

# Transfer Pricing Country Summary Italy

February 2018

## Legislation

### Existence of Transfer Pricing Laws/Guidelines

Transfer pricing legislation is laid down in Article 110, Para. 7, of the Italian Income Tax Act, expressly referring to the arm's length principle. A number of rules related to transfer pricing were issued from 1980:

- Circular No. 32/1980 that transfer pricing transactions should occur between an Italian entity and a foreign entity;
- Law-decree No. 78 dated 31 May 2010, converted into law No. 122 of 30 July 2010 harmonizing the Italian landscape with the OECD Transfer Pricing Guidelines;
- Decision of the Commissioner of the Italian Revenue Agency No. 2010/137654 dated 29 September 2010 providing the transfer pricing documentation requirements;
- Circular No. 58/E dated 15 December 2010, which provides clarification on the expected documentation;
- Circular No. 21/E dated 5 June 2012, settlement of international tax disputes;
- The 2014 Stability Law includes changes regarding transfer pricing rules applied for the computation of the Regional Tax on Productive Activities (IRAP);
- Legislative Decree n.147/2015, dated September, 14<sup>th</sup> 2015, in force since October, 7<sup>th</sup> 2015. The main provisions of the decree are about Advanced agreements for Multinational Enterprises and superseded the so-called international ruling standard;
- Budget Law 2016 (also known as the Stability Law) dated 28 December 2015 implementing a country-by-country reporting requirement;
- Regulation of the Italian Revenue Office No. 42295 dated 21 March 2016 contains provisions for the application of the rules on advance pricing agreements (APAs) for enterprises with international activities;
- Law Decree No. 32 dated 15 March 2017 considers the mandatory automatic exchange of tax information in the context of cross-border preventive rulings and transfer pricing agreements;
- Article 59 of Law-Decree No. 50 dated 24 April 2017 that include a number of transfer pricing measures in order to align Italian law with the OECD standards;
- Guidance (No. 275956) issued by the Italian Revenue Agency on 28 November 2017 setting forth instructions for filling country by country reporting in Italy;
- The Ministry of the Economy and Finance and the Italian Revenue Agency on 22 February 2018 launched a public consultation on transfer pricing, with regard to the implementation of the provisions of Article 110, paragraph 7 of the TUIR and Article 31-*quater* of the D.P.R. n. 600/1973. This consultation phase will end on 21 March 2018.

### Definition of Related Party

A civil law notion of control is given by Article 2359 of the Civil Code, however limited to the hypothesis of mere corporate control. The following definitions are applicable in the Italian transfer pricing regulations:

- a) "*Holding Company belonging to a Multinational Group*" shall mean a company resident, for fiscal purposes, within the territory of the State, which:

- Is not controlled by another commercial company or enterprise, that is an entity having a juridical nature, which carries out commercial activities, wherever resident;
  - Controls, even by means of a sub-holding, one or more companies not resident for fiscal purposes within the territory of the State;
- b) *"Sub-holding Company belonging to a Multinational Group"* shall mean a company resident, for fiscal purposes, within the territory of the State, which:
- Is controlled by another commercial company or enterprise or by another entity having a juridical nature, which carries out commercial activities, wherever resident;
  - In turn, controls one or more non-resident companies, for fiscal purposes, within the territory of the State;
- c) *"Controlled Company belonging to a Multinational Group"* shall mean a company or enterprise resident for fiscal purposes, within the territory of the State, which:
- Is controlled by another commercial company or enterprise or by another entity having a juridical nature, which carries out commercial activities, wherever resident;
  - Does not control other companies or enterprises not resident for fiscal purpose, within the territory of the State.

The above definitions are of importance to the scope of the documentation requirements; please refer to Level of Documentation section for more details.

The Italian Tax Authorities gave a rather extensive interpretation to the concept of *"control"*, through their Circular N. 32/1980, deeming that the transfer pricing regime was applicable to all such cases in which a set of circumstances was indicative of a given company's influence, even if only potential, over the entrepreneurial decision of another.

The Supreme Court aligned itself with the position of the tax authorities through its ruling N. 8130 of April 22, 2016, by upholding the Second Instance judges' ruling, pursuant to which the civil law notion of corporate control was not binding and therefore, transfer pricing rules should have been rightfully and duly applied. In the particular case at issue, being in and of itself devoid of any commercial structure, had entrusted the foreign company, with the distribution of its own products – on an exclusive basis – which ultimately occasioned some of the hypotheses included under Circular N. 32/1980. Pursuant to the Supreme Court, the lack of any definition in the norm ruling the *"control"* concept is hence indicative of Legislator's manifest and intentional choice not to bind the notion of tax control to that of the Italian Civil Code; in fact, for such cases in which the civil law concept of control appears to be relevant, the various TUIR rules specifically refer back to Article 2359 of the Italian Civil Code.

The choice, in the judges' opinion, appears to be instrumental to the goals pursued by the tax legislator, by the tax legislator, which are certainly different from the ones aimed at by the civil law provision, since the latter's purpose is to help the transfer pricing regime become more adaptable also to cases in which one enterprise affects the entrepreneurial decisions of another, regardless of the stringent requirements set forth by civil law. Within such kind of framework, it is quite evident that a control concept delimited by contractual or shareholding obligations is far too restrictive. Hence, the concept of *"control"* must be extended to all hypotheses of economic influence that may be inferred from the single circumstances.

## Transfer Pricing Penalties

No transfer pricing specific penalties apply. General penalty provisions can result in penalties from minimum 90% to maximum 180% of the additional tax due as a result of a transfer pricing adjustment. No interest is charged on penalties, but on the additional taxes generated by transfer pricing adjustments.

Legislative Decree No. 74 of 10 March 2000 permits tax inspectors to refer assessments to the public prosecutors to explore possible criminal tax law implications.

Article 26 of law-decree No. 78 of May 31, 2010 provides that, in the case of a transfer pricing assessment, no penalties will be levied if the taxpayer both complies with specific documentation requirements and a specific communication is filed with the Italian tax authorities.

In accordance with the Budget Law for 2016, non-compliance with the Country-by-Country reporting obligations, the administrative sanctions amounting to € 10.000 – € 50.000. Non-compliance may refer for example to lack of filing of Country-by-Country Reporting or provision of incomplete or inaccurate information.

The disapplication of penalties is linked to the revenue office's assessment on the suitability of the TP documentation provided.

Suitability must be ascertained from a formal standpoint based on:

- The consistency of the documentation compiled by the taxpayer;
- The nature and structure of such documents set forth in explanatory regulation issued by the Italian Revenue Agency issued on September 29 2010 (Measure 137654/2010); and
- A substantial perspective, examining the suitability of the documents compiled by the taxpayer to provide the revenue office with whatever data and findings that will be necessary to carry out a comprehensive and thorough analysis of the transfer prices that were actually applied.

## Advance Pricing Agreement (APA)

Unilateral and bilateral APA are available. No fee is charged on APA application. APAs can be concluded with the Italia tax authorities by: Italian resident companies or non-Italian resident companies which carry on or have the intention to carry on their business activity in Italy through a permanent establishment. The aims of APA can be: determine the methodology; attribution of profits to a permanent establishment in another state of an Italian company or determine the payment to foreign subjects residing in Italy or the receipt from a foreign subject residing in Italy, of dividends, interests, royalties and/or other income.

According to the Legislative Decree n.147/2015, the advance agreements provides:

- the definition of arm's-length price in intercompany transactions;
- the applications of norms on the allocation of profits or losses to the permanent establishment in another state, as well as on the payment to or receipt by nonresidents of dividends, interests, royalties, and other income components; or
- prior definition of entry or exit values for residence transfers.

The legislative framework of Preventive Agreements has been upgraded by virtue of the so-called "*Internationalization Decree*" (Legislative Decree N. 147/7.10.2015) and its implementing regulation, i.e. Regulation N. 42295/21.3.2016 of the Italian Revenue Agency (IRA).

The Internationalization Decree introduced the "*Preventive Agreements for Enterprises with International Activities*" (Preventive Agreements), substituting the previous "International Tax Ruling" (as per Art. 8 of Law Decree N. 269/2003). Presidential Decree N. 600/1973, where the aforementioned Internationalization Decree added Art. 31-ter, regulates the new instrument.

The Preventive Agreement shall be in principle valid for 5 years including the year of execution.

It may also have retrospective effect in the following cases:

- it follows conclusion of agreement(s) with foreign tax authorities in the context of Mutual Agreement Procedure (MAP) under a Treaty; or
- it is based on the same factual and legal circumstances existing before its execution.

## Documentation and Disclosure Requirements

### Tax Return Disclosures

The availability of transfer pricing documentation must be disclosed to the tax authorities. Intercompany transaction volumes must also be disclosed.

In addition, to be protected against penalty regime, companies should tick the box in the income tax return form, which indicate that it has prepared proper documentations.

### Level of Documentation

The Transfer pricing documentation includes:

- the Master File;
- the National File;

And also the Country-by-Country reporting.

The Master File shall contain information about the group and shall be structured as follows:

1. General description of the Multinational Group ;
2. Group structure;
3. General strategies pursued by the Group and any changes of strategy compared to the prior financial year;
4. Flow chart of the intercompany transactions;
5. Intercompany transactions;
6. Functions, assets and risks;
7. Intangible assets;
8. Transfer pricing policy;
9. APAs and rulings concerning transfer pricing with the tax authorities of EU Member States.

It is possible to deliver more than one Master File if the MNE operates in different sectors each of them being governed by specific transfer pricing policies.

The National File shall contain information about the company and shall be divided as follows:

1. General description of the company;
2. Sectors in which the company operates;
3. Operational structure of the company;
4. General strategies pursued by the company and any changes of strategy compared to the prior financial year;
5. Intercompany transactions;
6. Cost Contribution Arrangements.

The Country-by-Country Reporting shall contain information about:

1. Amount of revenue;
2. Profit and loss before income tax;
3. Income tax actually paid;
4. Income tax accrued;
5. Stated capital;
6. Accumulated earnings;
7. Number of full-time employees and;
8. Net book values of tangible assets.

The first tax year of application of the regime about Country-by-Country Reporting in Italy is 2016.

The obligations about Country-by-Country Reporting refer exclusively to Italian parent companies of MNE Groups that:

- have annual revenue equal to or exceeding € 750 million per year starting from 1 January 2015;
- are required to file group consolidated financial statements;
- are not controlled by any other entities.

Holding companies or permanent establishments of holding companies are required to present the Master File as well as the National File. If the threshold revenue (€ 750 million) is exceeded the Italian parent companies have an unconditional obligation to file Country-by-Country Reporting with the Italian Revenue Agency.

Sub-holding companies and permanent establishments of sub-Holding companies are required to present the Master File as well as the National File. A sub-holding company can present together with the National File, the Master File prepared by its non-resident holding company.

Controlled companies and permanent establishments of controlled company are only required to present the National File. The Italian subsidiaries have to comply with Country-by-Country Reporting obligation only in case the Italian Revenue Agency is unable to obtain Country-by-Country Reporting or equivalent report regarding the respective multinational group from another source, e.g. in lack of equivalent obligation of the parent company in its residence jurisdiction.

## Record Keeping

Records must be kept for at least 10 years.

## Language for Documentation

Both the Master File and the National File have to be written in Italian. The Master File of a sub-holding can be presented in English when presenting the Master File of a non-resident company. Attachments can also be presented in English. Attachments in any language other than Italian or English have to be translated into Italian. No specific formats are prescribed for Country-by-Country Reporting, but it should

be drawn up in at least one official EU language (in Italy both Italian and English).

## Small and Medium Sized Enterprises (SMEs)

SMEs are defined as companies with turnover or revenues of maximum EUR 50 million.

SMEs have the right not to update the information relevant to the transfer pricing method for the two years following the year concerned if both:

- the comparability analysis is based on publicly available sources; and
- the key features of goods and services, the analysis of the functions, assets and risks, the contractual terms, the economic conditions and the strategies of the company do not undergo significant changes.

## Deadline to Prepare Documentation

Generally deadline for the submission of the tax return is the 30 September of the year following the tax years. Transfer pricing documentation must be prepared simultaneously with the tax return.

Deadline for the submission of Country-by-Country Reporting is due 12 months from the last day of the relevant tax year, this, in essence, implies that the first Country-by-Country Reporting shall be filed in Italy by the end of 2017.

## Deadline to Submit Documentation

Upon request of the tax administrative, taxpayers must supply the transfer pricing documentation within 10 days and any supplemental information within seven days or other terms agreed with. According to the Italian law tax audits must be finalized in a maximum of 30 working days, which can be extended by additional 30 days.

## Statute Of Limitations

According to the 2016 stability law, a tax assessment for income tax can be issued up to 31 December of the fifth year following the year when the relevant tax return was submitted to the tax authorities. In case of failure to file annual tax return, the statute of limitations is extended to 31 December of the seventh year following the year in which the tax return should have been filed. For the fiscal years prior to 2016 still are subject to the previous rules: the statute of limitations is 4 years following the tax year and one year extension is granted in case of failure to file annual tax return. This period is double if taxpayers incur in criminal tax purposes, under certain conditions.

## Transfer Pricing Methods

Transfer Pricing Methods in the OECD Transfer Pricing Guidelines 2017 is fully adopted, including transaction-based methods and profit-based methods although the Circular No. 32/1980 considers the hierarchy of methods.

Transaction-based methods are preferred to profit-based methods, CUP method is preferred to other methods. Sufficient explanations must be given in case it is possible to apply CUP or any other transaction-based methods but the company chooses to apply profit-based methods.

## Comparable

If the tested party is located in Italy, there is a preference for Italian comparable. However, Italian Tax Authorities accept the use of pan-European comparable.

## Relevant changes to the TP framework in Italy

Until the Law Decree No. 50/2017 the relevant provision implied the principle of open market conditions, regulating by reference to other provisions of the Italian Income Tax Code including it (art. 9). Following the recent amendment, the provision explicitly refers to such principle. In particular, according to the amended provision, profit from transactions between Italian enterprises and related foreign enterprises shall be estimated *"by reference to the conditions and prices that would have been agreed between subjects operating in open market conditions under comparable circumstances"*.

Further guidance on the transfer pricing criteria and methods, in line with the respective OECD Guidelines, is foreseen to be provided by virtue of future ministerial decree.

It arises that the above outlined legislative intervention aimed at:

- Further aligning the Italian transfer pricing regime with the relevant OECD Guidelines, as updated in 2010, taking into account most recent considerations in the context of the base erosion and profit shifting (BEPS) projects;
- Provide undated guidance at a domestic level as regards the application of the transfer pricing regime. It is worth noting that the latest relevant circular was issued in 1980, following publication of the 1979 OECD Guidelines, introducing the open market conditions' principle in the context of transfer pricing evaluations and adjustments.

Apart from the above, an additional amendment introduced in Italy by virtue of the same recent legislation refers to transfer pricing adjustments by foreign enterprises related to Italian ones and involved in transactions therewith implying decrease of the Italian taxable base. The amendment seeks to allow adjustment in Italy without activation of mutual agreement procedures (MAP).

Consequently, in case of such adjustment, the corresponding decrease of the taxable income of the Italian enterprise may be recognized either through the (traditional) MAP or in one of the following ways:

- With the conclusion of audits effected in the context of international cooperation which outcomes are to be shared among the cooperating states;
- Following application of the taxpayer in case the adjustment is definitive, in accordance with the arm's-length principle and leading to increase of the taxable base in foreign jurisdiction. It is a precondition that a convention for the avoidance of double taxation (DTA) is in effect between Italy and such foreign jurisdiction, providing for exchange of information.

Both the amendment, decrease of the taxable base in Italy following transfer pricing adjustment by foreign jurisdiction was allowed only in case of agreement with the foreign competent authorities in the context of MAP under applicable DTA.

The amendment aims at warranting to multinational corporations elimination of double taxation in case of transfer pricing adjustments, regardless of MAP (as per art. 25 of the OECD Model Tax Convention). Such guarantees are particularly important in view of the ongoing revision of MAP in the context of the **BEPS** project.

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