Italy

Transfer Pricing & Dispute Resolution

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Latest Information:

This chapter is based on information available up to 6 May 2019. Please find below the main changes made to this chapter up to that date:

The Italian Ministry of Economy and Finance launched a public consultation on the implementation measures associated with the application of domestic transfer pricing provisions.

Italy signed the MLI.

1. Introduction

1.1. Overview of TP documentation procedure

See Italy – Transfer Pricing section 13.

1.2. Overview of local dispute procedure

1.2.1. Availability of international procedures and relief from double taxation

Ex ante measures: Advanced pricing agreements

Italian companies have increasingly sought refuge in advance pricing agreements (APAs), which provide the opportunity to agree in advance on transfer prices with the Revenue Agency (RA). According to the RA 2013 International Standard Ruling Report,[1] almost 135 APA ruling requests have been filed since the programme was introduced in Italy in 2004.

An APA, which is binding on the taxpayer and tax authorities, remains in force for 5 years starting from the tax period in which it is signed or, under certain circumstances, starting from the tax year in which the application was submitted (*see* section 5.2.3.).[2] For the period during which the agreement is valid, the RA may not challenge the transfer prices of the transactions covered by the APA, although the tax office will monitor the Italian company in order to ascertain whether the terms of the APA are being respected.

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1. RA, *Bollettino del Ruling di standard internazionale, II edizione* (19 Mar. 2013) (the latest available version at the time of writing).
2. Art. 31-ter (2) Presidential Decree 600 of 29 Sept. 1973.

At the end of the period of validity of an APA, and at least 90 days before it expires, the taxpayer may submit an application for renewal.[3]

Reference can be made to section 5.

Ex post measures: Mutual agreement procedure

Double taxation arising from adjustments to profits of associated enterprises based on Italian transfer pricing law may be resolved through a mutual agreement procedure (MAP) (*see* section 5.). There are different features of MAPs depending on whether the MAP is initiated pursuant to an Italian income tax treaty or the Arbitration Convention (Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises).

On the one hand, MAPs under the Arbitration Convention represent an alternative to the ordinary tax litigation procedure and provide for an obligation to resolve the dispute. On the other hand, MAPs under tax treaties usually merely require that the competent authorities attempt to eliminate the double taxation (i.e. a mere obligation of diligence is imposed on the tax administrations, which simply "shall endeavour" to eliminate the double taxation).

Reference can be made to section 4.

1.2.2. Tax authorities

1.2.2.1. Organizational structure with relevant areas of jurisdiction

Italian Revenue Agency

The Revenue Agency (*Agenzia delle Entrate*, RA) is the authority responsible for tax assessments and, jointly with the Tax Police (*Guardia di Finanza*), tax audits. The RA is a non-economic public body (*ente pubblico non economico*) that operates amongst others to ensure tax compliance, through providing assistance to taxpayers, ensuring collection of taxes and taking measures to reduce tax evasion.

The RA is supervised by the Minister of Economy and Finance, although the RA acts with full managerial responsibility and has regulatory, administrative, patrimonial, organizational, accounting and financial autonomy. Dealings between the Ministry of Economy and Finance and the RA are governed by a 3-year agreement with adjustments for each financial year.[4] This is a crucial aspect, as the RA is substantially an independent public administration, yet its goals can be determined only with the approval of the Minister of Economy and Finance.

At the territorial level, the RA is organized into regional directorates (*direzioni regionali*) and provincial directorates (*direzioni provinciali*).

In 2009, the special Large Taxpayer (*Grandi Contribuenti*) section was established[5] within the regional directorates and focuses on the tax compliance of enterprises the yearly revenue of which is more than EUR 100 million.[6]

Tax Police

In order to more efficiently carry out its operational activity, the RA coordinates its operations, especially in the case of tax audits, with the Tax Police. The Tax Police, supervised by the Minister of Economy

3. Art. 10 Order of RA Director 42295 of 21 Mar. 2016.
4. Art. 2-ter Legislative Decree 300 of 30 July 1999.
5. Art. 27(9) Law Decree 185 of 29 Nov. 2008.
6. Art. 27 Law Decree 185 of 29 Nov. 2008.

and Finance, is a military body specialized in combating tax fraud, smuggling and other tax crimes. On behalf of the RA, it carries out tax audits,[7] which are then documented (as is also the case for tax audits carried out directly by the RA itself) in the tax audit report (*processo verbale di constatazione*, PVC). The various claims that may be raised in the tax audit report are then subject to review by the competent provincial directorate or regional directorate, which will ultimately issue a notice of assessment (*avviso di accertamento*).

Territorially, the Tax Police is organized into three levels. On the top, there are Inter-regional Chief (*Comando Interregionale*) located in Rome, Milan, Florence, Venice, Naples and Palermo. Each one coordinates and has authority over the Regional Chiefs (*Comando Regionale*) who operate within its jurisdiction.

At the second level, Regional Chiefs are located in every regional seat (*Capoluogo di regione*). The Regional Chief has planning and organizational responsibilities in order to better coordinate the activities of the Provincial Chiefs (*Comando Provinciale*).

In turn, Regional Chiefs coordinate the third level, namely the Provincial Chiefs (*Comando Provinciale*), who are located in every provincial capital (*capoluogo di provincia*) except for the district of Aosta. The Provincial Chiefs carry out all the operational activities and oversee two offices, *Comando* and *Operazioni*, which are in turn organized into further sections.

The Office for Advance Rulings and International Disputes

The Office for Advance Rulings and International Disputes (*Ufficio Accordi preventivi e controversie internazionali*) of the RA is composed of professionals with extensive, in-depth experience in transfer pricing matters, who deal with APA requests. The Office for Advance Rulings and International Disputes is organized into two divisions, based in Milan and Rome.

The Order of the RA Director 21 March 2016 (*Provvedimento del Direttore dell'Agenzia delle Entrate del 21 marzo 2016*) establishes that any application can be submitted indifferently to each division irrespectively of the Region in which the relevant company has its fiscal domicile.[8]

In the case of bilateral or multilateral APAs, documents must be simultaneously filed with the International Ruling Office and the International Relations Directorate – Department of the Finance Minister (*Direzione Relazioni Internazionali del Dipartimento delle Finanze del Ministero dell'Economia e delle Finanze*).[9]

1.2.2.2. Other relevant players

Tax courts

If a taxpayer pursues litigation, the matter falls under the jurisdiction of the tax courts, the role and functions of which are governed by Presidential Decree 546 of 31 December 1992. Tax courts are organized as Provincial Tax Courts (*Commissioni Tributarie Provinciali*), which are tax courts of first instance, and Regional Tax Courts (*Commissioni Tributarie Regionali*), which are Tax Courts of Appeal. Provincial Tax Courts have jurisdiction over the cases involving tax offices of the RA belonging to the territorial competence of each provincial district, while Regional Tax Courts have jurisdiction over tax cases decided by tax courts of first instance of the provincial district of each respective region.

7. Art. 33(3) Presidential Decree 600 of 29 Sept. 1973.
8. Art. 2 Order of RA Director 42295 of 21 Mar. 2016.
9. Art. 31-ter Presidential Decree 600 of 29 Sept. 1973 and art. 25(3) of the OECD Model.

Supreme Court

Regional Tax Court verdicts may be contested only before the Supreme Court (*Corte di Cassazione*) for reasons indicated in article 360, paragraphs 1-5, of the Civil Procedure Code.[10] The Supreme Court acts as a court of last instance. However, the Supreme Court is the court of legitimacy, and its sole function is to ensure that the judge who decided on the merits applied the law correctly. Its role is to ensure the strict observance and uniform interpretation of the law.

The Supreme Court is divided into specialized divisions (including the Tax Chamber (*Sezione Tributaria*), which focuses on cases involving tax law). For important cases, usually where there are overlapping jurisdictions, a special Court (*Sezioni Unite*) is appointed with a substantially larger number of judges, who are chosen from the different divisions.

1.2.2.3. Programmes to ensure consistent application of TP policies and penalties

Taxpayer obligations under an APA

In addition to the activity carried out by the RA and/or by the Tax Police in the due course of tax audits, the main commitment of the competent tax officers in ascertaining the proper application of transfer prices is connected with the monitoring of APAs. Indeed, it should be expected that the RA will determine whether the transfer prices as agreed in the APA have been respected by the taxpayer. In this regard, the RA will seek to verify whether the APA has been duly executed and whether there have been any changes to the factual background on which the APA was based.[11] In order to permit the RA to carry out this task, a taxpayer that has signed an APA must prepare and submit to the competent officer, upon specific request, documents and information, and must facilitate inspections at the premises of the taxpayer. Non-cooperation and lack of transparency, preventing the RA from verifying whether the APA has been duly executed, represents a violation of the terms of the APA[12].

Violation of the terms of an APA

If the RA concludes that the taxpayer has violated the terms of the APA, a request for clarification is served by means of a registered letter. In response, the taxpayer is requested/entitled to submit memoranda within the following 30 days.[13] If the competent tax officers deem the responding memorandum to be unsatisfactory (or if the 30-day period has expires), the APA is fully or partially terminated, starting from the day on which the violation was first committed. If it is not possible to determine the date of the violation, the APA is terminated from the date on which the APA was signed.[14]

Penalties

Violation of the terms of an APA may lead penalties under the ordinary rules, depending on the type of violation and any related tax underpayment(s).[15]

10. Art. 62 Legislative Decree 546/1992.
11. Art. 7 Order of RA Director 42295 of 21 Mar. 2016.
12. Art. 8 Order of RA Director 42295 of 21 Mar. 2016.
13. Art. 8 Order of RA Director 42295 of 21 Mar. 2016.
14. Art. 8 Order of RA Director 42295 of 21 Mar. 2016.
15. *See* sec. 2.3.9. Tax penalties are stated in Legislative Decree 471 of 18 Dec. 1997. The criminal ones (Legal Decree 74 of 10 Mar. 2000) are applicable in any case.

1.2.2.4. Downward TP adjustments procedure

The downward adjustment procedure has been amended by article 59 of Law Decree 50 of 24 April 2017. According to this provision, a downward adjustment is acknowledged under conditions set forth by article 31-quater of Presidential Decree 600 of 29 September 1973 and in particular:

- upon conclusion of a MAP;
- after the results of an international audit have been shared by the cooperating countries (e.g. joint audits, *see* section 2.3.2.); and
- upon receipt of an application from the taxpayer (in accordance with rules to be defined by the Italian tax authorities) following a final arm's length transfer pricing adjustment made by a country with which Italy has a tax treaty allowing an adequate exchange of information.

Application for a downward adjustment

On 30 May 2018, an Order of the RA Director (Order) was issued, as provided for by article 31-quater of Presidential Decree n. 600 of 29 September 1973, regarding the newly introduced procedure allowing Italian taxpayers to obtain a unilateral downward adjustment on their taxable income as a result of a transfer pricing adjustment made by foreign tax authorities.

The Order specifies that a downward adjustment can be requested by Italian residents where the primary transfer pricing adjustment is (i) final (i.e. not subject to modifications); (ii) deemed consistent with the arm's length principle; and (iii) carried out by the competent authority of a foreign country with which a convention for the avoidance of double taxation, that provides an adequate exchange of information, is in place.

Moreover, the Order includes specific rules relating to the unilateral downward adjustment procedure regarding, inter alia, access, terms, causes of termination and the relationship with the MAP.

According to the Order, the application for downward adjustment must be filed with the Office for Advance Rulings and International Disputes, including applications filed by means of certified electronic mail. It should necessarily indicate the specific legal instrument for resolution of international disputes to be activated, i.e. a MAP under a double tax treaty or under the EU Arbitration Convention or under other legal framework. Under the penalty of inadmissibility, the deadlines stipulated in such legal instrument should be complied with and the request should include the information necessary for the activation of such instrument.

The Order provides that the RA has to accept (or reject) the application within 30 days from its submission by the taxpayer. In the same timeframe, the competent authority shall notify the taxpayer of the absence of any necessary information, as above, granting 30 days to provide it. If this lack of information is not remedied promptly, the request shall be rejected as inadmissible.

The procedure should be concluded within 180 days from the receipt of the request. In the case of acceptance, the RA shall communicate to the tax authority of the foreign state the recognition of the downward adjustment. Following receipt of the foreign tax certificate (or equivalent document) confirming the definitive nature of the upward adjustment abroad, the Director of the RA shall issue a ruling on the downward adjustment in Italy corresponding to the upward adjustment abroad.

Furthermore, the Order provides for the right of the RA to terminate the procedure in the event of a lack of cooperation or transparency of the taxpayer.

Finally, the Order includes provisions on the link between the procedure for downward adjustment in Italy under article 31-quater of Presidential Decree n. 600 of 29 September 1973 and a MAP. In this regard, the Order stipulates that the submission of a request for a downward adjustment functions to activate a MAP as per the applicable legal instrument.

In case the downward adjustment is not granted by the RA, the taxpayer can still independently activate a MAP under a double tax treaty or the EU Arbitration Convention. Equally, taxpayers can proceed directly with a MAP, without first submitting a request under the procedure described herein.

1.2.2.5. Contact information

The largest offices of the Regional Directorate (*Direzione Regionale delle Entrate*) are those of Milan and Rome. The relevant addresses and contact details are as follows:

Via Manin, 25

20121, Milan

Tel.: +39-02-65504 440

Email: dr.lombardia.gc@agenziaentrate.it

Via Giovanni Capranesi, 60

00155, Rome

Tel.: + 39-06-225 981

Email: dr.lazio.gc@agenziaentrate.it

The addresses and contact details of the Office for Advance Rulings and International Disputes are:

Via Manin, 25

20121, Milan

Tel.: +39-02-65504 757

Email: dc.acc.accordi@agenziaentrate.it; and

Via Cristoforo Colombo, 426 C/D

00145, Rome

Tel.: +39-02-65504 757

Email: dc.acc.accordi@agenziaentrate.it

1.2.2.6. Comment on profile and aggressiveness

The adoption of the required transfer pricing documentation is positively evaluated by the RA. The proper preparation of transfer pricing documentation (and the timely notification of the possession thereof to the RA) not only provides penalty protection, but – in more general terms – reduces tax risks and the potential for litigation.

However, experience shows that transfer pricing documentation is often not sufficient to exclude that a challenge will be raised towards the taxpayer. This encourages taxpayers to more often consider

seeking an APA, as this is viewed as the best possibility to achieve proper protection for taxpayers engaged in extensive cross-border transactions.

Trends also show that where a taxpayer's transfer pricing challenged, an extra-judicial settlement (*accertamento con adesione*) may ultimately be the more suitable alternative to resolve the dispute. In fact, although in such a case there is a concrete risk that existing double taxation will not be eliminated completely, this route offers the possibility for a relatively fast and definitive resolution of the dispute. An extra-judicial settlement certificate is finally signed by the taxpayer if and to the extent that a satisfactory reduction of the original claim is achieved.

2. Audit

2.1. Historical background

The following tables indicate some trends and relevant outcomes of the activities carried out by the RA. First, the following table reflects the last available information on the number of tax assessments served to Italian taxpayers and amounts determined.

	2016	**2017**	**Variation (%)**
Tax assessments	773,123	583,766	- 24.49
Amounts determined (EUR million)	19.2	18.6	- 0.6

Source: Ministry of Economy and Finance, *Relazione sull'economia non osservata e sull'evasione fiscale e contributiva* (2018).

The following table presents, for FY 2017, the types of taxpayers that were subjected to a tax audit (i.e. the most audited bodies).

	Audits	**Revenues (EUR million)**
Total	295,267	18.023
Large taxpayers (yearly revenue over EUR 100 million)	2,264	2.701
Medium-sized companies (yearly revenue between EUR 5.164 and 100 million)	10,776	3.714
Small companies (yearly revenue up to EUR 5.164 million) – self-employed	144,877	9.437
Individuals	122,322	1.715

Source: Ministry of Economy and Finance, *Relazione sull'economia non osservata e sull'evasione fiscale e contributiva* (2018).

2.2. Primary current controversies

Transfer pricing/base erosion and profit shifting allegations

Tax audits that result in challenges of alleged violations of transfer pricing rules have become increasingly frequent in Italy in recent years.[16] Challenges in this context include the alleged misrepresentation of the functional and risk profile of Italian enterprises; the incorrectness of the economic analysis; the misattribution of profits to Italian permanent establishments; and the inappropriate selection of a transfer pricing method.

In addition, business restructurings involving the transfer or migration of tangible and/or – more likely – intangible assets (such as patents, trademarks and know-how) are frequently challenged.

Abuse of law

In the past years, the RA focused on tax evasion through tax avoidance provisions and the abuse of law doctrine, arguing, in certain cases, that some tax savings or deductions were not granted to the taxpayer because transactions were not motivated by sound business reasons.

In 2015, the tax avoidance rule, contained in article 37-bis of Presidential Decree 600 of 29 September 1973, was repealed and a specific provision on abuse of tax law was introduced into the Italian tax system. [17]

The new abuse of law regulation, provided by article 10-bis of Law 201/2000,[18] covers cases in which a taxpayer manipulates the content of rules and obtains advantages that are technically legal, but which could not have been obtained if the relevant rules had been correctly interpreted and applied. As a consequence, the legal act is rendered fiscally void.

In structuring a transaction, however, the taxpayer may freely choose among different options offered by the law and involving a different tax burden, without undue restrictions. The RA has the burden of proving the existence of abusive behaviour. In case it deems a transaction to be abusive, it shall notify the taxpayer with a request for clarification, illustrating the reasons for the claim. The taxpayer is required to demonstrate that the transaction was justified by valid and non-marginal economic reasons, other than to avoid taxes, such as organizational and managerial reasons (i.e. in order to improve the structure of the taxpayer's business).

In any case, even if an abuse of law is recognized in such claim, it does not give rise to criminal liability, as only administrative penalties are applicable.[19]

Schemes involving abusive tax residency and artificial foreign structures

Numerous challenges of foreign entities have been raised based on the allegation that their effective place of management and control is, despite the formal representation, in Italy. Such a challenge leads

16. *See* sec. 3.3.
17. With regard to registration tax, *see* e.g. IT: SC, decisions 14150/2013, 16345/2013 and 17956/2013. With regard to corporate income tax, *see* IT: SC, decisions 4901/2013, 12282/2013 and 37/2014.
18. Introduced by art. 1(2) Legislative Decree 128/2015.
19. Art. 10-bis (13) Law 212/200.

to the assertion that the relevant entity should have filed a tax return in Italy and been subject to taxation in Italy on the corresponding income.[20]

Frequently, attempts are made by the competent tax authorities to neutralize the effects of hybrid mismatch arrangements, as well as to limit erosion of the Italian taxable base of companies by means of interest deductions, when achieved through the use of related-party schemes or even third-party financial debt.

Assessment of hidden permanent establishments

This recurring challenge tends to attract taxable income to Italy on the alleged grounds that the non-Italian enterprise de facto carries out a business activity in Italy by means of a hidden permanent establishment. As a consequence, income (to be) attributed to the (presumed) permanent establishment in Italy is considered as not having been duly reported in a tax return and, therefore, not having been subject to corporate taxation in Italy.[21]

Corporate reorganizations and leveraged buyout transactions

With regard to the deductibility of interest related to leveraged buyout transactions, the RA often claimed the presumed violation of the general anti-avoidance provision or challenged the tax deductibility of interest, in light of the fact that the relevant interest was not considered inherent to the business activity.

This practice was ended after the issuance of Circular 6/E of 30 March 2016, in which the RA stated that interest related to leveraged buyout transactions is to be considered inherent to the business activity and therefore deductible. Accordingly, the competent offices have been invited to re-evaluate ongoing claims concerning leverage buyouts that were presumed to violate the general anti-avoidance provision or in which the interest linked to the buyout was not considered inherent to the business activity. [22]

Expenses paid to entities in blacklisted jurisdictions

Budget Law 2016[23] has repealed article 110(10) and 110(11)[24] of the Income Tax Code (*Testo unico delle imposte sui redditi*, TUIR), which provided a limitation of the deductibility of expenses paid to blacklisted counterparties (either related or unrelated). Thus, with effect from 1 January 2016, these type of costs are deductible under the ordinary rules.

Beneficial ownership of outbound dividends, interest and royalties

The RA has been very strict in evaluating the existence of status as beneficial owner of the foreign (i.e. non-Italian) recipient of outbound dividends, interest and royalties, with the consequence that reduced

20. IT: SC, decision 2869, sec. V, 7 Feb. 2013. This case classifies as an abuse of law a situation where a taxpayer utilizes an offshore company exclusively to achieve a tax advantage. In particular, according to this decision, in order to establish whether there is an abuse of law, it is essential to ascertain whether the overall structure is indeed a wholly artificial arrangement. *See also* DE: ECJ, 28 June 2007, Case C-73/06, *Planzer*, ECJ Case Law IBFD.
21. *See* e.g. IT: SC, 29 Apr. 2016, decision 8543. In this case, the Court held that a Swiss company is considered to have a permanent establishment in Italy also when it just has a permanent and non-independent agent there, given that the subjective element is sufficient to evaluate the presence of a permanent establishment in the country.
22. RA Circular Letter 6/E of 30 Mar. 2016.
23. Art. 1(142) Law 208 of 28 Dec. 2015.
24. For the sake of completeness, please note that arts. 110(10) and (11) were previously amended by art. 5(1) Legislative Decree 147 of 14 Sept. 2015, which provided that, starting from 2015, the expenses paid to blacklisted counterparties were deductible within the limit of the normal value. After that, Budget Law 2016 definitively repealed arts. 110(10) and (11).

withholding rates under an applicable tax treaty and exemptions granted under the EU Interest and Royalties Directive were sometimes denied.[25]

However, as clarified in the Revenue Agency Circular 6/E,[26] [27] there is an exemption applicable to interests and other profits arising from medium- or long-term loans issued by foreign lending institutions.[28]

2.3. Audit process and milestones

2.3.1. Authorities involved

Tax audits are alternatively handled by the competent provincial or regional directorates (i.e. *Direzione Provinciale* or *Direzione Regionale*), depending on the taxpayer's status as a large taxpayer (i.e. revenue exceeding EUR 100 million), or by the Tax Police. There is a special section within the Tax Police, the Major Audit Section (*Sezione Verifiche Complesse*), which carries out more complex audits, generally involving large taxpayers or cross-border transactions.

In 2015, Legislative Decree 128 of 5 August 2015 introduced the cooperative compliance regime, the underlying purpose of which is to implement an ex ante approach to resolving potential tax controversies instead of resorting to ex post methods via ordinary inspections, with related benefits in terms of taxpayer compliance whilst increasing certainty and predictability in advance. Under the cooperative compliance regime, companies are requested to commit to a certain degree of compliance, transparency and disclosure in their dealings with tax authorities. In exchange, the tax authorities commit to answering all the requests and resolving all the issues of companies in a timely and effective manner.

Companies that would apply for the cooperative compliance regime must have a Tax Control Framework to manage tax risks.[29]

Furthermore, in first instance, the regime is reserved to:[30]

- companies that have a volume of business or revenues not less than EUR 10 billion;
- companies that have a volume of business or revenues not less than EUR 1 billion and which have applied to participate in the pilot programme of cooperative compliance launched in 2013; and
- companies that want to comply with the RA's reply on a ruling instance regarding new investments[31], regardless of the volume of business or revenues.

25. IT: Provincial Tax Court (CTP) Piemonte, 19 Oct. 2010, decision 124. In this case, the Italian tax authorities claim that the Luxembourg company was not the beneficial owner of the royalties. Therefore, the relevant withholding tax to be applied is 30%, instead of 10% as argued by the taxpayer. The Court affirmed that the non-resident receiving the royalties may invoke the provisions of the applicable tax treaty, when deemed to be the actual beneficial owner of those royalties. The absolute lack of entrepreneurial risk connected with the trademark's acquisition and a limited amount of control of the recipient of the royalties are material clues that that lead to the conclusion that the latter is not the beneficial owner of the royalties, as it is the sole formal recipient, excluding in that case the possibility to apply the reduced withholding tax under to the applicable treaty. The taxpayer must prove its status as beneficial owner.
26. RA Circular Letter 6/E of 30 Mar. 2016.
27. Art. 26(5-bis) Presidential Decree 600 of 29 Sept. 1973, introduced by art. 22(1) Law Decree 91 of 24 June 2014.
28. RA Circular Letter 6/E of 30 Mar. 2016.
29. Art. 4 Legislative Decree 128 of 5 Aug. 2015 and para. 3 Order of RA Director N. 54237 of 14 Apr. 2016.
30. Art. 7 Legislative Decree 128 of 5 Aug. 2015 and para. 2 Order of RA Director N. 54237 of 14 Apr. 2016.
31. In accordance with art. 2 Legislative Decree 147 of 14 Sept. 2015.

2.3.2. Joint audits

The Italian practice on the performance of joint audits has evolved to align its standards with the guidance provided for by the OECD.

In particular, on 15 July 2016, the Italian RA and the Bavarian tax administration signed an agreement aimed to strengthen the administrative cooperation in tax matters through the implementation of joint simultaneous audits of taxpayers belonging to the same group of companies based in Italy and Bavaria.

After an initial pilot phase coordinated by the Central Directorate for Tax Assessment of the Italian Revenue Agency, which involved the Veneto region and Bavaria, the Italian and Bavarian tax authorities renewed their commitment to strengthen the administrative cooperation in tax matters. The new phase of the project, which also involves the Lombardy region and the Autonomous Province of Bolzano, foresees a joint cross-border audit plan for 2016/17.

The main objectives of the new phase of the project are:

- enhancing the efficiency of tax audits relating to cross-border issues;
- reducing the administrative burden for taxpayers;
- achieving effective implementation of the administrative cooperation instruments;
- reducing the number of MAPs; and
- fighting aggressive tax planning and issues related to base erosion and profit shifting (BEPS).

Where, at the conclusion of a joint audit, a lower taxable income has been ascertained in Italy, a downward adjustment will be acknowledged, pursuant to article 31-quater of Presidential Decree 600 of 29 September 1973, (*see* section 1.2.2.4.).

2.3.3. Audit timeline

The legal framework for tax audits can be found, for example, in article 32 of Presidential Decree 600 of 29 September 1973, article 52 of Presidential Decree 633 of 26 October 1972 and article 12 of Legislative Decree 212 of 27 July 2000.

In principle, tax audits may not last more than 30 working days (in common practice, not on a continuous basis). In the case of particularly complex tax inspections, the audit process may be extended by an additional 30 days.[32] However, extension must be approved by the Head Director of the competent tax office.

2.3.4. Rights and obligations of taxpayers

When a tax inspection is commenced, taxpayers have the right to:

- be informed of the reasons justifying the selection of the relevant enterprise for audit, as well as the scope of the tax audit (e.g. transfer pricing, VAT, withholding taxes);
- be supported by a tax adviser;
- be informed of the rights, duties and obligations to which the taxpayer is entitled and/or which the taxpayer must observe in the due course of the tax audit;

32. Art. 12(5) Legislative Decree 212/2000.

- request clarifications of the tax auditor's activity; and
- expect that the audit will cause the least prejudice to the taxpayer's normal business activity.

Specific protection is also provided for taxpayers that are entitled to seek the opinion of the taxpayer ombudsman (*Garante del Contribuente*).[33]

2.3.5. Rights and obligations of tax authorities

In addition to the general obligation to possess the proper authorization to perform the tax audit and present personal identification documents (in order to assure taxpayers of the overall legitimacy to carry out the audit), inspectors must first inform the taxpayers of their rights, duties and obligations (*see* section 2.3.4.), including any consequences that taxpayers will suffer if they refuse to submit their accounting and financial books and records.

During a tax audit, the inspectors generally request that the following corporate documentation be provided:

- primary ledger;
- inventory book;
- VAT output register;
- VAT input register;
- supplementary records;
- company books;
- issued and received invoices; and
- any other fiscal and accounting document deemed to be useful for tax audit purposes.[34]

If a taxpayer refuses to submit the above-mentioned documents:

- it will suffer a number of administrative sanctions under article 9(1), (2) and (3) of Legislative Decree 471 of 18 December 1997 (i.e. pecuniary sanctions);
- the taxpayer may not use the documents, data or information during any litigation proceedings; and
- in cases of extreme failure to submit documents, the tax authorities may determine the taxable income of the taxpayer by recourse to inductive assessment measures.

If there is a need to open safes, seals, bags or other personal belongings, the tax inspector must request authorization from the public prosecutor. The same applies if the tax inspector seeks to obtain data covered by professional confidentiality.[35]

The competent authorities must fully document their daily activities in an informal report (*processo verbale giornaliero*, PVG). The various remarks that may arise in the course of the audit activity are eventually summarized in the final tax audit report (PVC).

33. All of these taxpayer rights are described in article 12 Legislative Decree 212/2000.
34. Art. 52 Presidential Decree 633/1972.
35. Art. 52 Presidential Decree 633/1972; art. 33 Presidential Decree 600/1973.

2.3.6. Information used in tax audits

Information acquired by tax inspectors will be used to evaluate whether the taxpayer has committed a tax violation or any other fiscal misconduct. Tax auditors may request information regarding the taxpayer under inspection from other public administrative bodies, insurance companies, collection agents, financial institutions, asset management companies (*società di gestione del risparmio*) and undertakings for collective investment.[36]

The competent authorities may also rely on a tax information exchange clause under an applicable Italian tax treaty.

2.3.7. Confidentiality of information

Tax inspectors must maintain the highest degree of secrecy for all information and data gathered in the due course of an audit.[37]

However, the Italian authorities may be requested to provide information on a certain taxpayer that was acquired during a tax audit to other EU tax authorities in accordance with EU Directive 2011/16/EU concerning mutual assistance by the competent authorities of the Member States in the field of direct and indirect taxation.

Tax inspectors must provide the outcome of a tax audit to the public prosecutor when tax violations with criminal implications are discovered.[38]

2.3.8. Right of access to information

All factual and legal information collected in the due course of an audit must be disclosed to the taxpayer. If the relevant notice of assessment relates to documents other than those collected in the course of the audit, those documents must be properly attached.

All documents and reports must indicate:

- the competent office from which the taxpayer should request all the information and documents regarding the taxpayer's proceeding;
- the competent authorities before which the taxpayer may file a complaint, request for annulment or appeal, etc. in order to protect its position; and
- the deadline and means by which to file the relevant complaint, request or appeal.

As a general principle of public administrative law, there is a right to have access to documents of the public administration (including the RA) that may be of interest for the taxpayer's defence.[39]

2.3.9. Penalties

A number of administrative and criminal sanctions may be imposed for violations committed by the taxpayer. The most relevant administrative sanctions – set forth in Legislative Decree 471 of 18 December 1997 – are the following:

36. Art. 32 Presidential Decree 600/1973.
37. Under art. 66 Presidential Decree 633/1972 and art. 68 Presidential Decree 600/1973.
38. Art. 331 Criminal Procedure Code.
39. Art. 24(7) Law 241.

- failure to file an income tax return: from 120% to 240% of unpaid taxes, which, in certain cases, may be doubled;[40]
- incorrect reporting of taxable income in the tax return: from 90% to 180% of the higher taxes due;[41]
- failure to file a VAT tax return: from 120% to 240% of the relevant amount;[42] and
- incorrect reporting of VAT in the tax return: from 90% to 180% of the relevant amount.[43]

Criminal sanctions are set forth in Legislative Decree 74 of 10 March 2000, including the following:

- fraudulent tax return by means of false invoices or other document attesting non-existent transactions (*dichiarazione fraudolenta mediante uso di fatture o altri documenti per operazioni inesistenti*): imprisonment from 1 year and 6 months to 6 years;[44]
- false tax return (*dichiarazione infedele*): imprisonment from 1 to 3 years.[45] However, a criminal violation is punished if (i) the unpaid taxes exceed EUR 150,000 and (ii) the income not included in the relevant tax return exceeds 10% of the taxpayer's assets (*elementi dell'attivo*) or, in any case, EUR 3 million; and
- failure to file a tax return (*omessa dichiarazione*): imprisonment from 1 year and 6 months to 4 years, if the avoided tax exceeds EUR 50,000.[46]

Generally, underpayment of tax due to a violation of Italian transfer pricing law was considered to constitute a false tax return. However, in 2015, article 4 of Legislative Decree 74 of 10 March 2000 was amended with the introduction (among other things) of paragraph 1-bis, according to which any mistakes in evaluating or classifying effective active or passive elements do not give rise to a false tax return if the relevant evaluation criteria have been described in the financial statement or in other relevant tax documentation.[47] Given that the transfer pricing documentation should be included within such "tax documentation", the risk of criminal sanctions has decreased significantly.

2.3.10. Access to foreign-based information

With specific reference to the exchange of information that may be initiated with regard to transfer pricing matters, such exchange is frequently instigated either at the taxpayer's initiative, or by the RA itself. In practice, the RA (generally the officers charged with issuing the notice of assessment) will file a formal request to the foreign competent authorities describing the issue(s) under investigation and requesting various clarifications regarding the associated enterprise during the phase in which they review the conclusions of the tax audit and before issuing a notice of assessment.

In transfer pricing matters, from a practical perspective, the various requests to a foreign competent authority are normally aimed at obtaining a clearer picture of the functional and risk profile of the (non-Italian) associated enterprise. The foreign authorities, in turn, will deal with the requests to the associated enterprise. This tool is generally regulated under article 26 of the OECD Model Tax

40. Art. 1(1) Legislative Decree 471/1997.
41. Art. 1(2) Legislative Decree 471/1997.
42. Art. 5(1) Legislative Decree 471/1997.
43. Art. 5(4) Legislative Decree 471/1997.
44. Art. 2 Legislative Decree 74/2000.
45. Art. 4 Legislative Decree 74/2000.
46. Art. 5 Legislative Decree 74/2000.
47. Art. 4(1-bis) Legislative Decree 74/2000, introduced by Law Decree 158/2015.

Convention on Income and on Capital (2017) (OECD Model), which, in paragraph 1, expresses the general principle of mutual cooperation among treaty partners.

2.3.11. Burden of proof

In the context of transfer pricing disputes, Italian law does not indicate the party that bears the burden of proof (i.e. the RA or the taxpayer) regarding the existence – or not – of arm's length conditions. Some decisions[48] of the Italian Supreme Court have stated that the burden of proof with regard to tax avoidance is to be borne by the taxpayer, whereas the RA must prove only the existence of irregular dealings between associated companies. However, according to other Supreme Court case law,[49] the RA, instead, bears the burden of proof in disputes regarding transactions subject to Italian transfer pricing legislation. Specifically, according to this case law, the RA bears the burden of proof to demonstrate the correctness and legitimacy of transfer pricing adjustments. The determination of increased items of income, as a consequence, must be fully justified by the inspectors; it will not be sufficient for the inspectors to merely underline in the tax audit report/notice of assessment that there is a gap between intra-group prices paid and arm's length prices.

In addition, in the absence of any specific legislative provision governing the burden of proof in transfer pricing disputes, the ordinary rules on the burden of proof must be observed. In practice, the RA, based on the above-mentioned jurisprudence, is the "substantive" plaintiff, and so it bears the burden of proof.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators (2017) (OECD Guidelines) recommend that the burden of proof should not be misused by tax administrations or taxpayers as a justification for making groundless or unverifiable assertions about transfer pricing.[50]

2.3.12. Statute of limitations

A notice of assessment shall be served to the taxpayer by 31 December of the fifth year following the year in which the income tax return was filed.[51] In the case of a failure to file a tax return, the assessment notice may be served by 31 December of the seventh year following the year in which the income tax return should have been filed.[52]

2.3.13. Information requests

The taxpayer must notify the RA of events such as a change of its legal status, or any other data that may be of interest to the competent authority (e.g. the beginning or cessation of business activity, variations of any data previously provided to the RA). The disclosure of these events must be communicated within 30 days from their occurrence.

2.3.14. Solicitor-client privilege

Attorneys, solicitors and tax advisers are among those professionals who are allowed to refuse to disclose evidence for the purpose of protecting specific information.[53] In fact, it may happen that the disclosure of certain facts and circumstances can have an extremely harmful effect on the defendant,

48. IT: SC, 15 Apr. 2016, decision 7493; IT: SC, 18 Sept. 2015, decision 18392; and IT: SC, 8 May 2013, decision 10739 of.
49. IT: SC, 5 Aug. 2015, decision 16399; IT: SC, 16 May 2007, decision 11226; and IT: SC, 13 Oct. 2006, decision 22023.
50. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* para. 4.16 (OECD 2017).
51. Art. 57(1) Presidential Decree 633/1972; art. 43(2) Presidential Decree 600/1973.
52. Art. 57(2) Presidential Decree 633/1972; art. 43(2) Presidential Decree 600/1973.
53. Art. 200 Criminal Procedure Code.

and/or on the relationship between the professional and his or her client, which must be based on trust and loyalty.

2.4. Recommendations for taxpayers during a tax audit

The taxpayer is required to guarantee the highest degree of collaboration during a tax audit, also bearing in mind that (as broadly described in section 2.3.5.) documents which are not disclosed during an audit may not be used in any future proceedings.

It is generally advisable to schedule periodic meetings between the taxpayer's counsel and the tax inspectors in order to facilitate the audit process in the most expedient and efficient way, in the interests of both parties.

Submitting memoranda and notes is also a standard practice in the due course of the audit, in relation to which a close cooperation between the taxpayer and its tax adviser is essential and should be established in advance. In practical terms, it would not be the wisest option to wait for the end of the audit and service of the relevant tax audit report to seek a remedy to mitigate a potential or possible tax dispute.

3. Appeals and Litigation

3.1. Historical statistics

According to the Report on the Monitoring of Tax Litigation and Tax Courts (*Relazione di monitoraggio sullo stato del contenzioso tributario e sull'attività delle commissioni tributarie 2017,* the latest available version at the time of writing), in 2017, the total amount of tax litigation decreased by 11.61% vis-à-vis 2014.[54]

	Pending on 31/12/2016	**Filed**	**Decided**	**Pending on 31/12/2017**	**Variation**	
					No.	**%**
Provincial tax courts	317,434	148,516	202,833	263,117	– 54,317	– 17.11
Regional tax courts	150,506	62,999	58,987	154,518	4,012	0.3
Total	467,940	211,515	261,820	417,635	– 50,305	– 10.75

As shown in the table below, during the period from 2014 to 2017, the number of appeals decided was always higher than the number of new appeals filed. As a consequence, the number of pending tax litigations is expected to decrease.

Regional and provincial tax courts	**2014**	**2015**	**2016**	**2017**
Filed	242,695	257,036	231,815	211,515
Decided	302,003	298,156	293,154	261,820

54. IT: La Giustizia Tributaria, *Relazione di monitoraggio sullo stato del contenzioso tributario e sull'attività delle commissioni tributarie*, available at www.giustiziatributaria.gov.it (accessed 17 July 2019).

Regional and provincial tax courts	2014	2015	2016	2017
Pending on 31/12	570,399	529,279	467,940	417,635

According to the Report on the Monitoring of Tax Litigation and Tax Courts, the average duration of a tax litigation proceeding – taking into consideration the period starting from the filing of the appeal – is approximately 2 years and 2 months before the provincial tax courts and approximately 2 years and 3 months before the regional tax courts.

Regarding litigation commenced in 2017, 21.79% of cases concerned the personal income tax (IRPEF).

Regarding the results of litigation, taxpayers prevailed in 31.42% of proceedings before the provincial tax courts and in 38.83% of the proceedings before the regional tax courts.

3.2. Appeals and litigation process

Within 60 days from the service of the tax audit report (PVC), the taxpayer may file with the RA an objection memorandum,[55] pursuant to which the taxpayer explains the reasons why the claims alleged in the tax audit report should not be included by the competent officers in a notice of assessment. The officers of the RA will then decide whether to accept or reject the taxpayer's arguments that were raised in the objection memorandum, and will eventually issue a notice of assessment within the ordinary statute of limitation.

From the moment the tax audit report is served and before the notice of assessment has been served, the taxpayer may undertake the active redemption procedure (*ravvedimento operoso*) and obtain the penalty reduction to one fifth of the minimum, settling the underpayment challenged in the tax audit report.

From the date on which the notice of assessment is served, the taxpayer has a 60-day period to:

- accept the claim articulated in the notice of assessment and benefit from reduced sanctions[56] (under certain conditions the full acceptance of the claims as articulated in the tax audit report may be elected with a reduction of penalties to one-sixth within 30 days from the service of the tax audit report and before the relevant notice of assessment is issued);[57]
- file a request for an extra-judicial settlement (*accertamento con adesione*) with the competent tax office;[58] or
- file an appeal with the provincial tax court.[59]

If the taxpayer chooses to pursue an extrajudicial settlement, from a procedural perspective, the period for filing the appeal is suspended for a 90-day period, during which the taxpayer and the RA have the opportunity to reach an agreement. If an agreement is reached, the taxpayer will benefit from a reduction of penalties on the claims (generally ranging from 90% to 180% of the underpaid tax) to one third of the minimum amount provided by law.[60]

55. Art. 12(7) Law 212/2000.
56. Art. 15 Legislative Decree 218/1997.
57. Art. 5-bis Legislative Decree 218/1997.
58. Art. 6(2) Legislative Decree 218/1997.
59. Art. 18 ss. Legislative Decree 546/1992.
60. Art. 6(2) Legislative Decree 218/1997.

If an agreement is not reached, the taxpayer may file an appeal. Until the public hearing is held, either at first instance or at appeal, the taxpayer and the RA may still come to an agreement by reaching a judicial settlement (*conciliazione giudiziale*).[61]

Pending an appeal before the competent provincial tax court, the RA requests from the taxpayer a payment equal to one third of the tax assessed plus the relevant interest. Against this payment obligation, the taxpayer may file a request for a suspension of the tax collection. The suspension will be granted if, and to the extent, the competent tax court acknowledges – on a preliminary basis – that the arguments of the appeal seem to be well-grounded (i.e. the *fumus boni iuris*), and that such payment may result in serious and irreparable damage to the company (i.e. the *periculum in mora*).[62] The suspension, if granted, lasts until a decision of the provincial tax court is rendered. In any case, the tax court may consider a bank guarantee to be given by the company conditional to the suspension.

After the ruling by the provincial tax court, if the decision is (even partially) negative, the effects of the suspension would in any case cease and the taxpayer would have to pay the RA:

- an amount equal to two thirds of the tax assessed, plus the relevant interest and penalties, if the court entirely rejected the appeal;[63] or
- the amount set forth by the judgment (but not exceeding two thirds of the tax assessed), plus the relevant interest and penalties, if the court partially accepted the appeal.[64]

Provincial Tax Court decisions may then be appealed before the regional tax court within 6 months from the judgment or 60 days from service.[65]

Finally, a judgment of a regional tax court may be appealed before the Supreme Court, but only in cases involving incorrect statutory interpretation by the lower court (i.e. the merits of the case may not be discussed again) within 6 months from the judgment or 60 days from its formal service.[66]

According to a literal interpretation of the relevant tax law, before the Regional Tax Court, the taxpayer may benefit only from a suspension of the collection of penalties, alternatively by (i) demonstrating the simultaneous existence of the above-mentioned *periculum in mora* and *fumus boni iuris* or (ii) providing a bank guarantee covering the entire amount due as penalties.[67] However, under the recent jurisprudence,[68] the suspension of the collection of the relevant tax amount has also been admitted under the general rule set forth in the Italian Civil Procedure Code.[69]

After the judgment of the regional tax court, if negative, the taxpayer must remit the remaining amount set forth by the judgment, plus relevant interest and penalties.[70]

From a practical perspective, the litigation proceeding before the (two) courts of merit generally can last, in total, approximately 4 years, whereas the proceeding before the Supreme Court may range from 3 to 5 years.

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61. Art. 48 Legislative Decree 546/1992.
62. Art. 47 Legislative Decree 546/1992.
63. Art. 68, para. 1, (b) Legislative Decree 546/1992.
64. Id.
65. Art. 49 ss. Legislative Decree 546/1992.
66. Art. 62 ss. Legislative Decree 546/1992.
67. Art. 19 Legislative Decree 472/1997.
68. IT: SC, 24 Feb. 2012, decision 2845.
69. Art. 283 Civil Procedure Code.
70. Art. 68, para. 1, (c) Legislative Decree 546/1992.

3.3. Notable court decisions

The following case law is among the most recent jurisprudence on transfer pricing matters, as decided by the provincial tax courts, regional tax courts and the Supreme Court.

Regional Tax Court of Milan (26 November 2018, Decision 5445)

According to the Regional Tax Court of Milan, the Italian tax authorities should consider the entire arm's length (interquartile) range of results for the relevant profit level indicator. The Court based its decision on the specific definition of "arm's length range" provided by article 6, Decree of the Italian Ministry of Economy and Finance issued on 14 May 2018, under which the arm's length result may lie anywhere in the range of all values derived from independent comparable transactions, all of which respect full comparability with the controlled transaction.

Supreme Court (10 November 2017, Decision 26646)

Article 5, paragraph 2 of Legislative Decree 147/2015 established that article 110(7) of the TUIR, which embodies the Italian transfer pricing provisions, does not apply to transactions between companies resident in Italy, superseding the former jurisprudence on the topic at stake.

In particular, the Supreme Court stated that the abovementioned provision has interpretative scope, therefore it applies even retroactively. It has, however, confirmed that transactions between resident companies shall be evaluated in terms of inherence pursuant to article 109 of the TUIR.

Provincial Tax Court of Milan (7 November 2017, Decision 6248)

According to the Decision of the Provincial Tax Court, to verify the compliance of intercompany prices with transfer pricing provisions, the RA must first apply the so-called "compared uncontrolled price" method, based on the taxpayer's transactions with independent enterprises ("internal comparables"). When this is not possible, another "traditional" method should be used, and, finally, only if none of those methods is applicable, the so-called "transactional net margin method" may apply. In essence, the Court outlines the hierarchy to be considered when selecting the most appropriate transfer pricing method.

Provincial Tax Court of Milan (26 January 2017, Decision 704)

The Court stated that transfer pricing claims are not relevant in relation to the Italian regional tax on productive activities (*Imposta regionale sulle attività produttive*, IRAP) up until fiscal year 2013 (inclusively).

The issue was raised in connection with the retroactivity of the Italian Budget Law 2014, which introduced a provision under which the major income ascertained in accordance with transfer pricing provisions should also be taken into account for IRAP purposes starting from fiscal year 2008 (even if no penalties were due in connection with adjustments regarding tax statements until fiscal year 2012).

Nevertheless, the Court ruled that the application of the provision introduced in 2014 with retroactive effect to previous fiscal years conflicts with the constitutional principle of trust and good faith in relations between the financial administration and the taxpayer.

Supreme Court (6 December 2016, Decision 24873)

According to the Decision of the Supreme Court, interest on payment delays, relating to receivables for the supply of goods, paid to a foreign company without a permanent establishment in Italy is deemed

to be income on capital and, thus, is subject to withholding tax pursuant to article 26, of Presidential Decree 600 of 29 September 1973.

Supreme Court, chamber V (22 April 2016, Decision 8130)

In light of the specific anti-avoidance purpose of the provisions on “transfer pricing”, the “power of control” of a company over another which shall be identified does not coincide with the one provided by article 2359 of the Italian Civil Code. With respect to transfer pricing, the “power of control” is extended to every hypothesis of economic influence, even potential economic influence, including, for example, the exclusive sales by an enterprise of the products of another, or the incapability of a company to operate without the equity, products and technical cooperation of another.

Supreme Court, chamber V (15 April 2016, Decision 7493)

According to the Decision of the Supreme Court, the evaluation of whether the transaction is in compliance with the normal value should be made independently of evaluating the ability of the operation to generate any income and, therefore, independently of any obligation undertaken by the parties in relation to the gratuitous nature of the transaction. The Supreme Court stated that the RA must prove only the existence of transactions with associated companies at values lower than the normal value, while the taxpayer shall prove that the transactions were at the normal value.

Supreme Court, chamber V (15 April 2016, Decision 7493)

The Supreme Court, in relation to an intercompany non-interest-bearing loan, superseded the previous and differing position of the same Court, which until then had stated that the transfer pricing provisions apply only in case of intercompany transactions for consideration rather than for gratuitous transactions.

Indeed, tax assessment related to transfer pricing consists in evaluating the economic substance of the transactions concluded between companies of the same group and comparing it with similar transactions carried out by independent parties, in comparable circumstances, in a free market. Therefore, it is irrelevant whether the intra-group funding is provided through a non-interest-bearing loan. The gratuity of the loan does not automatically imply the exclusion of an evaluation of the normal value. Moreover, believing that tax authorities should control transactions for little consideration, but that this is prevented in the case of contracts which are free of charge, would be clearly unreasonable and would encourage conduct aimed at avoiding transfer pricing rules.

Supreme Court, chamber V (18 September 2015, Decision 18392)

The company argued that transfer pricing provisions include an anti-avoidance rule, and that therefore the RA bears the burden of proving that the transaction was carried out in order to obtain a tax advantage (i.e. in order to shift the profit to a jurisdiction that ensured lower taxation).

Differently, the Supreme Court retained that the transfer pricing provision does not integrate an anti-avoidance rule, but is aimed at fighting the displacement of taxable income as a result of intra-group transactions. In light of this, the burden of proof of the RA does not concern the concrete tax advantage obtained by the taxpayer, but only the existence of transactions between related companies at values that seem to be lower than normal. The burden of proof that such transactions have occurred at market values is borne by the taxpayer.

Supreme Court, chamber V (5 August 2015, Decision 16399)

The Supreme Court affirmed that the Regional Tax Court erred in finding that the RA had not provided any evidence to support its claim regarding the costs incurred by the Italian company for goods and services provided to it by its parent company. Indeed, the Court held that the RA has the burden of proof regarding the transfer pricing adjustment on active elements of taxable income, while the taxpayer has the burden of proof for cost adjustments, given that, in allocating intercompany costs, such costs should exist. Therefore, in the case of costs of services or goods lent or given by a foreign parent company to an Italian subsidiary, the taxpayer bears the burden of proof for the existence and inherency of these costs, pursuant to the so-called “proximity-to-proof principle”.

Provincial Tax Court of Milan (29 September 2014, Decision 7996)

The Provincial Tax Court considered the choice of the RA, to take as the reference period from which to extract the data of comparables a different tax period than that which is under inspection, incorrect. The judges stated that the principle of free competition, in relation to transfer pricing inspections, requires the RA to take into account, in its analysis of the comparison of prices, companies actually comparable with the companies under inspection, not excluding those comparables that have ended 2 or more fiscal years reporting losses. Furthermore, for the purposes of the comparative analysis, the RA should use the data found in databases updated to the tax period subject to inspection of control and not to subsequent years.

Provincial Tax Court of Cremona (11 September 2013, Decision 77)

The Provincial Tax Court upheld an appeal by the taxpayer against a notice of assessment in which the RA sought the payment of a higher amount of tax due to interest expenses charged to the Italian entity in breach of transfer pricing rules. The Court concluded that the non-application of interest on advance payments and delayed payment conditions is at arm’s length, whereas certain contractual advantages among the associated enterprises are suitable to counterbalance the benefit arising from the non-application of interest. This position taken by the Court has particular relevance, as it effectively acknowledges the fairness of setoffs when dealing with the transfer pricing consequences of cross-border transactions.

Regional Tax Court of Milan (10 July 2013, Decisions 83 and 84)

The Regional Tax Court stated that, within the context of a transfer pricing challenge, the burden of proof is governed by the proximity-to-proof principle. This means that, on the one hand, the taxpayer must provide complete documents in order to substantiate the reliability of its transfer pricing policy, and may not oppose a notice of assessment by simply claiming a generic lack of justification while, on the other hand, the RA is expected to provide a complete explanation on the transfer pricing methods adopted when recharacterizing arm’s length conditions and it must also take into consideration the companies’ functional and risk profile.

Supreme Court, chamber V (27 March 2013, Decision 7716)

The Supreme Court affirmed the ruling of the Regional Tax Court, which had rejected the taxpayer’s request for a refund of customs duties that had been paid in excess (upon the importation of goods to Italy), due to the subsequent revision of the transfer prices of the same imported goods. The Supreme Court concluded that ex-post transfer pricing adjustments reflect a mere re-allocation of income within the multinational group, whereby such reallocation is not connected to the intrinsic value of the goods

for which the revision of the customs duties was being claimed. Rather, this was a case of virtual apportioning of the overall taxable base of the group among various subsidiaries.

Supreme Court, chamber V (27 February 2013, Decision 4927)

The Supreme Court rejected the appeal by an Italian company against a notice of assessment, which claimed that there was an undue deduction of a 30% royalty on software paid by the Italian company to its parent company based in the United States. The tax authorities considered a 7% deduction to be the normal value of the royalties. The Supreme Court upheld the rejection by tax inspectors of a 30% royalty paid by the Italian company, and instead recognized a different royalty percentage as the arm's length consideration. The Court based its conclusions on the guidance of the RA in Circular Letter 32/1980, which provides some safe harbour thresholds for the determination of a royalty by taking into account, for example, the technology level and the relevant industry.

Provincial Tax Court of Milan (21 January 2013, Decision 57)

The tax authorities claimed that the Italian company, during the course of a leveraged buyout transaction, had performed the intra-group service of "fundraising" in favour of its parent company and, consequently, claimed that a fee for this service should have been charged by the Italian company to the parent company.

The Provincial Tax Court disregarded the claim of the RA, stating that there is no breach of transfer pricing rules when BidCo (i.e. the investment vehicle purposely established to carry out the transaction) does not charge to its parent a service fee (for presumed fund raising activity) within the context of a leveraged buyout transaction. The RA argued that the fee should have been charged at an amount equal to the bank interest borne by BidCo itself to perform the acquisition of the target company. The Court concluded that, as leveraged buyout transactions are legitimate and broadly regulated from a civil law perspective, they should not lead, per se, to any undue fiscal advantage or tax abusive schemes.

Supreme Court, chamber V (19 October 2012, Decision 17953)

The Supreme Court rejected the Regional Tax Court's decision regarding the method adopted to determine the income of the company. Specifically, the judges considered transfer pricing provisions to be applicable based on the assumption that the company applied identical sale prices to goods sold to foreign subsidiaries regardless of the volume of goods sold. Indeed, the normal value was determined by making reference to generic interim period comparisons (based on alleged period averages) and confirmed comparisons referring to unspecified "statistical reports", disregarding the differences in the volume of goods between controlled and uncontrolled transactions. In practice, the Supreme Court has acknowledged that, in order to properly apply the transfer pricing rules, there is always a need to adjust comparisons both for purposes of general application of the arm's length principle and, more specifically, in the context of each method.

Supreme Court, chamber V (13 July 2012, Decision 11949)

The Supreme Court stated that a taxpayer which seeks to deduct some expenses related to services provided by another group member must first prove that such services have in fact been rendered (according to the economic benefit actually derived), and then must prove that the relevant charge is in line with the arm's length principle. On this basis, the mere provision to the competent authorities of an opinion drafted by legal counsel attesting to the existence of arm's length conditions is not per

se sufficient to reliably demonstrate that certain intra-group services were effectively rendered to the Italian group member (and therefore allowed as a tax deduction).

Regional Tax Court of Lombardy (10 June 2011, Decision 63)

The RA argued that prices applied to an intra-group transaction were less than those generally applied by the same company in transactions with comparable circumstances, and accordingly asserted an increased taxable income. The Regional Tax Court stated that if a taxpayer's transfer pricing shifts taxable income to a foreign jurisdiction (in this case France) that has a burden of taxation not dissimilar to the national (i.e. Italian) corporate income tax rate, the conduct of the taxpayer cannot be perceived as an attempt at tax evasion.

Regional Tax Court of Lombardy (7 June 2011, Decision 69)

The RA argued that the prices applied to intra-group transactions involving Swiss companies were lower than those generally applied to other companies outside the group. However, in doing so, tax authorities supported the asserted economic inconsistency of the transactions referring to incomparable and inhomogeneous data. The Regional Tax Court stated that, in challenging transfer pricing, when the RA assesses the normal value of goods, it must take into consideration the relevant geographical market(s), the physical features of the products and other variables such as the exchange rate.

Supreme Court, chamber V (31 March 2011, Decision 7343)

In cross-border intra-group transactions, an Italian company applied prices that were less than those applied in transactions with companies outside the group. The taxpayer justified its conduct as being in line with article 9(3) of the TUIR, under which the normal value is to be determined by taking into account, among other things, the discount (*sconto d'uso*). The Supreme Court rejected the taxpayer's argument, stating that price reductions cannot be regarded as a discount if they are applied only to intra-group transactions. In order to evaluate the correctness of intra-group transactions and whether agreed prices are at arm's length, the RA must verify whether the price paid is itself in line with the normal value, rather than basing the alleged violation on the difference between the price agreed in the relevant contract and the price actually paid.

Provincial Tax Court of Reggio Emilia (21 March 2011, Decision 134)

An Italian company applied prices in intra-group transactions that were less than those applied in transactions involving third parties. The Court stated that the RA bears the burden of proof to demonstrate that (i) the foreign jurisdiction had a more favourable tax regime than that in Italy and (ii) the conditions of sale are not in line with the arm's length principle.

Regional Tax Court of Lazio (9 December 2010, Decision 643)

The assessment notice was based on a claim of alleged violation of transfer pricing rules regarding sales of goods between affiliated companies involved in a franchising contract. The argument made against that claim was that the transaction was not elusive, given that the companies were located in the same geographic region and had been subjected to the same taxation regime. The Regional Tax Court stated that the competent authority bears the burden of proof to demonstrate that the relevant price reductions (or discounts) are not in line with fair market conditions. This implies that discounts themselves are not necessarily an indication of the absence of fair market conditions even if greater than those granted to third parties.

Regional Tax Court of Piemonte (14 April 2010, Decision 25)

The RA argued that the prices applied by the taxpayer to transactions with its subsidiaries, operating as distributors, were less than those applied to transactions with non-group members. More specifically, among the possible methods that could be used to determine the value of the transactions, the RA used the external CUP method, but, in doing so, the RA compared the price of those transactions with the price applied by the taxpayer's competitors for goods having a different market position and different characteristics. The Regional Tax Court's decision entailed a rejection of the reliability of the CUP method if a number of elements allowing for a reliable application thereof are absent. In fact, according to the Court, the OECD merely sets certain criteria to be followed when ascertaining fair market conditions, without necessarily imposing a priority in the selection of one method over another. Furthermore, the Court stated that, in practice, although – generally – privileged recourse must be had to the CUP method, this is not the case if the method is applied to items that are not comparable.

Regional Tax Court of Piemonte (29 September 2010, Decision 65)

The RA required the reinstatement of the interest rate of an intra-group financing arrangement to the normal value, disregarding the agreement between the parties to settle a non-interest-bearing loan. The Regional Tax Court explicated that group members are free to contract a non-interest-bearing loan, as this is in line with the relevant provisions of the Italian Civil Code[71] and, under certain conditions, such loans are allowed and may recur in domestic funding structures. As a consequence, according to the Court, justifications such as the general concept of freedom of establishment are to be applied in order to conclude that non-interest-bearing lending is (also) acceptable if carried out with foreign (i.e. non-Italian) group entities.

Regional Tax Court of Lazio (8 July 2009, Decision 176)

The RA challenged the deduction by an Italian resident company of expenses from a transaction involving an English counterparty, as there was no valid contractual agreement between the two companies. In the absence of such an agreement, there is no justification of the expenses from a contractual or accounting perspective. The lack of any documentation concerning the appropriateness of the prices would not allow the attribution of the relevant expenses to the Italian company as the actual beneficiary of the services. The Court accepted the argument of the RA that a taxpayer seeking to deduct expenses related to services provided by a group counterparty must provide contractual documentation, confirming the extent of payments and the type and extent of services rendered. A lack of this documentation may lead to the non-deductibility of the relevant expenses. In the absence of such documentation, the burden of proof is with the taxpayer.

3.4. Advantages and disadvantages

When considering whether to commence a litigation proceeding before the competent tax court, the taxpayer should bear in mind that judicial proceedings can take a long time to resolve (normally up to 10 years, but up to 15 years if the Supreme Court annuls the appealed decision). Additional factors to consider include the fact that a suspension of payment (as described in section 3.2.) is not automatic but must be requested through an ad hoc procedure. Such a procedure does not necessarily result in a consent to suspend the payment until the relevant hearing takes place. The consequence is that payments of higher taxes claimed and relevant interest may progressively accrue during the course

71. Art. 1815 Civil Code (Loan interest).

of a tax litigation proceeding. Additionally, commencing litigation means that penalties, as imposed in the relevant notice of assessment, become applicable according to the ordinary thresholds (generally ranging from 90% to 180%), without the possibility to benefit from the dramatic reductions that can be achieved under the various extra-judicial remedies.

However, one should consider (and in this sense, an advantage of entering into the litigation phase could be recognized) that filing an appeal might be the only viable remedy to obtain the non-application of sanctions if a MAP procedure has been commenced (assuming that the conditions for penalty protection are not met or recognized); *see* section 4.1.

4. Mutual Agreement Procedure and Arbitration

4.1. Historical statistics

In 2015, there were 6,176 MAPs initiated in OECD member countries, 319 of which involved the RA.[72] By the end of 2015, the total number of open MAP cases had increased by 14% over 2014, and by 163% over 2006.

The average time for the completion of a MAP with another OECD member country has been approximately 20.47 months in the 2015 reporting period.[73]

Further, as part of the BEPS initiative, the report on BEPS Action 14 (Making Dispute Resolution Mechanisms More Effective)[74] contains a commitment by jurisdictions to implement a minimum standard to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. All members of the Inclusive Framework on BEPS (IF), including Italy, commit to the implementation of the Action 14 minimum standard, which includes timely and complete reporting of MAP statistics pursuant to an agreed reporting framework as well as MAP profiles. The 2017 MAP statistics are reported under this new framework.[75]

According to the statistics provided by Italy, on 31 December 2016, its MAP inventory was 437 cases, 291 of which concern attribution/allocation cases and 146 other cases. During the period 1 January 2016 and 31 December 2016, 158 cases started and 29 cases were closed.

4.2. Mutual agreement procedure

The relevant provisions regarding the international legal basis of a MAP can be found, in substance, (i) in an applicable double tax treaty or (ii) under the Arbitration Convention.

The domestic provision on MAPs can be found in article 31-quater of Presidential Decree 600 of 29 September 1973, which states that a corresponding downward adjustment may be allowed also:

> in execution of binding agreements entered into with the Competent Authorities of a contracting state pursuant to a mutual agreement procedure provided for by international tax treaties or by the Arbitration Convention.

72. OECD, Centre for Tax Policy and Administration. *See* https://www.oecd.org/ctp/dispute/map-statistics-2006-2015.htm#italy (accessed 26 July 2019).
73. Id.
74. OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015).
75. For details, *see* https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm (accessed 26 July 2019).

In other words, in addition to the relevant provisions in Italian tax treaties and the Arbitration Convention, there is a specific rule in Italy to establish the connection between domestic transfer pricing provisions and tax treaties (MAP proceedings).

From a practical perspective, the effectiveness of MAPs has not been so satisfactory in past years in Italy. In fact, even though a number of proceedings were initiated, only a few were concluded.

Things are changing (or at least are supposed to change), given that due to a substantial increase in international tax disputes, the RA has released some extensive instructions on the possible recourse to a MAP by taxpayers as a possible remedy to resolve double taxation issues in transfer pricing matters. In addition, the RA has likely strengthened the department responsible for MAPs. The extensive instructions on MAPs can be found in Circular Letter 21/E of 5 June 2012[76], which comments on the various features of MAPs entered into under either a double tax treaty or the Arbitration Convention.

MAPs under the Arbitration Convention represent an alternative to the ordinary tax litigation procedure illustrated at section 3. and provide for an obligation to resolve the dispute. In fact, Italy is a jurisdiction in which administrative authorities may not deviate from the decision of a judicial body.

Therefore, specifically regarding MAPs under the Arbitration Convention, there is no possibility to carry on, in parallel, both domestic and international procedures. As a result, an Italian company will be requested to either withdraw domestic litigation (if undertaken) or allow the time provided for the appeal to expire. Alternatively, it is possible for the parties (i.e. the taxpayer and the tax authority) to jointly request a suspension of the proceedings[77] until the signing of the MAP.

From a practical perspective, if a taxpayer submits a MAP request under the Arbitration Convention and simultaneously brings forward an appeal against the notice of assessment (regarding elements thereof pertaining to the adjustments leading to double taxation), the litigation proceeding does not prevent the commencement of the MAP. However, if a judicial decision intervenes and the double taxation has still not been eliminated, the double taxation will not be removed unless a foreign competent authority signs a mutual agreement consistent with the domestic judicial decision. Nevertheless, the taxpayer may file an appeal with the competent tax court on issues other than those falling within the scope of the MAP, which issues might be stated in the relevant notice of assessment. This is clarified by Circular Letter 21/2012, which states:

> with sole reference to the application of tax penalties, the taxpayer may carry on the judicial proceedings in the event that the legal grounds substantiating its appeal relate to [...] the unlawfulness of the penalties charged because of the uncertain conditions concerning the scope and application of article 110, paragraph 7 of the Income Tax Code, pursuant to article 10, paragraph 3 of Law 212 of 27 July 2000.[78]

In practice, an Italian entity may instigate a MAP in order to achieve relief from possible double taxation while, at the same time, pursuing domestic litigation with regard to penalties. Concrete examples of

76. Circular 21/E can be accessed at https://www.agenziaentrate.gov.it/wps/file/Nsilib/NSE/Individuals/Double+taxation+relief/Mutual+Agreement+Procedure/Circular+letter+n.+21E+05062012/circularletter21.pdf (accessed 26 July 2019).
77. Art. 39(1-ter) Legislative Decree 546 of 31 Dec. 1992, as modified by art. 9(1) Legislative Decree 156/2015; see also RA Circular Letter 12 of 8 April 2016.
78. RA Circular Letter 21/2012, at p. 30. The circular can be accessed at https://www.agenziaentrate.gov.it/wps/file/Nsilib/NSE/Individuals/Double+taxation+relief/Mutual+Agreement+Procedure/Circular+letter+n.+21E+05062012/circularletter21.pdf (accessed 26 July 2019).

this can be seen in cases involving unlawful penalties imposed because of an incorrect application of article 1, paragraph 2-ter of Legislative Decree 471 (which sets forth the penalty protection described in section 1.2.), as well as in cases of unlawfully imposed penalties whereby the taxpayer asserts that, under article 10(3) of Law 212 of 27 July 2000, penalties should not have been imposed because, under the latter provision, "penalties shall not be applied when the relevant tax violation is caused by objective uncertainty in the application of the relevant tax provision".

In this specific context, Circular Letter 21/E clarified that:

> although the challenges are linked with the main claim concerning transfer pricing, yet they refer to elements other than those falling within the scope of the MAP. As a result, they do not trigger the consequence for the taxpayer of being forced to withdraw the appeal. Indeed, the taxpayer would be interested in upholding its claims during the appeal in order to avoid the application of penalties if Italy were to be attributed taxing rights upon conclusion of the MAP.

Clearly, the circumstance that a MAP under the Arbitration Convention is an alternative to litigation, is justified by the fact such a MAP involves the obligation to eliminate double taxation. In fact, if the competent authorities are not willing to reach an agreement, an arbitration phase will be initiated.[79] Specifically, article 7 of the Arbitration Convention states as follows:

> If the competent Authorities concerned fail to reach an agreement that eliminates the double taxation [...] within two years of the date on which the case was first submitted to one of the competent Authorities [...], they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question.

Unlike MAPs under the Arbitration Convention, MAPs under a tax treaty merely require that the competent authorities commit to attempting to eliminate the double taxation (i.e. a mere "obligation of diligence" is imposed on the relevant tax administration, which simply "shall endeavour" to eliminate the double taxation). Only 13 tax treaties include an arbitration clause, recourse to which must be evaluated on a case-by-case basis.

In parallel, article 25(1) of the OECD Model states that a MAP request may be submitted "[...] irrespective of the remedies provided by the domestic law of those States [...]".

However, the parallel progress of a MAP (under a tax treaty) and a domestic judicial appeal leaves room for a potentially conflicting outcome between the judgment of the domestic court and the agreement reached by the competent authorities involved in the MAP. This means that the Italian tax authorities might find themselves unable to comply with the international obligation arising from the mutual agreement.

Should the competent authorities agree to eliminate double taxation before a judgment is issued by an Italian tax court, the taxpayer may accept this agreement, although the taxpayer must renounce the

79. EU Arbitration Convention (1990): Convention 90/436/EEC of 23 July 1990 on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, art. 6, Primary Sources IBFD.

litigation in order to consent the execution of the agreement. Circular Letter 21/E offers the following clarification:

> in the opposite scenario (i.e. where a judgment has intervened before the competent authorities reached an agreement pending the MAP), the Italian competent authorities shall inform the foreign counterpart of the outcome of the domestic litigation. In this case, should the judgment not eliminate double taxation, the latter may not be avoided unless the foreign competent authorities concur with the position expressed by the Italian tax court.

In practice, pending a MAP, the parties (i.e. the taxpayer and the tax authority) can jointly request a suspension of the domestic litigation procedure.[80] To date, experience shows that tax courts have granted a suspension of the litigation proceeding pending the outcome of the negotiations between the competent authorities under the relevant MAP. This presumably has the consequence that, if the competent authorities cannot reach an agreement, the taxpayer may be entitled to reactivate the litigation procedure.

OECD Multilateral Instrument

BEPS IF members, including Italy, commit to implement the Action 14 minimum standard and to have their compliance with the minimum standard reviewed and monitored by their peers. Italy's peer review report was published in December 2017.[81]

The Action 14 minimum standard requires members to:

- carry out timely and complete reporting of MAP statistics [82] based on a new MAP statistics reporting framework; and
- publish their MAP profiles [83] pursuant to an agreed template.

According to the Italy's peer review report, "Its treaty network is largely consistent with the requirements of the Action 14 Minimum Standard, except mainly for the fact that:

- More than three quarters of its tax treaties do not include the full equivalent of article 25(1) of the OECD Model (2015), mainly due to a protocol provision requiring taxpayers to initiate domestic proceedings before a MAP request can be filed.
- More than two thirds of its tax treaties do not include a provision stating that mutual agreements shall be implemented notwithstanding any time limits in domestic law (which is required under article 25(2), second sentence), or include the alternative provisions for article 9(1) and article 7(2) to set a time limit for making transfer pricing adjustments.
- More than half of its tax treaties do not include a provision equivalent to the second sentence of article 25(3) of the OECD Model (2015), allowing competent authorities to consult with each other on the elimination of double taxation in cases not provided in the convention."

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80. Para. 19.1.6 RA Circular Letter 12/E of 8 April 2016.
81. OECD, *Making Dispute Resolution More Effective – MAP Peer Review Report, Italy (Stage 1): Inclusive Framework on BEPS: Action 14*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2017).
82. MAP statistics as submitted by Italy can be found at https://www.oecd.org/tax/dispute/2017-MAP-Statistics-Italy.pdf (accessed 26 July 2019).
83. The MAP profile of Italy can be found at https://www.oecd.org/tax/dispute/Italy-Dispute-Resolution-Profile.pdf (accessed 26 July 2019).

In order to address the above deficiencies, Italy reported that it is currently in negotiations with a number of jurisdictions to replace or amend existing tax treaties bilaterally and has also signed the MLI, potentially covering more than 80 of its tax treaties.

Italy was a member of the ad hoc group that developed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion Profit Shifting (2017) (OECD Multilateral Instrument) and signed the agreement on 7 June 2017.

In relation to the MAP, Italy has opted out of the first sentence of article 16(1) of the OECD Multilateral Instrument, which includes the possibility to present the MAP request to the competent authority in either contracting jurisdiction, irrespective of the remedies provided by the domestic law of those contracting jurisdictions.[84]

In addition, Italy has adopted the mandatory binding arbitration procedure (articles 18 and 19 of the OECD Multilateral Instrument).

In this regard, Italy has made the following reservations:

a) any unresolved issue arising from a mutual agreement procedure case otherwise within the scope of the arbitration process provided for by the Convention [OECD Multilateral Instrument] shall not be submitted to arbitration, if a decision on this issue has already been rendered by a court or administrative tribunal of either Contracting Jurisdiction;

b) if, at any time after a request for arbitration has been made and before the arbitration panel has delivered its decision to the competent authorities of the Contracting Jurisdictions, a decision concerning the issue is rendered by a court or administrative tribunal of one of the Contracting Jurisdictions, the arbitration process shall terminate. [85]

The reservations a and b will apply for Italy (i.e. the reserving party) in its relations with the other parties, whether or not the other contracting jurisdiction has also made the reservation.[86]

Moreover, Italy is willing to apply the “final offer” arbitration process (i.e. the so-called “baseball arbitration”) – under which the competent authority of each contracting jurisdiction submits a final proposition to the arbitration panel, which than decides between one of the proposals – except to the extent that the competent authorities of the contracting jurisdictions mutually agree on different rules.

Lastly, Italy has formulated the following reservations with respect to the scope of cases that are eligible for arbitration:

84. Italy intends to meet the minimum standard on improving dispute resolution by ensuring that under each of its covered tax treaties (other than a covered tax treaty that permits a person to present a case to the competent authority of either contracting jurisdiction), the taxpayer may present its case to the competent authority of the contracting jurisdiction of which it is a resident (or a national in cases involving the non-discrimination provision based on nationality) and that the competent authority of that contracting jurisdiction will implement a bilateral notification or consultation process with the competent authority of the other contracting jurisdiction for cases in which the competent authority in which the MAP request was presented does not consider the taxpayer’s objection to be justified.

85. Italy’s position on the OECD Multilateral Instrument, available at http://www.oecd.org/tax/treaties/beps-mli-position-italy.pdf (accessed 17 July 2019).

86. Under article 28 (3) of the OECD Multilateral Instrument, unless explicitly provided otherwise, any reservation made by a contracting jurisdiction will modify the provisions to which it relates to the same extent for both the reserving contracting jurisdiction and the other contracting jurisdiction. In other words, reservations will apply symmetrically, unless otherwise provided.

1. Italy reserves the right to exclude from the scope of Part VI cases concerning items of income or capital that are not taxed by a Contracting Jurisdiction because they are not included in the taxable base in that Contracting Jurisdiction or because they are subject to an exemption or zero tax rate provided under the domestic tax law of that Contracting Jurisdiction.

2. Italy reserves the right to exclude from the scope of Part VI cases involving the application of an anti-abuse rule in a Covered Tax Agreement or in Italy's domestic legislation, namely article 10-bis of L 212/2000 (as enacted by Legislative Decree 128/2015). Any subsequent rules replacing, amending or updating this anti-abuse rule would also be comprehended. Italy shall notify the Depositary of any such subsequent rule.

3. Italy reserves the right to exclude from the scope of Part VI cases concerning dual resident persons.

4. Italy reserves the right to exclude from the scope of Part VI cases involving penalties related to tax fraud, wilful default and gross negligence. [87]

4.2.1. Notification process and conditions to the request

If a MAP is initiated by a taxpayer resident in Italy, the request to commence the procedure must be filed with the Office for Advance Rulings and International Disputes – International Division of the Central Directorate for Tax Assessment of the Revenue Agency, which, with effect from 1 January 2017, has replaced the Ministry of Economy and Finance as the competent authority for dealing with MAPs for elimination of double taxation.

The request may be submitted in any format, either by regular mail or delivered by hand. Under a specific proxy, advisers representing the taxpayer are also entitled to submit the request to commence the MAP and attend the various meetings that may be organized with the officers of the RA during the preliminary activities.

The submission of the request to commence a MAP (which does not require the payment of a fee) must contain at least the following information:[88]

- identification (such as the name, address, tax number) of the enterprise that is submitting the request, as well as of the other parties to the relevant transactions;
- details of the relevant facts and circumstances of the case, including details of the trade relations between the enterprise and the other parties to the relevant transactions;
- identification of the fiscal years covered by the procedure;
- copies of the tax assessment notice, tax audit report or equivalent thereof leading to the alleged double taxation;
- details of any appeals and litigation proceedings initiated by the enterprise or the other parties to the relevant transactions (e.g. enterprises part of a tax consolidation group, associated enterprises) and any court decisions concerning the case;

87. Italy's position on OECD Multilateral Instrument, available at http://www.oecd.org/tax/treaties/beps-mli-position-italy.pdf (accessed 17 July 2019).
88. RA Circular Letter 21/2012, at p. 31. The circular can be accessed at https://www.agenziaentrate.gov.it/wps/file/Nsilib/NSE/Individuals/Double+taxation+relief/Mutual+Agreement+Procedure/Circular+letter+n.+21E+05062012/circularletter21.pdf (accessed 26 July 2019).

- an explanation of the reasons why the taxpayer considers that the claim articulated by the RA does not comply with the arm's length principle, including: a description of the transactions carried out between associated enterprises subject to adjustments and the transfer pricing method adopted by the enterprises involved, including the underlying reasons why the enterprise has concluded that the adopted method leads to results consistent with the arm's length principle;
- a declaration that the enterprise will respond as completely and quickly as possible to all reasonable and appropriate requests made by the competent authorities, and have documentation at the disposal of the competent authorities;
- a declaration that the enterprise will provide all specific additional information requested by the competent authorities within 2 months upon receipt of the relevant request; and
- an indication – if applicable – that the transactions falling within the scope of the MAP have been properly documented (i.e. a Master File and/or a country file have been made available).

4.2.2. Time limits

The filing of a request for the commencement of a MAP must generally be performed within a 3-year period from the date on which the relevant notice of assessment was served. However, a shorter 2-year period generally applies under the Italian tax treaties for MAPs under an applicable treaty.

However, the taxpayer may submit a request before it has been served with a notice of assessment, although it is possible, for instance, for the taxpayer to submit a request for the commencement of a MAP following receipt of the tax audit report (*processo verbale di constatazione*) (which precedes service of the notice of assessment).

4.2.3. Penalties and interest

As described in section 2.3.9., penalties for under-reporting of taxable income in the tax return generally range from 90% to 180% of the relevant tax underpayment.

As described above, even in the case of a MAP under the Arbitration Convention (which is an alternative to tax litigation), an appeal against the alleged unlawful application of penalties may be filed with the competent tax court.

4.3. Arbitration

As mentioned earlier, Italy has opted for part VI of the MLI concerning the introduction of a mandatory and binding arbitration provision in tax treaties. According to Italy's peer review report, 19 out of Italy's 101 treaties provide for an arbitration procedure as a final stage to the mutual agreement procedure, of which 18 are in force.[89]

Italy is also a signatory to the EU Arbitration Convention, which provides for a mutual agreement procedure supplemented with an arbitration procedure for settling transfer pricing disputes and disputes on the attribution of profits to permanent establishments between EU Member States.[90]

For details, *see* section 4.2.

89. This concerns the tax treaties entered into with Armenia, Canada, Chile, Congo, Croatia, Georgia, Ghana, Hong Kong, Iceland, Jordan, Kazakhstan, Lebanon, Moldova, Mongolia, San Marino, Slovenia, Uganda, the United States and Uzbekistan. The arbitration clause under the treaty with Mongolia is not yet in force.
90. Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC) of 23 July 1990.

5. Advance Pricing Agreements

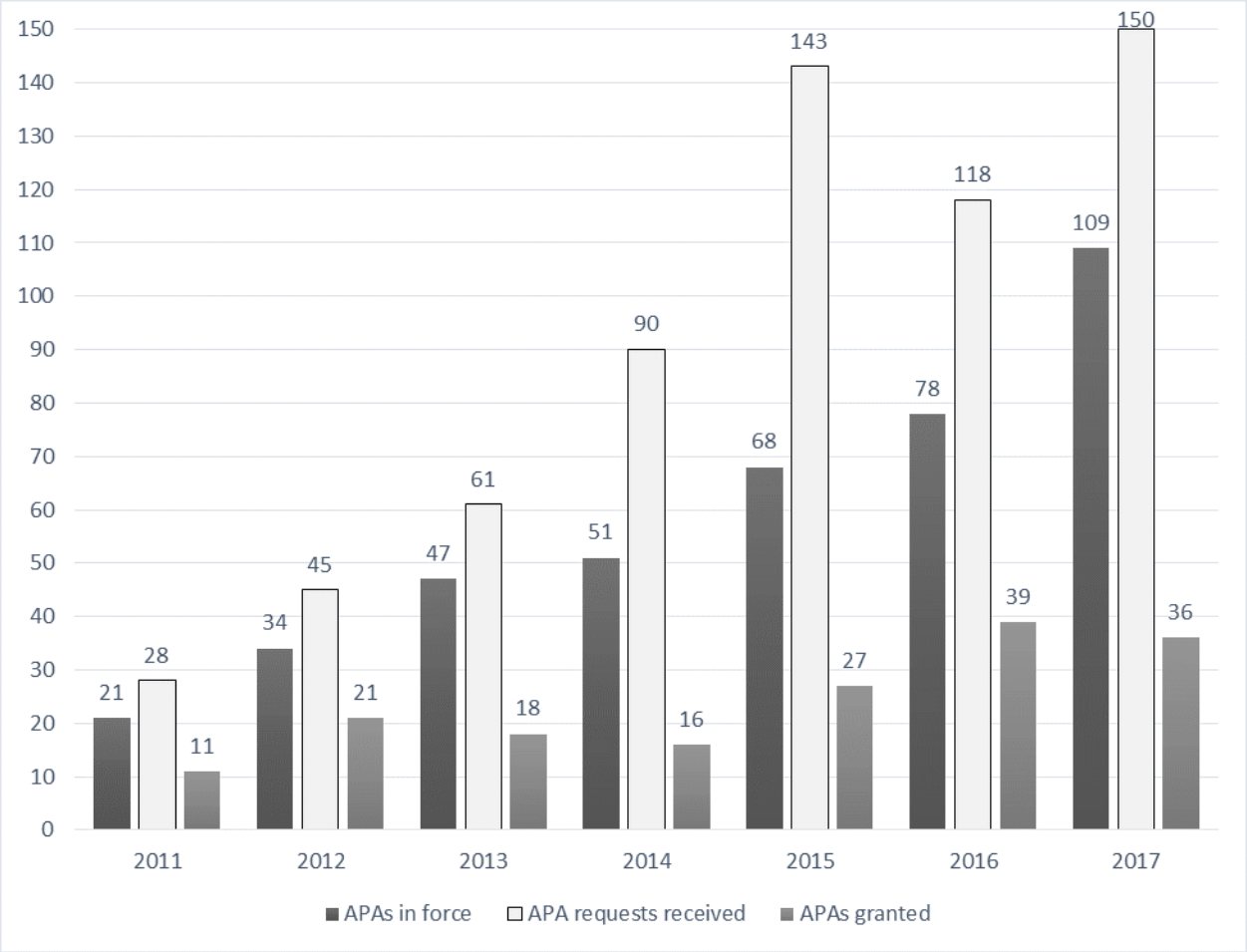
5.1. Historical statistics

The following table summarizes details regarding applications for international standard rulings[91] on pending procedures and on agreements concluded from 2011 to 2017:[92]

	2011	2012	2013	2014	2015	2016	2017
APAs in force	21	34	47	51	68	78	109
Unilateral APAs in force	21	34	47	51	61	73	105
Bilateral/multilateral APAs in force					7	5	4
APA requests received	28	45	61	90	143	118	150
APAs granted	11	21	18	16	27	39	36
APA applications rejected	1	2	4	4	7	9	5
APA applications withdrawn					2	15	17

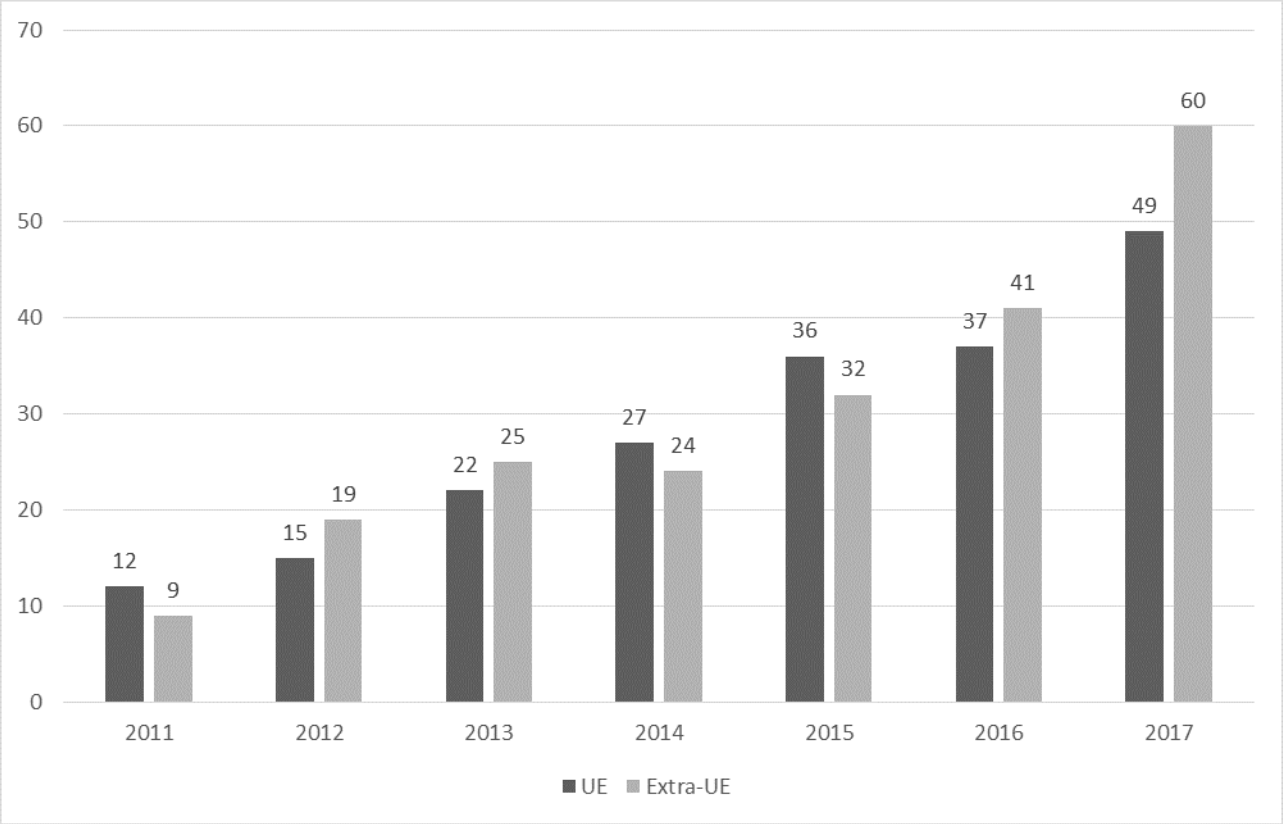
The following figure summarizes details regarding the APAs in force, granted and submitted between 2011 and 2017. [93]

91. The international standard ruling procedure only came into effect in Feb. 2005. Exhaustive instructions on bilateral and multilateral APAs were provided in the RA 2013 International Standard Ruling Report. *See* sec. 3.1.
92. EU Joint Transfer Pricing Forum, Statistics on APAs in the EU, available at https://ec.europa.eu/taxation_customs/sites/taxation/files/statistics_on_pending_maps_under_the_arbitration_convention_2017_en.pdf (accessed 16 July 2019).
93. Id.



The following figure shows the APAs in force between 2011 and 2017, broken down by European and non-European countries.[94]

94. Id.



5.2. Advance pricing agreement process

Access to the APA procedure is on a voluntary basis and, unlike in some other countries, is not subject to the payment of an application fee.

5.2.1. Governmental agencies involved

As mentioned in section 1.2.2.3., an application for an APA[95] must be submitted to the Office for Advance Rulings and International Disputes – International Division of the Central Directorate for Tax Assessment of the Revenue Agency, of either Milan or Rome.

If the taxpayer seeks to apply for a bilateral or multilateral APA, the application must be simultaneously submitted[96] to the International Ruling Office – International Division of the Central Directorate for Tax Assessment of the Revenue Agency in Rome and to the International Relations Department of the Ministry of Economy and Finance. The application must be sent by registered letter with return receipt, on unheaded paper in an unsealed envelope.

5.2.2. Domestic regulations; bilateral or multilateral

The legal framework applicable to APAs, when initiated by an Italian taxpayer, consists of the following provisions:

95. Art. 2 Order of RA Director 42295 of 21 Mar. 2016.
96. Under art.31-ter Presidential Decree 600 of 29 Sept. 1973 and art. 25(3) of the OECD Model.

- article 31-ter of Presidential Decree 600 of 29 September 1973;
- the 2016 Order of the RA Director;[97] and
- article 25(3) of the OECD Model, which states as follows:

> the competent Authorities of the contracting states shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

Pursuant to Law 190 of 23 December 2014, the taxpayer may also apply for an APA when adopting the patent box regime.[98]

Subjective requirements

A taxpayer must possess the status of an "enterprise with international activity"[99] in order to be entitled to enter into an APA. The 2016 Order of the RA Director sets forth a number of eligibility requirements and distinguishes between resident and non-resident subjects. Specifically, the status of an "enterprise with international activity" is also granted to non-resident enterprises that carry on business in Italy through a permanent establishment, which qualifies as such under the relevant provisions of the TUIR.

Objective requirements

An APA application must provide information such as:

- the name of the enterprise;
- its registered office or fiscal domicile;
- the taxpayer identification number and VAT registration and, if applicable, the local addressee for the procedure, which may differ from the enterprise to which communications relating to the procedure are sent;[100]
- documents proving that the applicant meets the subjective requirements when the request is filed by a resident company. Applications by non-residents must indicate the presence of a permanent establishment in Italy;
- the intended scope of the ruling, specifying the cross-border transactions in goods and/or services that will be covered by the APA; and
- the criteria and methods used to determine the arm's length consideration in the relevant transactions and the reasons why these are regarded as consistent with Italian transfer pricing rules.[101]

97. Order of RA Director 42295 of 21 Mar. 2016.
98. In very brief terms, under article 1(37)-(45) of Law 190, Italian enterprises are entitled to benefit from a reduction of the taxable base of royalties and similar items down to 50%.
99. Art. 1 Order of RA Director 42295 of 21 Mar. 2016.
100. Art. 2 Order of RA Director 42295 of 21 Mar. 2016.
101. Art. 2 Order of RA Director 42295 of 21 Mar. 2016.

In general, transactions to be covered by an APA may involve the transfer of goods (tangible or intangible property), the provision of services and/or cost sharing agreements. However, under current legislation that governs Italian APA procedures, it seems not feasible to agree on the determination of the capital gain to be subject to applicable exit tax provisions.[102] Regarding this latter issue, a type of cooperation with the Italian tax authorities may be sought, at least to a certain extent, by filing a request for an interpretative ruling pursuant to Law 212/2000.

More generally, upon the interpretative ruling, a formal request for the opinion of the RA regarding the correct interpretation of an objectively uncertain tax provision may be officially filed with the competent office of the RA. However, in this regard, the objective uncertainty is deemed to exist when there is no official interpretation available (e.g. circular letter, resolution).

5.2.3. Coverage

An APA, which is binding on both parties, remains in force for 5 years[103] starting from the tax period in which it is signed.

The effects of an APA may apply retrospectively to the tax year in which the application was submitted (i) if such APA depends on a previous agreement reached with a foreign tax authority pursuant to the Double Taxation Conventions or (ii) if the facts and the circumstances on which the agreement is settled were present also in previous tax periods and the taxpayer has expressly requested the APA be applied retrospectively.[104] In such a case, the “protection” of the APA may be backdated to the first day of the fiscal year in which it is filed.

Taxpayers may elect which transactions will be covered by the APA.

5.2.4. Process

Starting of the procedure (the pre-filing)

The Office for Advance Rulings and International Disputes, before formally starting the APA procedure, may carry out one or more pre-filing meetings with the taxpayer and/or its representatives, in order to provide clarifications and explanations on the method of submission as well as, in more general terms, to outline the essential features of the unilateral and/or bilateral procedure. This pre-filing stage begins at the taxpayer’s request, and is characterized by a lack of any prescribed format. It may take place anonymously, so that taxpayer’s identity is not revealed, although its object should be general and not dealing with specific cases.

Evaluation and negotiation

Within 30 days from the receipt of the application, the Office for Advance Rulings and International Disputes will evaluate whether the above-mentioned eligibility requirements are met. If so, the Office will schedule a meeting with the taxpayer in order to define the terms and development of the procedure. It is also possible that the Office will request additional information from the taxpayer.[105]

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102. Art. 166 of the ITC, which governs the migration of Italian enterprises out of Italy for income tax purposes. Under this provision, the transfer of the tax residence abroad, which implies the loss of tax residence in Italy, triggers the taxation at fair market value of yet unrealized increases in the values of all business goods and assets not remaining connected with a permanent establishment in Italy (i.e. exit tax).
103. Art. 4 Order of RA Director 42295 of 21 Mar. 2016.
104. Art. 31-ter (2-3) Presidential Decree 600 of 29 Sept. 1973.
105. Art. 3 Order of RA Director 42295 of 21 Mar. 2016.

If any of the essential requirements are not met, the Office will declare the inadmissibility of the application. In any case, the application may not be declared inadmissible if, by means of further examination, it is possible to determine that the applicant meets the conditions to be considered an “enterprise with international activity”. During this additional examination, the 30-day period is suspended.

The procedure consists of several meetings with the taxpayer during which a set of documents is generally required. Over the course of the procedure, the RA and the taxpayer may agree that the tax officers dealing with the procedure could visit the taxpayer’s premises (i.e. the place where business is carried out), in order to obtain, for example, direct knowledge of the factual circumstances represented in the application.

If the RA requests documents and information and such request is not satisfied by the taxpayer without the taxpayer giving any specific reasons, the procedure will be terminated. The application process for the APA shall also be terminated if the RA becomes aware of events or facts that affect the transparency, trust and collaboration between the RA and the taxpayer.[106]

The procedure must be completed within 180 days from the date on which the application was filed. Nevertheless, as this period is not absolute, the parties may agree to extend the procedure depending on the circumstances.[107] Indeed, as described below, experience shows that the overall procedure, culminating in the signing of an APA, lasts approximately 16 months.

Drafting of the APA and acceptance by the taxpayer

The procedure is completed by signing the relevant agreement which sets out the criteria and methods for calculating the normal value of the transactions covered by the APA. The APA then remains in force for 5 years.

At least 90 days before the 5-year period lapses, the taxpayer may submit an application for renewal.[108]

Assessment of compliance with the APA: Monitoring the APA

During the 5-year period during which an APA remains in force, the RA and, more specifically, the Office for Advance Rulings and International Disputes will verify that the terms of the agreement are duly complied with, and will ascertain whether any factual or juridical circumstance have modified the assumptions on which the APA is based. This activity may be carried out by means of one or more inspections at the taxpayer’s premises.

More specifically, according to an Order of the Director of the Revenue Agency,[109] it is indeed part of the APA that the taxpayer agrees to (i) make available to the competent authorities on a periodic basis, or upon specific request, all documentation and/or any other information that may be deemed necessary and (ii) allow the RA to have access to the company’s premises to acquire any information or documentation.

It goes without saying that for the fiscal years covered by the APA, the transactions covered by the APA may not be audited, nor may the relevant transfer prices be challenged.

106. Art. 6 Order of RA Director 42295 21 Mar. 2016.
107. Art. 4 Order of RA Director 42295 of 21 Mar. 2016.
108. Art. 10 Order of RA Director 42295 of 21 Mar. 2016.
109. Art. 7 Order of RA Director 42295 of 21 Mar. 2016.

5.2.5. Fees

As stated in section 5.2., access to the APA procedure is not subject to the payment of any fee.

5.2.6. Timing for filing requests for advance pricing agreements

In principle, an APA application may be filed at any time. However, the protection granted by an APA dates back to the beginning of the fiscal year in which it was signed or, as stated in section 5.2.3., in certain cases, the protection may be granted retrospectively from the beginning of the fiscal year in which the application was submitted.[110]

5.2.7. Timeline for unilateral advance pricing agreement

As stated in section 5.2.4. the procedure must be completed within 180 days from the date on which the application is filed. Nevertheless, this period is not absolute. Statistics show that completing a unilateral APA takes approximately 44 months[111], although practical experience suggests that the time needed to complete the entire procedure significantly depends on the diligence and efficiency of the taxpayer in replying to the various requests made by the competent office from time to time.

5.2.8. Timeline for bilateral advance pricing agreement

In terms of timing, references should be made to the same considerations as seen in unilateral APAs (*see* section 5.2.7.). Statistics show that completing bilateral APAs takes approximately 55 months with an EU Member State and 51 months with a non-EU Member State.[112]

5.2.9. Critical assumptions

Critical assumptions are crucial in an APA, as they define and focus on the scope of the agreement. For purposes of these assumptions, all facts and circumstances should be considered to the extent that they are relevant to the application of the agreed transfer pricing method.

Critical assumptions serve to properly refine the scope of the APA during the stage of the initial request. Specifically, according to the 2016 Order of the RA Director, the initial request must, among other things:[113]

- specify the cross-border transactions in goods and/or services that will be covered by the APA. An APA does not necessarily need to cover all the intercompany transactions carried out by the taxpayer;
- specify non-resident companies with which transactions are carried out and any further information that may be significant to refine the scope of the APA appropriately, in order to ascertain that the relationship between the applicant company and the non-resident companies is covered under article 110(7) of the TUIR;
- specify the criteria and methods used to determine the arm's length consideration in the relevant transactions and the reasons why the criteria and methods are considered consistent with Italian transfer pricing rules;

110. Art. 31-ter (2) Presidential Decree 600 of 29 Sept. 1973.
111. EU Joint Transfer Pricing Forum, Statistics on APAs in the EU (from 2015 to 2017), available at https://ec.europa.eu/taxation_customs/news/statistics-apas-and-maps-eu_en (accessed 6 Aug. 2019).
112. Statistics on APAs in the EU at the End of 2017, EU Joint Transfer Pricing Forum, Meeting of 24 October 2018.
113. Art. 2 Order of RA Director 42295 of 21 Mar. 2016.

- include all suitable documents according to the taxpayer's own assessment.

In case the facts and circumstances change, the taxpayer should inform the Office for Advance Rulings and International Disputes.

5.2.10. Withdrawals

Because the APA procedure is based on an application, withdrawal of the application is theoretically feasible and removes the basis for the APA proceeding, which would then be terminated. However, as described in section 5.2.4., the pre-filing stage provides taxpayers with the possibility to ascertain whether, in a particular case, an APA is a viable option. Indeed, the fact that the taxpayer may remain anonymous during the pre-filing stage provides the taxpayer a useful tool to evaluate whether it is recommendable for the taxpayer to file an APA application. On the other hand, if it is clear that the taxpayer should proceed with its application for APA, after the pre-filing phase has lapsed the taxpayer will no longer be entitled to any form of anonymity, as its identity will be fully disclosed in the APA application.

5.2.11. Agreement with taxpayer

The overall procedure concludes with the signing of the APA. The APA must be signed by both parties, namely the Head Officer of the Office for Advance Rulings and International Disputes and the taxpayer (or its legal representative or advisor).

As mentioned, once effective, an APA is valid for 5 years.[114] During the period in which the agreement is in force, the powers attributed to the RA by article 32 of Presidential Decree 600/1973 (*see* section 2.3.4.) are suspended and the tax authorities may not challenge the transfer pricing of the transactions covered by the APA.

5.2.12. Revocation, revision and renewal

Revocation

If, in the course of monitoring a concluded APA (or in carrying out any other form of inspection), there is an indication that the APA has been breached, the RA may request that the taxpayer provide any documentation that is considered appropriate to verify the proper application of the terms of the APA. In such a case, the taxpayer must submit the documentation within 30 days of the request.[115]

In this scenario, (i) should the documentation sent not be considered exhaustive or (ii) the taxpayer does not provide documentation at all, the APA may be considered wholly or partially void. Revocation commences from the day on which the APA violation is ascertained or, if it is not possible to ascertain that date, even from the date on which the APA was effective.[116]

Revision

If, in the due course of monitoring a concluded APA or during ordinary inspections, the RA becomes aware of a change in the factual circumstances on which the APA was based, a revision of the agreement is theoretically possible. In practice, however, in such cases, the RA will serve the

114. Art. 31-ter Presidential Decree 600 of 29 Sept. 1973.
115. Art. 8 Order of RA Director 42295 of 21 Mar. 2016.
116. Id.

taxpayer with a specific request to generally schedule a meeting to evaluate a possible revision of the agreement.[117]

The revision of an APA may also be initiated upon the taxpayer's request, for example when unpredictable circumstances make it impossible to apply the APA. In such a case, the taxpayer must duly provide all the information regarding the necessary adjustments to the transfer pricing methods. If no agreement can be reached regarding the revision, the APA will be revoked from the day on which the change in factual circumstances occurred.

Renewal

At the end of the APA term, the taxpayer may apply for a renewal by sending a request within 90 days prior to the expiration.[118] The RA will reply within 15 days before the expiration of the APA[119] and – in order to evaluate the taxpayer's application – may:

- request additional documentation or information from the taxpayer;
- invite the taxpayer to attend meetings in order to acquire relevant information that may be considered useful when starting the renewal procedure; and/or
- carry out audits and inspections at the taxpayer's premises and other locations.

5.2.13. Annual compliance reporting

In order to verify compliance with the APA and ascertain whether there have been any changes to the factual circumstances, the RA may perform various evaluations in order to verify whether the terms of the APA are duly complied with, and whether any changes have occurred to the factual circumstances on which the APA is based.

The evaluation of compliance with an APA can also be carried out by means of one or more pre-agreed inspections of the taxpayer's premises. Such inspections may also lead to a possible amendment of the terms of the APA.

It is the taxpayer's duty to prepare (and adequately support) a set of documents regarding its compliance with the APA, and to provide those documents to the RA upon request.

5.2.14. Public disclosure of advance pricing agreements

As a matter of principle, the RA is never authorized to disclose data or information on taxpayers to public sources of information. However, the RA is required by law to send copies of an APA to all competent tax authorities of the countries in which companies with which the taxpayer carries out transactions are resident and are subject to the APA.[120]

5.3. Practical experience with advance pricing agreements and advance tax rulings

Practical experience shows that, given the growing interest of the RA in auditing transfer pricing matters, the choice to pursue an APA is largely the only remedy to prevent a challenge or recharacterization of the taxpayer's overall transfer pricing policy and, thus, potential double taxation. As a result, in recent years, large numbers of Italian taxpayers have opted to pursue an APA.

117. Art. 9 Order of RA Director 42295 of 21 Mar. 2016.
118. Art. 10 Order of RA Director 42295 of 21 Mar. 2016.
119. Id.
120. Art. 31-ter (4) Presidential Decree 600 of 29 Sept. 1973.

In order to encourage taxpayers to pursue an APA, the RA is available to participate in one or more meetings with the taxpayer's counsel in order to explore the possibility and/or existence of necessary conditions to enter into an APA. As mentioned, the taxpayer may choose to remain anonymous during such meetings.

However, among the remedies available to eliminate double taxation, recourse to a MAP should also be considered a viable option.

5.4. Advance pricing agreement in times of economic downturn

In times of economic downturn, the signing of an APA should be considered even more by companies with intra-group cross-border transactions. Indeed, an APA would lead to a reduced tax risk and improve certainty in planning for the tax years during which it is effective.

It may be frequent during economic downturns that a taxpayer will file a request for revision of an APA (*see* section 5.2.12.). Practical experience reveals a reasonable degree of flexibility on the part of the RA in evaluating such circumstances.

In substance, APAs serve as a very helpful tool in enabling taxpayers to discuss and agree with the RA on the effect of a recession on transfer prices. Sometimes, slow-economy conditions can also be reflected in the critical assumptions of the APA.

5.5. Special advance pricing agreements

No special procedures are envisaged with regard to APAs under Italian law. Only those APAs described in section 5.2.2. are possible in Italy.

5.6. Advantages and disadvantages

Through the implementation of the ruling procedure, a tool has been introduced in the Italian tax system that is commonly available in many other OECD member countries.

An APA may be very useful to set clear requirements for the determination of transfer prices for transactions with related parties, and this leads to more planning security, avoidance of uncertain tax positions for financial reporting and a contribution to the reduction of expenses.

While an APA is in force, one can expect that tax audits will be more limited, and thus less time consuming and costly for the taxpayer. Legal certainty may increase by minimizing the risk of double taxation.

It is remarkable that a fair and trusting relationship with the RA is also a significant effect of an APA. Finally, investors now seem to regard APAs positively, as they view the increased certainty as a positive effect.

Another advantage that turns APAs into a very flexible tool is the possibility for the taxpayer to customize the scope of the agreement. This means that there is no all-in/all-out criteria to be followed; the type of transaction and the group members may be included in the scope of an APA are entirely up to the taxpayer's choice.

One potential disadvantage is the relatively comprehensive disclosure of internal data to the RA, which clearly provides the latter with a complete picture and in-depth knowledge of the company. However, given the possibility to schedule pre-filing meeting(s), any topic that could be a possible obstacle to the

efficient conclusion of an APA, may be resolved in advance without disclosing the taxpayer's identity during the preliminary phase.

Another disadvantage could be the overall duration of the procedure, which can be time consuming in terms of resources to be committed.

6. Recommendations

As mentioned, there are very significant reasons for taxpayers to pay specific attention to their transfer pricing policy, given the ever-growing interest of Italian tax authorities in transfer pricing. In Italy, this growing interest, together with the uncertainty that characterizes the issue of transfer pricing, first requires adequate documentation and support of the taxpayer's pricing policy with an appropriate transfer pricing report. The preparation of such documentation triggers the non-application of penalties in cases of ascertained breaches of relevant transfer pricing rules. Second, these circumstances should encourage taxpayers to enter into an APA, on a bilateral or multilateral basis, in order to acquire the maximum extent of certainty as regards their fiscal position.

In addition to transfer pricing, APAs may also cover the tax treatment (including treaty treatment) of dividends, interest and royalties, as well as the determination of the existence of a permanent establishment in Italy of a foreign enterprise.

Application of the arm's length principle

On 14 May 2018, the Italian Ministry of Economy and Finance issued a Decree on the implementation measures associated with the application of domestic transfer pricing provisions.

As part of the consultation, a Ministerial Decree based on the revised wording of article 110(7) of the TUIR was issued in order to clarify certain transfer pricing issues.

The Decree set out the general guidance for the correct application of the arm's length principle in line with international best practices and is mainly aimed at implementing the OECD Transfer Pricing Guidelines within the Italian tax system.

Specifically, the Decree covers:

- a definition of "related entities" by including both juridical and *de facto* control over the entity as well as the definition of control over risk and capital, by including a 50% threshold of ownership;
- guidance on defining comparability based on the five comparability factors provided by the OECD Transfer Pricing Guidelines (i.e. contractual terms, functions, assets and risks of the parties to the transaction, characteristics of the goods or services, economic and market circumstances and business strategies);
- criteria to identify the transfer pricing methods available and selection of the most appropriate method;
- the possibility to analyse different transactions jointly; and
- a definition of the arm's-length range as the range (not specifically the interquartile range) of values that comprises all transactions comparable to the tested transaction. It is also indicated that if the value of the tested transaction (or the margin of the tested party) falls outside the "arm's

length range", the tax authorities shall make an adjustment to bring that value within the range (although there is no specification on which point of the range).

VAT implications of TP adjustments

On 2 November 2018, the RA issued Reply No. 60, regarding the VAT treatment of transfer pricing adjustments.

The case examined by the RA concerns an Italian company (Alfa), which, in the context of intra-group transactions, operates as a contract assembler for the manufacturing of a specific product.

The intra-group agreement in relation to such activity between Alfa and the non-Italian group member – which acts as principal and assumes all risks related to production and marketing of the products (Beta) – provides that, if the profit margins achieved by Alfa in a given year fall outside the reference interquartile range, specific adjustments must be made. Accordingly, Beta undertakes to recognize (where necessary) the payment of a contribution in favour of Alfa whenever the latter incurs operational losses, such as those resulting from the activities carried out and the significant costs incurred for the purchase of equipment used in the production cycle.

In relation to such transaction, Alfa submitted to the RA a ruling request asking whether the payment for such adjustment should be subjected to VAT in Italy.

With reference to the case at stake, RA clarified that the transfer pricing adjustment:

i. i. is not attributable to a remuneration for a specific supply of goods or services, given that Alfa does not undertake contractual obligations, other than those already remunerated by the price provided for the purchase of products and the provision of specific services; and

ii. ii. can affect the determination of the VAT taxable base (as already highlighted by the European Commission in Working Paper No. 923, “Possible VAT implications of Transfer Pricing”, of 28 February 2017), increasing or decreasing the price agreed between the parties for the supply of goods or services, only when:

a. a consideration exists, i.e. a payment either in money or in kind;

b. it is possible to allocate the consideration to a specific supply of goods or services; and

c. a direct link exists between the consideration and the supply of goods or services.

In light of these elements, with reference to the case at stake, the RA maintained that transfer pricing adjustment does not alter the VAT taxable base, given that from the agreement’s provisions it is not possible to identify a direct link between the consideration and specific supplies of goods or services.

Given the above, the RA agreed with the interpretation expressed by the European Commission, stating that, in principle, transfer pricing adjustments would be relevant for tax purposes only in case of a direct link between the payment and the supply of goods and services.

7. Case Study

The Weight Resources Group is a multinational group resident in Wonderland, a low-tax jurisdiction. The group is in the business of developing, manufacturing and distributing weight loss supplement products. One of their products is a weight loss pill registered under the trademark "Less Is More". It

is the crème de la crème of weight loss supplement products, and has proven to be one of the group's best sellers. It contains a secret active ingredient known as Minimynox.

Facts:

The parent company of Weight Resources Group (resident in Wonderland) discovered Minimynox (the active ingredient) at its research facilities. It also developed the Less Is More product in its commercial form there, obtained the necessary patents, conducted all trials, invented the technology for the manufacture of the active ingredient, was the first to launch the product outside Wonderland and has developed the worldwide marketing strategy.

ItaCo is a company resident in the case study country, and a distributor of Less Is More. It purchases the product in market-ready form directly from its parent company.

There is a licence agreement between ItaCo and its parent company, under which ItaCo pays the parent a royalty (7% of sales) for the exclusive distribution rights in the case study country.

ItaCo took the lead in acquiring approval of regulatory authorities for bringing Less Is More to the local market. It also implemented the marketing strategies established by the parent company and introduced the product on the local market by conducting on-site sales activities using its sales staff. The customer base includes first-tier (upper-end market) shops, private clinics and wellness centres. Regulatory approval was obtained in 2013, and ItaCo began selling the product in 2014.

Profits for LocalCo are as follows (all figures in millions):

	2013	**2014**	**2015**	**2016**	**2017**	**2018**
Sales	0	150	220	270	310	360
COGS	0	100	150	175	205	240
Gross profits	0	50	70	95	105	120
Gross profits (as a percentage of sales)	n/a	33.3%	31.8%	35.2%	33.9%	33.3%
Operating expenses	25	50	60	70	71	77
Royalty expense	0	13.3	15.4	18.9	21.7	25.2
Net profits	– 25	– 13.3	– 5.4	6.1	12.3	17.8
Net profits (as a percentage of sales)	n/a	– 8.9%	– 2.5%	2.3%	4%	5%

Questions and answers

1. Based on the above facts, looking back, what action could ItaCo have taken to address the transfer pricing risks when it first established operations and/or began to distribute Less Is More through ItaCo (e.g. documentation, APA)? And what would be the relative advantages or disadvantages?

The best way to address the transfer pricing risks would be, first, to prepare the country file, which, according to the Order of the RA Director of 29 September 2010, provides a description of the transfer pricing policy and methodology adopted by the taxpayer, in addition to illustrating the outcome of the functional analysis and providing some factual information, including the flows of the cross-border transactions.

It is advisable for possession of the country file to be communicated to the RA (i.e. within the period for filing the tax return of the relevant fiscal year – 30 September for a calendar tax year). Such a notification is necessary in order to trigger the penalty protection that ItaCo may achieve if a tax violation in connection with transfer pricing matters is ascertained.

At a further stage (or even in parallel with the preparation of the country file), ItaCo may consider commencing the APA procedure with the RA. An APA may be entered into on a unilateral basis, binding exclusively the RA; under certain conditions (i.e. in essence, if an APA is provided for under the applicable tax treaty), it may also be agreed on a bilateral or multilateral basis.

The mere preparation of transfer pricing documentation would have the advantage of creating awareness in ItaCo about the potential risks it could bear in the case of a transfer pricing audit, with the result that the local management would be vigilant about transfer pricing matters so as to avoid potential risks.

The further advantage of an APA is that once a transfer pricing method is agreed with the RA, ItaCo will obtain certainty of the acceptability of its transfer prices for the duration of the APA process. The disadvantage of entering into an APA is that the process is typically time consuming and expensive. In general, an APA procedure will last approximately 16 months. The protection granted by an APA begins (only) from the beginning of the tax period in which it is signed or, in some circumstances, it may be backdated to the first day of the fiscal year in which the APA was filed.

2. Which transfer pricing method is likely to be the most acceptable to the tax authorities based on the above facts, and why? What factors are critical in making this judgment?

Most acceptable transfer pricing method

With reference to the distribution of products:

- Considering that exclusive distribution rights and unique intangible assets (Minimynox patents) are contemplated, the CUP method is not likely to be applicable.
- The cost-plus method is also not likely to be applicable, as ItaCo acts as a distributing entity (and the cost-plus approach is more suitable for manufacturing activities). In addition, given Wonderland's status as a low-tax jurisdiction, assuming that WonderlandCo is classified as the tested party when applying the cost-plus method, the cost-plus method would not likely be accepted by the RA (especially where Wonderland is a blacklisted jurisdiction[121] or if Italy has not entered into a treaty with Wonderland) due to a (presumed) limited access to information. However, it is not even likely that WonderlandCo would qualify as the tested party, as the possession of IP may tend to assign such qualification to the less complex counterparty.
- Either the resale price method, the TNMM or the profit split method could be theoretically acceptable to the RA here. However, due to the difficulties in identifying reliable gross margin information in the public domain for purposes of applying the resale price method, the TNMM is likely to be the most suitable method. Also, the profit split method could be appropriate, but practical experience suggests that a profit split approach could be agreed in advance with the RA in the course of an APA procedure.

121. Id.

With reference to the royalty payments, the best method (and likely the most acceptable by the RA) would be the CUP method.

- If WonderlandCo has a licence agreement also with third-party distributors – even if in other countries – the internal CUP method could be the most suitable, although from the perspective of the RA, the need for comparability adjustments may weaken the reliability of the method.
- An alternative would be to seek external CUPs. However, experience shows that the RA may tend to disregard the reliability of an external CUP if the relevant royalty rates are obtained through an electronic search of foreign (i.e. US) databases.

Given the above, one should consider the impact of the royalty rate (possibly determined as per the above) on the operating margin of ItaCo (resulting from the application of the TNMM).

Most critical factors

The most critical factors are, first, the determination of the arm's length royalty rate (due to the Minimynox patents, the Less Is More trademark and the exclusive distribution rights); second, the remuneration of ItaCo for liaising with the regulatory authority in relation to the Less Is More product in Italy; and, finally, compensating the on-site sales activity of ItaCo.

3. Could ItaCo apply for an APA in Italy? If so, which facts would be taken into consideration and which requirements and documentation should be met/provided?

ItaCo could indeed apply for a bilateral APA, assuming that there are adequate provisions in the Italy's tax treaty with Wonderland. Alternatively, ItaCo could apply for a unilateral APA, which would still be advisable also taking into consideration that WonderlandCo resides in a low-tax jurisdiction.

The information to be included in the APA application, under penalty of non-acceptance of the initial request, is as follows:[122]

- general information on ItaCo, such as the name, its registered office, its tax and VAT identification numbers;
- documentation proving that the eligibility requirements are met; and
- the scope of the application and the purpose of the APA request.

4. If the tax administration were to look at ItaCo's transfer pricing, what would be the process (information request, review, audit etc.)?

The risk of being audited on transfer pricing in Italy is definitely high. When filing their tax returns, Italian companies with intra-group cross-border transactions must check a box on the relevant form, thereby alerting the RA of the existence of possible transfer pricing implications.

From fiscal year 2012, ItaCo could choose to communicate the existence of its transfer pricing documentation in its tax return (i.e. by checking the designated box) and therefore could benefit from penalty protection in the case of relevant claims. As mentioned, disclosure of the existence of intra-group operation and the amount of expenses and revenue from intercompany transactions is mandatory (similar disclosure is also required in the annual financial statements).

122. Art. 2 Order of RA Director 42295 of 21 Mar. 2016.

When the RA requests ItaCo's transfer pricing documentation, the submission of those documents must be carried out in a timely manner, specifically within 10 days from the request.[123] Supplementary information must be provided within 7 days of the request, or a longer time period depending on the complexity of the transaction, to the extent that such period is consistent with the duration of the audit.

Tax officers generally take a sophisticated approach to the various aspects of transfer pricing (i.e. not only the method may be challenged, but also, for example, the outcome of the functional analysis, the choice of comparables, the selection of the tested party or the existence – or not – of an economic benefit for a related party).

The officers may perform a tax audit over 30 days (not continuous), which may be extended to 60 days.[124] However, the above could imply that, in practice, an audit involving complex transfer pricing matters may last for more than 1 year.

5. What would be the areas of concern of the tax authorities in Italy?

The RA would mainly focus on the following issues:

- start-up losses possibly generated by ItaCo;
- the royalty rate. The royalty rate of 7% on sales, from an Italian perspective, could be considered on the higher side (although Italy historically has offered some safe harbours);[125] and
- the profitability of the distribution activity of ItaCo's business (in terms of the operating margin applied under the TNMM).

6. Is it likely that the tax authorities in Italy would make a primary adjustment? And if so, why and based on what? What other actions might they take (e.g. penalties, secondary adjustments)?

The Italian tax authorities could make primary adjustments for the following factors:

- they may tend to consider that the royalty rate paid by ItaCo to WonderlandCo is not at arm's length; and
- the profitability of the distribution activity of ItaCo is lower than an arm's length profitability.

As such, the RA could disregard the set of comparables identified by ItaCo, arguing that there is a lack of comparability.

Losses could be accepted for the start-up phase (the duration of which should be limited to a few years). Obviously, a permanent loss position would be disallowed.

In the case of a transfer pricing adjustment, no administrative penalty should apply if the taxpayer has properly prepared the relevant documentation to support its intercompany transactions and communicated its possession of such documentation to the RA. Otherwise, applicable penalties generally range from 90% to 180%, except for reductions that may be achieved under application of certain extra-judicial remedies.[126]

123. Para. 8.2 Order of RA Director of 29 Sept. 2010.
124. Art. 12(5) Law 212/2000.
125. IT: SC, decision 4927/2013.
126. Art. 1(2) Legislative Decree 471/1997.

7. If a primary adjustment is made by the Italian tax authorities, what options would realistically be available for ItaCo if (a) it does not agree with the adjustment or (b) it agrees with the adjustment but does not wish to be subject to double taxation?

If the Italian taxpayer does not (partially or wholly) agree with the challenges raised by the Revenue Agency, the following should be considered.

First, at the end of the tax inspection, a tax audit report is served to the company. Against the various claims stated in the tax audit report, the taxpayer may file an objection letter (within 60 days) in order to prove that those claims are partially or wholly unfounded.[127]

The RA may then accept (or reject) the arguments raised in the objection letter and accordingly revise the subsequent notice of assessment. Once the notice of assessment is served, the taxpayer has a 60-day period within which to:

- file a request for an extra-judicial settlement with the competent tax office in order to commence discussions with the officers in an attempt to negotiate a reduction of the original claim;[128] or
- commence litigation proceedings before the competent tax court.[129]

If the option for an extra-judicial settlement is chosen, from a procedural perspective, the period for filing the appeal would be suspended for a 90-day period, during which the taxpayer and the RA would have the opportunity to reach an agreement.[130]

If an agreement is reached, the company will benefit from a reduction of penalties on the claims to one third.[131] If an agreement is not reached, the taxpayer may file for an appeal. Until the public hearing is held, the taxpayer and the RA may still settle the dispute by means of a judicial settlement.

If the option to pursue litigation is chosen, the starting point is generally filing the appeal with the provincial tax court (court of first instance).

If the Italian taxpayer agrees with the challenges raised by the Revenue Agency, the following may happen.

Double taxation arising from adjustments to profits of associated enterprises based on domestic transfer pricing rules are amongst those that may be resolved through a MAP.

The features of MAPs differ depending on whether the MAP is established pursuant to a tax treaty or the Arbitration Convention. On one hand, MAPs under the Arbitration Convention (i) represent an alternative to the ordinary tax litigation procedure described under section 4.1. and (ii) provide for an obligation to resolve the dispute. On the other hand, MAPs under a tax treaty merely require the competent authorities to attempt to the elimination of the double taxation (i.e. a mere obligation of diligence is imposed on the relevant tax administration, which simply “shall endeavour” to eliminate the double taxation).

127. Art. 12(7) Law 212/2000.
128. Art. 6 Legislative Decree 218/1997.
129. Art. 18 Legislative Decree 546/1992.
130. Art. 6(3) Legislative Decree 218/1997.
131. Art. 2(5) Legislative Decree 218/1997.