERSECURITY LAW REVIEW

THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW

THE TRANSPORT FINANCE LAW REVIEW

THE SECURITIES LITIGATION REVIEW

THE LENDING AND SECURED FINANCE REVIEW

THE INTERNATIONAL TRADE LAW REVIEW

THE SPORTS LAW REVIEW

THE INVESTMENT TREATY ARBITRATION REVIEW

THE GAMBLING LAW REVIEW

THE INTELLECTUAL PROPERTY AND ANTITRUST REVIEW

THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW

THE ISLAMIC FINANCE AND MARKETS LAW REVIEW

THE ENVIRONMENT AND CLIMATE CHANGE LAW REVIEW

THE CONSUMER FINANCE LAW REVIEW

THE INITIAL PUBLIC OFFERINGS REVIEW

THE CLASS ACTIONS LAW REVIEW

www.TheLawReviews.co.uk

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ARENDT & MEDERNACH

BAKER McKENZIE

CHEVEZ, RUIZ, ZAMARRIPA Y CIA, SC

D'EMPAIRE REYNA ABOGADOS

DE BRAUW BLACKSTONE WESTBROEK

DELOITTE & ASSOCIADOS, SROC, SA

HERZOG FOX & NEEMAN LAW OFFICES

MARIZ DE OLIVEIRA E SIQUEIRA CAMPOS ADVOGADOS

MORRISON & FOERSTER LLP

NORTON ROSE FULBRIGHT CANADA LLP

SCORDIS, PAPAPETROU & CO LLC

SLAUGHTER AND MAY

SOŁTYSIŃSKI KAWECKI & SZLĘZAK – KANCELARIA RADCÓW PRAWNYCH I ADWOKATÓW SPK

STUDIO LEGALE E TRIBUTARIO BISCOZZI NOBILI

WHITE & CASE LLC

WOLF THEISS ATTORNEYS AT LAW

CONTENTS

PREFACE

It has been a great honour – and an even greater education – to be asked to edit the inaugural edition of *The Transfer Pricing Law Review*.

Since the financial crisis in 2008, there has been continuous public attention on multinationals' tax position – which, for the most part, turns on their transfer pricing policy, and whether this properly aligns the taxable profits in each country with the value-generating activities taking place there. In the past couple of years, that public and political pressure has begun to turn into concrete action: for example, through the BEPS reforms on country-by-country reporting and transfer pricing; the European Commission's state aid investigations into Apple, Starbucks and others, which almost all relate to transfer pricing matters; and, as several chapters in this review make clear, increased audit scrutiny at the national level. It seems clear that transfer pricing issues will be filling tax professionals' working lives for several years at least.

This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered. Each chapter summarises the substantive transfer pricing rules, explains how a transfer pricing dispute is handled, from initial scrutiny through to litigation or settlement, and discusses the interaction between transfer pricing and other parts of the tax code (such as withholding taxes, customs duties, and attempts to prevent double taxation).

This review contains contributions from 17 countries, covering a broad spread both geographically and economically. We are very grateful to the authors of the country chapters for lending their time and expertise to this project.

Four key themes that emerge from the country chapters are:

a More disputes: unsurprisingly, many countries (including Mexico and Poland) report an increase in transfer pricing disputes, particularly around profit allocation in a multinational supply chain.

b Profit splits: several countries (including Israel, Mexico and the UK) are seeing tax authorities push for a greater use of profit splits, particularly for high value-added activities where it may be difficult to find a precise comparable. (How you identify an appropriate share of profits for each different country is, of course, a separate challenge here.)

c TP compliance tools: many of the reporting countries have adopted rules that are designed to encourage greater transfer pricing compliance. Country-by-country reporting, which has been very widely adopted, is the prime example of this, but other instances include automatic transfer pricing penalties in Canada and Russia, and the diverted profits taxes adopted in Australia and the UK.

d Varied transfer pricing approaches: it is striking that different countries continue to apply transfer pricing in rather different ways. At one end of the spectrum, Brazil has rejected the OECD arm's-length principle entirely, arguing that imposing fixed ratios and limits is more effective. Even within the large majority of reporting countries that apply the OECD principles, however, there are differences in approach which could lead to diverging outcomes in practice. For example, Germany's transfer pricing rules apply a 'prudent and diligent managing director' test on top of the normal arm's-length principle (which has perhaps inspired the 'prudent economic operator' concept developed by the European Commission in their tax state aid investigations); and the Luxembourg chapter discusses a recent case in which an interest-free loan from Luxembourg to Italy resulted in taxable interest income in Luxembourg, with no corresponding deductions in Italy. These variations, of course, increase the risk of double taxation of the same profits – and it is thus important (if perhaps optimistic) that countries adopt the BEPS Action 14 recommendations on tax dispute resolution mechanisms with the same enthusiasm they have often shown for the tax-raising recommendations.

Finally, we would like to thank the publishing team at Law Business Research for their diligence and enthusiasm in commissioning, coordinating and compiling this review.

Steve Edge and Dominic Robertson
Slaughter and May
London
June 2017

Chapter 8

ITALY

Franco Pozzi, Lisa Vascellari Dal Fiol, Stefano Grossi and Roberta D'Angelo[1]

I OVERVIEW

Statutory rules on transfer pricing are set out in Article 110 of the Italian Corporate Tax Act (CTA). Transfer pricing rules apply to corporation tax (IRES) as well as regional tax on productive activities (IRAP), pursuant to Article 1, paragraphs 281 to 284 of Law No. 147/2013.[2] There are no separate rules for capital transactions.

Article 110, paragraph 7 has been recently restated by Law Decree No. 50/2017[3] and it presently states that items of the income statement of an enterprise derived from operations with non-resident corporations that directly or indirectly control the enterprise, are controlled by the enterprise or are controlled by the same entity[4] that itself controls the enterprise are valued on the basis of the conditions and prices that would have been agreed among third parties, at arm's length and in similar circumstances, if an increase in taxable income would arise thereby. Reductions in taxable income are allowed only in the specific cases expressly indicated by the new Article 31 *quater*[5] of Presidential Decree No. 600/1973:

a on the basis of mutual agreement procedures (MAPs) or the European Union Arbitration Convention (Convention 90/436/EEC of 23 July 1990);

b after the tax inspections carried out upon international cooperation activities whose outcomes are shared by the participating countries; or

c by filing a specific request of the taxpayer, if the transfer pricing adjustments involved a state with which Italy has in force a tax treaty to avoid double taxation that provides an adequate exchange of information.

---

1 Franco Pozzi is a partner and Lisa Vascellari Dal Fiol, Stefano Grossi and Roberta D'Angelo are associates at Studio Legale e Tributario Biscozzi Nobili.

2 Transfer pricing rules apply to resident companies and permanent establishments of foreign companies resident in Italy.

3 Law Decree No. 50/2017 was published in the Official Gazette on 24 April 2017 and is still to be converted into law by Parliament (within 60 days), but it is already in force for the time being. The previous wording referred to the concept of 'valore normale' (corresponding, in substance, to 'arm's-length principle'), which is defined by Article 9, paragraph 3 of the CTA as the average price or consideration paid for goods and services of the same or similar type, carried on at market conditions and at the same level of business, at the time and place in which the goods were purchased or the services were performed. The revised wording is more in line with the OECD Guidelines, even though it does not introduce substantial changes in the transfer pricing methodologies to be applied.

4 Please note that entities controlled by the same individuals are within the scope of the provision.

5 Introduced by Law Decree No. 50/2017. Implementing provisions are expected in the coming months.

On 22 September 1980, the Ministry of Finance issued Circular Letter No. 32/9/2267, which provides principles and methods, based on the OECD Transfer Pricing Guidelines applicable at that time ('Transfer Pricing and Multinational Enterprises', OECD 1979), to be used in determining arm's-length prices. No further clarification about the application of transfer pricing provisions has been issued by the Italian Tax Administration (ITA) since the issuance of the Circular Letter.

In relation to transfer pricing documentation, the relevant provisions were included in Law Decree No. 78 of 31 May 2010, which was subsequently regulated by the Decision of the Commissioner of the ITA dated 29 September 2010 and by Circular Letter No. 58/E of 15 December 2010. The latter expressly refers to the OECD Guidelines 2010 ('Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations'), although it does not add any new technical clarification to Circular Letter 32/1980 mentioned above.

In Italy, where a transaction is found not to be compliant with the arm's-length principle there are no specific corporate law implications; however, this could trigger legal or judicial actions aiming to protect the stakeholders' rights (i.e., due to overpayment of goods or services or accounting fraud, etc.).

As a general rule, the ITA requires the use of data from the public balance sheet and profit and loss (P&L) account. However, taxpayers carrying on several activities can use management data (taken from Enterprise Resource Planning systems) for transfer pricing documentation purposes, as this allows them to develop a breakdown of the P&L for areas of business. It should be considered that this approach can be challenged by the ITA if the taxpayers are not able to produce a reconciliation with the statutory data.

In addition, the new Italian accounting principles, deriving from Legislative Decree No. 139/2015, will have an impact mainly on financial transactions, as a direct consequence of the application of the amortised cost method.

II FILING REQUIREMENTS

In Italy, there are no specific transfer pricing returns and there are no mandatory reports to be prepared, but transfer pricing documentation is recommended as evidence of compliance with the arm's-length principle in intercompany transactions. Furthermore, if the documentation complies with specific regulations, it allows the taxpayer access to the penality protection regime provided for by Article 1, paragraph 2 *ter* of Legislative Decree No. 471 of 18 December 1997. In this regard, documentation is composed of a master file and country-specific documentation (country file). However, the documentation requirements change depending on the taxpayer (i.e., subsidiaries are only required to prepare the country file, while sub-holdings and holdings are required to prepare both the country file and the master file).

If taxpayers wish to take advantage of the penalty protection regime, they must communicate the availability of the transfer pricing documentation in their annual income tax return. In order to obtain penalty protection, the documentation must be compliant from a substantial point of view and it must follow the structure required.[6]

As a general rule, documentation for penalty protection must be updated on an annual basis, including the economic analysis, before filing the tax return for each financial year (e.g., deadline 30 September for companies with financial year ending 31 December).

6 Decision of the Commissioner of the Revenue Agency dated 29 September 2010.

Small and medium-sized enterprises, defined as enterprises with an annual turnover of less than €50 million, are entitled to update the economic analysis included in their documentation every three years, provided that no significant modifications in the comparability factors have occurred.

The filing of the documentation to the ITA must be executed within 10 days upon request. Tax auditors may also request additional information or documentation; in this case, the supplementary information must be provided within seven days upon request or within a longer time period depending on the complexity of the transactions under analysis, to the extent that the above period is consistent with the time of the audit. Once these terms have elapsed, the ITA is not bound to apply the penalty protection.

On 23 February 2017, the Italian government issued a ministerial decree that sets out the terms and conditions for filing the country-by-country report (CBCR).

III PRESENTING THE CASE

i Pricing methods

Acceptable pricing methods are those recommended by the OECD. The selection of a transfer pricing method requires an explanation of the reason for choosing such method, also arguing why the results are consistent with the arm's-length principle. Transaction-based methods are usually preferred over profit-based methods and the comparable uncontrolled price (CUP) method, if applicable, is preferred over the resale price and the cost plus methods. However, the ITA is aware of the difficulties of the CUP or the resale price method application met by the operators and so the profit-based methods (especially the transactional net margin method (TNMM)) are accepted.

From a practical point of view, proof of the consistency of the method chosen is not possible without a careful selection of comparables. The approach of the ITA is often to perform a new benchmark analysis in order to check the results obtained by the taxpayers, and the tax challenges are usually based on the median value of the set of comparables resulting from the benchmark analysis.

Since the ITA uses the databases provided by Bureau Van Dijk, taxpayers also tend to use them, except for financial transactions or operations involving intangibles (royalties, etc.) for which different databases are used in addition to or instead of the databases provided by Bureau Van Dijk.

In addition to the above, the ITA has expressly stated in Circular No. 25/E, 2014 that activities scrutinising transfer pricing matters must always be carried out with the primary aim of establishing a deeper understanding of the facts and circumstances of the case, also considering the actual economic conditions that characterise intra-group transactions. This approach is also required for managing the possible relationships with foreign tax administrations within MAPs.

ii Authority scrutiny and evidence gathering

The ITA consists of two 'entities': 'Agenzia delle Entrate' (the Italian Revenue Agency) and 'Guardia di Finanza' (the Tax Police) and they are both entitled to carry out inspections aimed at detecting infringement of the tax law.

In recent years, the ITA has increasingly been carrying out inspections of companies that belong to multinational groups, with the aim of checking the consistency of the transfer prices applied in intercompany transactions.

The approach of the ITA during tax audits is mainly oriented towards understanding the role of the Italian companies under scrutiny in the group's value chain, also through requests for clarification about the activities performed by their foreign related counterparts. This is to check the consistency of the transfer pricing methods applied and the results of the benchmark analysis. The procedure for acquiring the information usually starts from the analysis of transfer pricing documentation, agreements in force and a breakdown of their figures. Face-to-face interviews can be held with the heads of the relevant departments, also for the purposes of tax rulings or advance pricing agreements (APAs).

If necessary, additional information may be requested from the employees of the Italian company. However, in complex cases, and when the audit is carried out by the Tax Police, the tax auditors can look for evidence of the information provided by the company by asking for confirmation from third parties, such as customers or suppliers, and also through access to and inspections of the premises of the taxpayer.

For confidentiality reasons, audit results are not published.

The possibility to ask questions or request documents from taxpayers outside the Italian tax jurisdiction is, however, limited to cases of joint tax audits with the foreign tax authorities.

Nevertheless, attention paid to the group as a whole is expected to increase following the implementation of the CBCR.[7]

IV INTANGIBLE ASSETS

As a general rule, intangible assets held by each single company involved in intercompany transactions must be considered when setting the correct pricing. To this aim, when taxpayers prepare the transfer pricing documentation (master file), they are required to provide a complete list of such assets with a separate indication of any royalty received and paid, also specifying the licensor's and the licensee's names. Furthermore, the list of the assets used in a specific transaction must also be reported in the country file, together with the contractual terms.

Given the importance of intangible assets, for completeness, taxpayers are also required to describe any intangibles not reported in the financial statements (i.e., the know-how, the positive impact from synergies, the positive effects of networks, etc.). Any business restructuring that involves a reallocation of intangibles must also be included, in addition to the analysis related to the legal ownership and the time of creation of the assets.

In Italy, in recent years, there has been growing attention to matters concerning intangible assets from both sides (taxpayers and the ITA), with particular focus on the 'DEMPE' functions (developing, enhancing, maintaining, protecting and exploiting intangibles). Such functions are key issues in determining prices for controlled transactions and in determining which entity or entities ultimately will be entitled to returns derived by the multinational enterprise group from the exploitation of intangibles.

These functions are also subject to an in-depth analysis by the ITA when taxpayers apply for rulings or in the case of MAPs.

Additional to transfer pricing regulations, from 2015, Italian taxpayers may elect for a 'patent box' regime; taxpayers that apply for the patent box tax relief are required to explain to the ITA the contribution of the intangibles owned to the value creation, in order to establish the tax benefit. To this aim, taxpayers have to show both the costs incurred in

7 See BEPS Action 13.

creating, developing and protecting the intangibles, and the extra profits deriving from such intangibles. The methods deemed to be acceptable by the ITA for the calculation of the tax relief derive from transfer pricing criteria (CUP or profit split). Even if the ITA has not issued specific internal guidelines regarding intangible assets for transfer pricing purposes, further to the introduction of the patent box relief, it is reasonable to expect a more analytical approach even during ordinary tax audits on transfer pricing matters.

It should also be considered that Circular Letter No. 32/1980 (see Section I, *supra*) provides for 'safe harbour' ranges with respect to royalties paid by Italian companies for intangibles (royalties higher than 5 per cent must be justified by legal and economic conditions of the relevant agreement).

V SETTLEMENTS

General rules regarding settlements among taxpayers and tax authorities are applicable to transfer pricing assessments too. The typical settlement process, according to Legislative Decree No. 218 of 19 June 1997, takes place following a tax audit: after the notification of an assessment notice,[8] the taxpayers have 60 days to challenge the assessment before the tax court or to submit a request to the ITA in order to reach an agreement. During the 90 days subsequent to the settlement request,[9] taxpayers and the ITA can meet several times to discuss their positions and to exchange proposals. In the event an agreement is reached (before the deadline for the filing of the appeal against the assessment before the competent tax court), the settlement agreement is signed by both the taxpayer and the ITA; the taxpayer is then obliged to pay the related liability immediately.[10] The settlement involves the year(s) and the matter(s) under assessment; in the event there are multiple years under assessment, they can be dealt with either together or separately. Normally, in the case of unvaried conditions, it is in the interest of both the taxpayer and the ITA to settle all the years under assessment in the same manner.

Where an agreement is not reached, litigation continues before the tax court (see Section VII, *infra*). However, a settlement can be reached even after the beginning of the judicial procedure, until the hearings take place before the second instance tax court.

Applicable penalties[11] are reduced in case of settlement; the reduction varies depending on the timing of the agreement (reduction to one-third of the original amount before the beginning of the judicial procedure; to 40 per cent before the first instance tax court hearing; and to 50 per cent before the second instance tax court hearing).

8 After investigation activities are concluded, and before the notification of an assessment notice, tax authorities usually issue a preliminary report (PVC) addressing the proposed adjustments to taxpayer position and taxable income. After the PVC notification, the taxpayer has 60 days in which to reply with comments, observations and requests. Otherwise, the taxpayer has the opportunity to settle the audit by correcting its tax return and paying (in part or in full) the liability contained in the PVC. In such cases, the applicable penalties are reduced to one-fifth of the original amount.

9 During the 90-day period of discussion, the deadline to challenge the assessment is suspended. Note that the opportunity to request a settlement cannot be used in an opportunistic way to increase the time frame or to delay the opposition period; in case of abuse, tax authorities can decide to stop the discussion even before the 90-day period has elapsed.

10 An instalment plan can also be granted.

11 In principle, penalties should not be applicable for transfer pricing assessment, provided the taxpayer is compliant with the penalty protection regime (see Section II, *supra*).

After the signature, the settlement cannot be disregarded either by the ITA or by the taxpayer. On the other hand, settlements are not binding for future years or different matters and are not automatically incorporated into an APA; they can only represent a starting point for future discussions. Settlements are generally confidential, as well as their contents; in some cases general information about the settlements reached by large multinational groups are made available.

In the above-mentioned framework, APAs are recommended in order to reduce the risk of future assessments.[12] The ITA is currently encouraging APAs in order to prevent litigations and to avoid recourse to MAPs (which are not effective at present, due to lack of human resources; for further details see Section IX.ii, *infra*).

VI INVESTIGATIONS

Tax auditors involved in transfer pricing investigations have ordinary and broad audit powers provided by law[13] (see Section III.ii, *supra*).

Law No. 212 of 27 July 2000 provides taxpayers subject to tax audits with several rights and protections (see in particular Article 12).

A tax audit could take several months to be completed; there is a time limit, but this is often surpassed by tax inspectors.[14]

A common issue that is deeply investigated during multinational enterprises' tax inspections relates to management fees and intra-group services; in particular, in cases where costs are borne by the Italian entity in respect of such types of services, the ITA often questions the deductibility in respect thereof, based on the general principle of inherence[15] rather than on the basis of transfer pricing provisions (with consequent higher risk of non-recognition of the full costs borne by the Italian entity, rather than restatement of the pricing of the transaction).

The opportunity for tax authorities to challenge costs related to intra-group services or management fees based on the general inherence principle gives rise to three main negative consequences for taxpayers; in particular: (1) the penalty protection regime is not granted; (2) access to MAPs and arbitration is excluded; and (3) under certain conditions, criminal penalties could be applicable too.[16]

Therefore, it is very important to keep adequate documentation regarding the detailed activities performed by foreign group entities for the benefit of the Italian entity (e.g., emails, meeting reports, flight tickets, hotel bills, contracts, etc.).

12 Rulings for multinational enterprises have recently been modified by Article 31 *ter* of Presidential Decree No. 600 of 29 September 1973; the new procedure is regulated by the Decision of the Commissioner of the Revenue Agency issued on 21 March 2016.

13 Reference is made to Presidential Decree No. 600 of 29 September 1973.

14 In principle, investigations based on physical access to the taxpayer's premises cannot last more than 30 days – even when not consecutive. This can be extended for an additional 30 days only, in case of particular needs.

15 As a general rule, the CTA allows deductions of costs only to the extent they are connected to the taxpayer's activity and to the extent they refer to services that have actually been rendered.

16 However, it must be noted that different tax offices could assume inconsistent positions on such matter.

As a general rule,[17] a tax assessment must be issued by the end of the fifth year of the date of filing of a tax return;[18] as a practical example, the assessment for a tax year ended on 31 December 2016 has to be completed by 31 December 2022 (since the tax return must be filed by 30 September 2017).[19]

VII LITIGATION

i Procedure

Tax assessments may be settled by reaching an agreement with the ITA (see Section V, *supra*) or directly challenged before the tax court.

The typical litigation process involves the following steps (briefly described):[20]

a challenge before the tax court of first instance (usually represented by the provincial tax court of reference for the taxpayer's domicile) within 60 days of the notification[21] of the tax assessment;

b first instance tax court hearing: it usually takes place several months (at least six months but up to two years, depending on the workload of the specific court) after the presentation of the petition to the court;

c first instance decision: it is usually issued between three months and one year after the hearing;

d the losing party can then appeal the first instance decision with the tax court of second instance (usually represented by the regional tax court of reference for the taxpayer's domicile); the deadline to file the appeal is six months after the decision has been issued;[22]

e second instance tax court hearing and decision: the procedure and timing are similar to the first instance hearing and decision; and

f the losing party can then apply to the Supreme Court for the final decision on the litigation; the deadline for filing an appeal is six months after the second instance decision has been issued.[23]

Tax litigations usually take at least five years. Decisions of the courts of first and second instance are based on facts, while the Supreme Court's decisions can only refer to matters of law. Before assuming their positions, the tax courts are allowed to engage independent experts in order to analyse the case, although it is not a very common practice.

17 Reference is made to Article 43 of Presidential Decree No. 600 of 29 September 1973.

18 In the event the filing of the tax return has not been done, the deadline for the tax assessment is the end of the seventh year of the date in which the tax return should have been filed.

19 For previous fiscal years different terms are applicable.

20 The relevant provisions regarding the tax litigation procedure are contained in Legislative Decree No. 546 of 31 December 1992.

21 Summer holiday suspension (from 1 to 31 August) should also be considered.

22 The term is reduced to 60 days in case of formal notification of the decision by the winning party.

23 The term is reduced to 60 days in case of formal notification of the decision by the winning party.

After the decision of the Supreme Court, in principle there are no further opportunities to discuss the litigation.[24] Partial payments are imposed by law during the judicial procedure;[25] in the event the taxpayer is the winning party, such payments are reimbursed by the ITA.

ii Recent cases

Generally speaking, transfer pricing litigations by the Supreme Court in Italy have been limited; the reason is that the tax courts do not have specific and in-depth knowledge of transfer pricing matters and consequently taxpayers often prefer to settle the assessment (before or during the judicial procedure) with the ITA, rather than bear the risk of an adverse decision.

The main issues related to transfer pricing dealt with by the Supreme Court in recent years are:

a transfer pricing regulation as an anti-avoidance provision and burden of proof in transfer pricing assessment (e.g., Supreme Court No. 2805, 5 February 2011; Supreme Court No. 11949, 13 July 2012; Supreme Court No. 10739 and No. 10742, 8 May 2013; Supreme Court No. 22010, 25 September 2013; Supreme Court No. 15282 and No. 15298, 21 July 2015; Supreme Court No. 16398, 5 August 2015; Supreme Court No. 6311, 1 April 2016; Supreme Court No. 7493, 15 April 2016; Supreme Court No. 13387, 30 June 2016; Supreme Court No. 26545, 21 December 2016): the main position of the Supreme Court is to consider transfer pricing regulation as a safeguard of the principle of fair competition among countries, rather than as an anti-avoidance provision (regardless of the tax rate of the foreign country involved in the case). As far as the burden of proof is concerned, the Supreme Court in most cases stated that it shall be fulfilled by the taxpayer, based on the assumption that the latter has a closer and deeper knowledge of facts, with particular reference to the deduction of costs;

b the scope of domestic transfer pricing provisions (Supreme Court No. 17955, 24 July 2013; Supreme Court No. 8849, 16 April 2014; Supreme Court No. 13475, 13 June 2014): the main position of the Supreme Court in the past was to consider transfer pricing provisions as general rules, applicable even to transactions among resident entities; the issue has finally been clarified by Legislative Decree No. 147 of 14 September 2015,[26] which expressly excludes the application of transfer pricing provisions to domestic transactions;

c intra-group services and shareholders' loans (Supreme Court No. 16480, 18 July 2014; Supreme Court No. 27087, 10 December 2014; Supreme Court No. 15005, 17 July 2015; Supreme Court No. 7493, 15 April 2016; Supreme Court No. 13387, 30 June 2016): the Supreme Court position confirms the applicability of transfer pricing provisions even to non interest-bearing loans granted by shareholders.

24 In exceptional and specific cases identified by law, even the decision of the Supreme Court could be reviewed.

25 Under certain conditions, a petition to suspend the collection of the partial payments can be submitted either to the competent court or to the ITA.

26 See, in particular, Article 5, paragraph 2.

The positions of the provincial and regional tax courts are very fragmented and do not represent reliable precedents, since Italy is a civil law country; however, some recent tax courts' decisions make reference to transfer pricing methods, validating the use of the TNMM where transactional methods are not applicable.

VIII SECONDARY ADJUSTMENT AND PENALTIES

In Italy there are no specific provisions for secondary adjustments and, in practice, they are not applied.

On the other hand, if, in the event of a tax assessment, the documentation provided (master file and/or country file) is considered not to be compliant with Law Decree 78/2010 by the ITA, ordinary administrative penalties are applied, ranging from 90 per cent up to 180 per cent of the assessed higher income. Taxpayers can submit preliminary comments on the results of the tax audit, before their formalisation in a tax assessment. After the notification to the taxpayer of the tax assessment is made, penalties can be challenged during a subsequent litigation (see Section VII, *supra*).

From a criminal law perspective, penalties are applicable to any director signing the relevant tax returns if certain conditions, set out in Article 4 of Law 74/2000, are jointly met. In principle, provided that transfer pricing documentation complies with the Italian regulations, criminal consequences should be excluded. Thus, the wording of Article 4 is somewhat unclear and some tax offices are still giving notice of criminal offence to the competent public prosecutor. However, in the event of an agreement with the ITA before starting a formal litigation before the competent tax courts, it is becoming common practice for public prosecutors to stop any criminal law procedures.

IX BROADER TAXATION ISSUES

i Diverted profits tax

There are no current provisions in Italy regarding diverted profit tax. Profits that are deemed to be realised in Italy (even by non-resident entities)[27] are subject to IRES and – to the extent they are related to activities performed in Italy – to IRAP.

There are specific additional anti-avoidance provisions aimed at addressing possible profits shifted to foreign countries, among which are: controlled foreign corporation rules; presumptions regarding the residence of foreign incorporated entities; and permanent establishment provisions. Such provisions have a broader scope than transfer pricing regulations, since they are enforceable even in the absence of controlled transactions.

ii Double taxation

Double taxation represents a very important issue for multinational enterprises in Italy, since international dispute resolution instruments are not effectively implemented, due to a lack of human resources. In principle, there are two different applicable procedures: (1) the EU

27 With the exception of individuals.

Arbitration Convention,[28] in case of disputes concerning cross-border issues involving other EU countries; and (2) MAPs provided by bilateral treaties (mainly based on Article 25 of the OECD Model Tax Convention) in cases involving non-EU countries.

The two procedures differ in several aspects, among which the most important are:

a scope of application: the procedure under (1) is applicable with reference to transfer pricing litigations only, while the procedure under (2) is applicable to all the matters covered by the specific treaty (including transfer pricing);

b mandatory result: in principle, in the procedure mentioned in (1) there is a mandatory arbitration phase, after two years of unsuccessful negotiations among the litigating countries; on the other hand, in the majority of the present tax treaties signed by Italy[29] there is no mandatory arbitration, consequently the dispute might not be resolved in event the litigating countries are not able to reach an agreement; and

c interactions with domestic litigation procedure:[30] the procedure mentioned in (1) is an alternative to domestic litigation, meaning that the result is binding both for the taxpayer and tax administrations; on the other hand, in principle any agreement reached pursuant to the procedure under (2) is not binding for the taxpayer, who can decide to refuse it and go through the domestic litigation procedure.[31]

In both cases (1) and (2), a recent provision regarding suspension of the domestic litigation procedure should apply.[32]

In addition, further guidance is expected after the implementation of the recent OECD multilateral convention; reduction of double taxation cases is also expected further to the new Article 31 *quater* of Presidential Decree No. 600/1973 (see Section I, *supra*).

An alternative way to prevent double taxation is represented by bilateral or multilateral APAs; the ITA is currently encouraging such agreements and the number of cases submitted to the competent revenue office has recently increased. On the other hand, it is worth remarking that in the current framework there are countries with which a bilateral agreement cannot be actually reached according to ITA feedback (e.g., China) and that bilateral and multilateral APAs take a longer time to be concluded than unilateral APAs.[33]

In principle, there is no possibility to avoid double taxation in cases of unilateral settlements (i.e., agreements concluded after tax assessments among the taxpayers and tax administration of a specific country).

---

28 Reference is made to EU Convention No. 90/436/CEE, which has been implemented in Italy with Law No. 99 of 22 March 1993.

29 Only a few treaties in force among Italy and foreign countries include an arbitration phase, which can be either discretionary or mandatory (e.g., Armenia, Canada, Chile, Croatia, Hong Kong, Jordan and the United States).

30 The matter is analysed in depth in Circular Letter No. 21/E issued by the Italian Revenue Agency on 5 June 2012.

31 In such cases, particular attention has to be paid to the expiry of terms to challenge the assessment and to discuss the controversy before the national courts (for more details, see Section VII, *supra*).

32 Reference is made to Article 39, paragraph 1 *ter* of Legislative Decree No. 546/1992.

33 Based on the last official report on international rulings, issued by the Italian Revenue Agency on 19 March 2013 (reference is made to 'Bollettino del Ruling di standard internazionale – II edizione'), there were 19 bilateral APAs under discussion as at 31 December 2012; the countries involved were: the United States (four requests), Germany and Switzerland (three requests each), Japan, the Netherlands and Sweden (two requests each), France, Spain and the United Kingdom (one request each).

iii Consequential impact

Italian legislation does not expressly address the VAT impacts of adjustments made for transfer pricing purposes; pursuant to the applicable law, the VAT taxable base is represented by the contractual consideration;[34] in general, adjustments made by the tax authorities can take either the form of price adjustments (difference affecting the prices of specific products or services sold, purchased or rendered by the company) or profitability adjustments (difference on the companies' margins so as to align them to the benchmark profitability).

In the first case, the adjustment can have an impact on the VAT side (both in case of products sold and services rendered) as well as on the customs side; instead, in the second case (profitability adjustments) the adjustment should be excluded from VAT and from the customs taxable base.

From a customs perspective, on 6 November 2015 a circular was issued by the Italian Customs Authority in order to reconcile the OECD transfer pricing methods used for tax purposes with the methods provided by European customs legislation. After summarising the main provisions concerning the determination of customs value to declare, the circular states that the OECD methods are deemed to be acceptable by Customs especially with reference to the traditional transaction methods. However, profit-based methods (i.e., the TNMM) could also be acceptable should specific conditions be met.

Furthermore, the circular proposes the use of two alternative procedures provided by European customs legislation (i.e., the European Customs Code and its implementing provisions) in order to handle the transfer pricing adjustments problem. In particular, the analysed procedures are contained in:

a Article 76 letter a) of the European Customs Code Customs Code and Article 254 et seq. of Council Regulation (ECC) No. 2454/1993, according to which the business operator can file a customs declaration, both for import and export transactions, omitting some elements or documents to be transmitted a second time and within a specific term; and

b Article 156 *bis* of Council Regulation (ECC) No. 2454/1993, stating the possibility for the business operator, only in import transactions, to make a lump-sum payment.

Both procedures are to be authorised by Customs.

X OUTLOOK AND CONCLUSIONS

In the above scenario, the following issues should be highlighted.

The increasing attention of the ITA to multinational groups and cross-border matters in general has entailed a greater focus on the tax risks deriving from transfer pricing matters. The ITA has become more skilled in transfer pricing matters and the OECD Guidelines; moreover, particular attention has been paid to intangibles since the introduction of the patent box regime.

As such, transfer pricing assessments have improved in terms of technicality and precision of the challenges. On the other hand, domestic judicial procedures are very long and uncertain, and at the same time, international dispute resolution instruments are not

34 Reference to the 'arm's-length principle' for VAT purposes is provided in exceptional cases only (Article 13, paragraph 3 and Article 14 of the VAT Code).

effective; as a consequence, multinational groups very often face a high risk of double taxation. The actual impact of the new Article 31 *quater* of Presidential Decree No. 600/1973 is still uncertain in the absence of the relevant implementation provisions.

In such circumstances, the importance of APAs is growing so as to reach a good degree of assurance, even though timing could become a material issue.

On the practical side, it would be helpful if the ITA aligned its internal procedures to the ever changing economic environment and also released additional guidance regarding specific issues and business sectors consistent with the OECD Guidelines. In fact, the only substantial documentation (Circular Letter 32/1980) still applied by the tax auditors (see, for example, the safe haven rules for royalty payments) was issued a long time ago and is anachronistic with respect to the current worldwide market conditions.

Appendix 1

ABOUT THE AUTHORS

FRANCO POZZI

Studio Legale e Tributario Biscozzi Nobili

Franco Pozzi graduated from the Università Commerciale Luigi Bocconi di Milano in 1993 with a degree in economics. He has been enrolled in the Register of Chartered Accountants of Busto Arsizio since 1993 and has been an auditor since 1999. He joined Studio Legale e Tributario Biscozzi Nobili in 1993 and was made partner in 2001. Franco's expertise includes domestic and international restructuring, transfer pricing, and tax issues related to artists and sportspersons. He regularly speakers at seminars and is the author of a publication on international tax matters. Franco is currently president of the statutory auditors of Poligrafici Editoriale SpA (a listed company).

LISA VASCELLARI DAL FIOL

Studio Legale e Tributario Biscozzi Nobili

Lisa Vascellari Dal Fiol graduated from the Università Commerciale Luigi Bocconi di Milano in 2008 with a degree in economics. She has been enrolled in the Register of Chartered Accountants since 2013. She joined PricewaterhouseCoopers in 2007, then worked at Studio per il Controllo Contabile. She joined Studio Legale e Tributario Biscozzi Nobili in 2011.

In 2012 Lisa completed a master's degree in corporate tax law *cum laude* at the Università Commerciale Luigi Bocconi di Milano. She attends the Law Faculty at Milan University. Her experience includes domestic and international corporate and tax matters, IFRS and transfer pricing.

STEFANO GROSSI

Studio Legale e Tributario Biscozzi Nobili

Stefano Grossi graduated from the Bocconi University of Milan in 2002 with a degree in economics. He also completed a master's degree in international taxation in 2017. He has been a chartered accountant and auditor since 2007. He has worked as a tax consultant for various legal and tax firms in Milan. He has been a tax consultant at Studio Legale e Tributario Biscozzi Nobili since 2017. Stefano's expertise includes transfer pricing consultancy and cross-border tax matters.

ROBERTA D'ANGELO

Studio Legale e Tributario Biscozzi Nobili

Roberta D'Angelo graduated from LIUC University – Castellanza (VA) in 2005 with a degree in economics. In 2010 she completed a master's degree in international tax and transfer pricing at Queen Mary University of London. She has been a member of the Chartered Institute of Taxation of London since 2011. She has worked in at various Big Four consulting firms in Italy and the UK. Roberta has been a chartered accountant and auditor since 2017. She joined Studio Legale e Tributario Biscozzi Nobili in 2014 and specialises in transfer pricing consultancy.

STUDIO LEGALE E TRIBUTARIO BISCOZZI NOBILI

Corso Europa, 2
20122 Milan
Italy
Tel: +39 02 7636931
Fax: +39 02 780146
franco.pozzi@slta.it
lisa.vascellari@slta.it
stefano.grossi@slta.it
roberta.dangelo@slta.it
www.slta.it