



Introduction

On November 26th, 2021, the Italian Revenue Agency (the “**IRA**”) published, following the public consultation time frame, the Circular Letter no. 15/E (the “**Circular**”) providing clarifications on transfer pricing documentation (the “**TP Documentation**”) rules contained in the Administrative Provision n. 360494 of November 23rd, 2020 (the “**Provision**”).

Italian taxpayers may opt to prepare TP Documentation to benefit of the penalty protection regime in the event of a tax assessment. In the absence, penalties for unfaithful tax return (from 90% to 180% of the higher due taxes) become applicable.

Below we provide a comprehensive view on Italian TP Documentation rules in the light of the above Circular, hoping that the existing uncertainties will be further clarified in the near future.

- **TP Documentation compliance requirements:** the eligible TP Documentation must be prepared on an annual basis and comprises both the Master File (the “**MF**”) and the Local File (the “**LF**”). The structure and content of the TP Documentation must strictly adhere to what is prescribed by the Provision, except for partial amendments and integrations not altering the information required (in the event of doubts reference should be made to the OECD Guidelines).

It is also confirmed that the previous distinction between holding, sub-holding and subsidiary no longer applies, so that the preparation of the MF becomes necessary for all Italian taxpayers that want to access to the elective penalty protection regime.

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- **Possibility of bounding the perimeter of the operations to be documented:** while all intercompany transactions need to be disclosed and reconciled with the data to be indicated in the annual Income Tax Return (the “ITR”), it is confirmed the possibility for the taxpayer of limiting the transactions to be fully documented in the TP Documentation. In such case, the penalty protection will be granted exclusively with reference to the operations described and for which the information provided is considered compliant with the law.
- **Clarifications specific to the content of the MF:** the Circular confirms the possibility for the Italian taxpayer to rely on the group MF and specifies that in case where the document presents (i) a different structure or (ii) it does not provide the set of information required by the Provision, the Italian taxpayer must integrate the MF with (i) a structure reconciliation document and/or (ii) one or more annexes providing the missing information.

Where the fiscal year of the controlling entity diverges from the fiscal year of the Italian taxpayer, it is still allowed for the local entity to present the group MF even if referred to an earlier closed fiscal year. However, where successively requested in the context of a tax audit, the MF referred to the subsequent fiscal year must be made available by the Italian taxpayer.

As an alternative to the group MF, the IRA admits the possibility for groups with decentralized operational structure model to prepare a MF referred to the division in which the Italian taxpayer operates.

- **Materiality threshold:** the Circular clarifies that a transaction (or a homogeneous category of transactions) is considered as being not material when it does not exceed the 5% of the total amount of intercompany transactions indicated in the ITR.

De facto, according to the Circular, the taxpayer must describe these transactions, even if not material, to benefit of the penalty protection regime. It remains to be understood how the IRA will interpret such caveat: whether a simple description will be sufficient or whether a complete functional and economic analysis will be required. The second option would of course deprive of any relevance the difference between material and not material transactions.

- **Comparability analysis:** in describing potential variations as compared to the previous fiscal years, it is required to evaluate the effects, positive or negative, of support programs implemented by local Governments to face Covid-19 emergency in countries where related companies involved in intercompany transactions operate.

- **Reconciliation of economic and financial data used in the TP analysis:** the Circular confirms the obligation for the Italian taxpayer to provide a reconciliation of the economic data used to determine the financial indicators (*e.g.*, price, royalty rate, ROS, etc.) of the tested party with the local statutory accounts or equivalent document, even in cases where the tested party is a foreign associated entity. In such a case, where the fiscal year of foreign entity diverges from the fiscal year of the Italian entity, the reconciliation can be referred to the earlier closed fiscal year. However, where successively requested in the context of a tax audit, the reconciliation referred to the subsequent fiscal year must be made available by the Italian taxpayer.

It is further specified that when Profit Split Method is adopted, detailed disclosure must be provided on the combined profits and the calculations performed to determine the profit split, as well as the financial data used must be reconciled with the accounts of all the entities considered in the analysis.

- **Clarifications on the TP Documentation for PEs:** the Circular confirms that the new Provision applies to Italian PEs of non-resident enterprises as well as to Italian enterprises with foreign PEs under the branch exemption regime. In particular, Italian entities can disclose in their TP Documentation transactions occurred with their foreign PEs as well as between their PEs and other group's entities. With the aim to document internal dealings, reference should be made to the so-called Authorized OECD Approach ("AOA") and Chapter V of the OECD Guidelines. The comparability analysis, included in the LF, should also cover step 1 of the AOA.

Finally, it is further clarified that Income Statement and Balance Sheet of the PE must be attached, as well as the Financial Statements of the foreign legal entity to which the PE belongs.

- **Simplified Small and Medium Enterprises ("SMEs"):** it is confirmed the simplification granted to SMEs (*i.e.*, possibility not to update economic analyses under certain conditions for a maximum of three years) to reduce the documentation burden (and compliance costs) on smaller taxpayers. The Circular also confirms that a company can be considered SMEs when the annual turnover does not exceed € 50 million for the fiscal year covered by the TP Documentation. Entities do not qualify as SMEs if any of their controlling and/or controlled entities exceed the above threshold.

- **Local language TP Documentation requirements:** the Circular confirms that LF must be written in Italian, while MF can be prepared in English. Attachments to both LF and MF can be presented in a different language than Italian; however, where such attachments are written in a language different from Italian or English, the local entity must provide under request a translation of the same.

- **Conditions for the effectiveness of TP Documentation:** the novelty of the electronic signature made by the legal representative (or a delegate subject) with time stamp having the same date as the tax return filing date is confirmed. It should be noted that this fulfillment concerns both LF and MF and it has been introduced to confer the certain date to the TP Documentation prepared and its late affixing is equivalent to its omission. All the relevant TP Documentation referred to by the Provision must be submitted in electronic format.

- **Timing for the provision of TP Documentation:** the Circular confirms the extension of the deadline for the delivery of TP Documentation that must be provided to the tax authorities by an increased term of 20 days from the relevant request (rather than the 10 days provided under the previous rules). Any additional documents required by the tax authorities should generally be provided by 7 days after the relevant request or a broader period depending on the complexity of the request.
- **Eligibility of the TP Documentation for penalty protection purposes:** the TP Documentation can be considered eligible for penalty protection purposes in all cases where it provides the tax officers with all the information necessary to carry out an independent transfer pricing analysis (with a particular focus on the accurate delineation of transactions and comparability analysis), regardless of whether the transfer pricing method or the selection of transactions or comparable entities adopted by the Italian taxpayer differ from those selected by the tax officers.

It is further clarified that minor omissions or inaccuracies that are not likely to compromise the transfer pricing analysis will be ignored; differently from what provided by the draft version of the Circular and, earlier, by the Circular Letter no. 58/E/2010, the omitted documentation of not material transactions are not considered as minor omissions. Such amendment seems to lead to the conclusion that, in order to benefit of the penalty protection regime, not material transactions will have to be deeply described as well.

Any negative judgment on the eligibility of the documentation needs to be justified and clearly mentioned by the tax inspectors in their audit report.

Finally, it has been clarified that where the IRA challenges the deduction of an intercompany cost because not “related” to the taxpayer’s business, the penalty protection regime does not apply since such favorable regime has been introduced for assessments concerning the arm’s length nature of an intercompany transaction which must, in principle, be related to the local entity’s business.

- **Communication of the possession of the TP Documentation:** taxpayer must communicate the possession of TP documentation with the submission of its annual ITR (currently to be filed 11 months after fiscal year end).

It is confirmed the possibility to present a late or amending ITR within 90 days from the original deadline. In such a case, LF and MF must be signed and time stamped prior to the date of filing of the late/amending ITR. Where the TP Documentation has been timely prepared (*i.e.* signed and time stamped no later than 90 days from the ordinary filing deadline), the omitted communication in the ITR can be fixed presenting an amending ITR before the deadline for the submission of the following year ITR (so-called, *remissione in bonis*).

Finally, under specific circumstances, amendments and modifications to the TP Documentation are allowed only through the submission of a supplementary tax return.

- **Low value-adding services:** the Provision includes specific documentation requirements for intercompany transactions relating to low value-added intercompany services. The Circular specifies that to allow the application of the simplified approach, Italian taxpayers must include the mandatory information required by the Provision in the LF, without the need to prepare a dedicated set of additional documentation.

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We remain available for any further clarification on the above topics.

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