

Overview

Alma LED, Taxand Italy

Alma LED is a fully integrated professional reality, created by Alma Società Tra Avvocati and LED Taxand Tax Law Firm. Alma LED offers customized assistance, providing expert advice on tax and legal issues and developing innovative solutions that allow the optimization of clients' projects.

Alma LED has a dedicated Transfer Pricing and Business Restructuring team that provides tailor-made assistance to the clients. The services provided include the following:

- ❖ Business model analysis, Definition/Design of TP Policies (based on ESG principles as well) and corporate restructuring/Operational Transfer Pricing/Complex statistical models for TP risk assessment
- ❖ Business/IP valuation, IP planning and structuring, Assistance with Patent Box regime
- ❖ Assistance during tax audits and litigation, Negotiation of mutual agreements and arbitration procedures
- ❖ Preparing transfer pricing documentation and assisting with Country-by-Country reporting.

General: Transfer Pricing Framework

Transfer Pricing rules are laid down in the Income Tax Code ("ITC", approved by the Presidential Decree No. 917 of 22 December 1986). Art. 110 para. 7 of the ITC, as amended in June 2017, is applicable to transactions that occurred between an Italian enterprise and non-resident companies that: "directly or indirectly control the Italian enterprise, or are controlled by it, or are controlled by the same company controlling the Italian enterprise". The Ministerial Decree dated May 14, 2018 (in the following "the Ministerial Decree"), implementing the arm's length principle in the general tax system, provided additional clarifications with reference to the definition of "associated enterprises", and namely:

- a) "associated enterprises" means an enterprise resident in the Italian territory as well as non-resident companies where:
 - 1) one of them participates directly or indirectly in the management, control, or capital of the other, or
 - 2) the same person participates directly or indirectly in the management, control or capital of both enterprises;
- b) "participation in the management, control or capital" means:
 - 1) a participation of more than 50% in the capital, voting rights or profits of another enterprise; or
 - 2) the dominant influence over the management of another enterprise, based on equity or contractual constraints.

The Decision of the Commissioner of the Italian Revenue Agency "Agenzia delle Entrate" of 23 November 2020 "the Provision", Circular Letter no. 15/2021 and Circular Letter no. 16/2022 provide some rules and clarifications concerning

transfer pricing documentation requirements and the arm's length range.

Accepted Transfer Pricing Methodologies

The Italian Transfer Pricing legislation follows the OECD standards. The Ministerial Decree implements the arm's length principle in Italy and sets forth the methods to be applied, consistently with the OECD Guidelines, updated from time to time.

In particular, the Ministerial Decree (in Article 4) refers to both traditional transaction methods (CUP, Resale Price, Cost Plus) and income methods (TNMM and Profit Split). Alternative methods can be selected where appropriate and when taxpayers can demonstrate the following:

- i) none of those methods could be applied with reliable results to determine the pricing of a controlled transaction based on the arm's length principle; and
- ii) such different method produces a result consistent with what independent enterprises would expect to obtain in carrying out comparable uncontrolled transactions.

In compliance with the OECD Guidelines "the best method rule" applies. However, when a traditional method and an income method can be applied with the same degree of reliability, the former must be preferred. Furthermore, if the CUP method can be applied with the same degree of reliability as other traditional methods, the former must be applied.

Transfer Pricing Documentation Requirements

Documentation requirements were first introduced in 2010 and updated in 2020 by the November 23 Provision. The Italian Tax Authority provided additional clarifications with the Circular Letter no. 15, released on 26 November 2021. In general terms, local rules are consistent with the OECD Guidelines. However, there are some differences that taxpayers must consider.

Local regulations do not require the taxpayer to prepare the documentation (Masterfile and Local File) as an obligation. Taxpayers filing "proper" documentation will benefit of so called "penalty protection" in case of upward adjustments assessed by the Tax Authority. Penalty protection is recognized only if the formal and substantive requirements of the Provision are met.

The Masterfile can be drafted in English; Local File must be drafted in Italian.

Both Masterfile and Local File must be prepared annually and signed electronically by the legal representative (or a delegate) with a time stamp, to be put by the date of filing of the relevant income tax return (for taxpayers with calendar year: 31 October of each year).

The documentation does not have to be sent to the Italian Tax Authority. Its possession must be communicated by “checking the box” in the annual tax return (“Modello UNICO”, Section RS, Line 106). In case of tax audit, the taxpayer shall submit the transfer pricing documentation to the Tax Authority in electronic form within 20 days upon request.

Country-by-country reporting “CbCR” was introduced in Italy by Law No. 208 dated December 2015, (published in the Official Gazette No. 302 on December 30, 2015) and entered into force on January 1, 2016. Ministerial Decree dated 23 February 2017 “the CbCR Decree” and the Decision of the Commissioner of the Italian Revenue Agency dated 28 November 2017 provided for detailed implementation guidance of CbCR.

In principle, CbCR must be prepared by eligible taxpayers, i.e., parent companies of multinational groups with a consolidated turnover exceeding €750 million. However, in some cases (e.g., where the group foreign parent company is not obliged to or fails to file the CbCR in its jurisdiction), the burden of filing the CbCR falls on an Italian entity of the group.

The CbCR Decree clarified that an entity (parent or subsidiary) subject to reporting obligation, within the deadline to file the tax return referred to the fiscal year forming the scope of the reporting must notify the Italian Tax Authority of its reporting obligation.

Local Jurisdiction Benchmarks

When the TNMM is selected following the “most appropriate method rule”, a benchmark is required to demonstrate that related party transactions are at arm’s length. Economic analyses can be carried out using Bureau Van Dijk databases or other ones (e.g., Bloomberg Professional Service®), taking into consideration the features of the transactions to be analysed.

When the tested party is the Italian entity local comparables are preferred; anyway, pan-European comparables are acceptable as well, providing Italian ones in the set. It should be noted that the selection of comparables is one of the most challenged topics in the event of an audit.

Taxpayers must carry out relevant benchmark analyses on a yearly basis. Small and medium-sized enterprises can update relevant financial data (i.e., not performing a “fresh” benchmarking), assuming that the comparability analysis is based on information from publicly available sources and that there have been no changes in the comparability factors.

The Italian Tax Authority provides clarification on the arm’s length range with the mentioned Circular Letter no. 16/2022, stating that any point in the full range should be considered at arm’s length, assuming that comparables are equally reliable. However, in practice, the interquartile range (often the median) is usually taken as reference in case of adjustments in the context of a tax audit.

Advance Pricing Agreement “APA”/Bilateral Advance Pricing Agreement “BAPA” Overview

In general APAs (unilateral/bilateral/multilateral) are available in Italy.

An APA may be requested by resident companies with “international activities”, i.e., fulfilling one or more of the following requirements:

- ❖ having transactions with non-resident associated companies;
- ❖ holding stakes in the assets, funds, capital of non-resident companies or whose assets, funds, capital are held by non-resident companies;
- ❖ paying to or receiving by non-resident companies income items such as dividends, interests or royalties;
- ❖ conducting their business through a permanent establishment outside Italy;
- ❖ transferring their residence from Italy to another State or from another State to Italy.

A specific application must be sent to the Italian Tax Authority; details of the procedure are set out in the Decision of the Commissioner of the Italian Revenue Agency of 21 March 2016. Filing an application for a bilateral or multilateral APA requires the payment of a fee as follows:

- ❖ € 10,000 for groups with consolidated revenues up to € 100 million.
- ❖ € 30,000 for groups with consolidated revenue of more than € 100 million and less than € 750 million.
- ❖ € 50,000 for groups with consolidated revenues over € 750 million.

The fees listed above are reduced to 50% in case of renewal of a previous APA. There is no charge for unilateral APA.

The procedure is concluded with a binding agreement between the Italian Tax Authority and the taxpayer for the fiscal year of the agreement and the four subsequent ones, unless changes occur in the relevant factual or legal circumstances.

The roll-back of the APA is applicable up to the last assessable fiscal year when certain conditions are met. More in detail:

- ❖ For unilateral APAs, rollback is permitted for fiscal years still subject to tax audits, provided that no changes occurred to the agreed conditions and no tax audits started.

- ❖ For non-unilateral APAs, rollback is permitted as of the fiscal year during which the APA request was filed with the Italian Tax Authority. However, rollback is allowed also to previous fiscal years, provided that:
 - the same factual and legal circumstances exist for these periods on the basis of the agreement stipulated with the competent authorities of foreign countries
 - the taxpayer has requested the roll back in the APA request
 - the competent authorities of foreign countries agree to extend the agreement to previous years, and
 - no inspections or tax audits started in relation to these fiscal years.

Transfer Pricing Audits

The Italian Tax Authority schedules the tax audits to be performed and defines the criteria for the selection of taxpayers to be audited. These criteria are as follows:

- ❖ **Large taxpayers:** Country-by-Country reporting (DAC 4, BEPS Action no. 13), tax ruling reports (DAC 3 and BEPS Action no. 5), cross-border tax arrangements (DAC 6).
- ❖ **Small/medium taxpayers:** benefit from preferential regimes, e-invoicing, grants linked to the Covid-19 pandemic, R&D credits, etc.

Tax audits can be performed by both Agenzia delle Entrate and "Guardia di Finanza" (Italian tax police), while assessment notices can be issued only by Agenzia delle Entrate.

During the transfer pricing audit process, the Italian Tax Authority may focus on the following topics:

- ❖ Selection of comparables and positioning of the profit level indicator within the arm's length range
- ❖ Intragroup services (effectiveness/benefit test/compliance with the arm's length principle)
- ❖ Royalty payments
- ❖ Business restructurings
- ❖ Permanent establishment issues
- ❖ Tax residence of entities
- ❖ Intercompany financing.

Burden of Proof in Transfer Pricing: Theory versus Practice

Regarding the burden of proof, the Italian Supreme Court ("*Corte di Cassazione*") has stated that the tax authorities bear the burden of proving the breach of the arm's length principle, while the taxpayer shall prove compliance with it in IC transactions.

According to the Ministerial Decree of May 14, 2018 (concerning the application of Italian transfer pricing regulations), if the Italian company has adopted one of the methods provided for in the mentioned Decree (i.e., the methods expressly provided for in the OECD Transfer Pricing Guidelines) in compliance with the comparability criteria and the best method rule, any re-assessment shall be based on the method selected by the taxpayer.

In practice it is common to experience situations in which the tax authority disregards the scenario described above, challenging the TP policy applied even if only on the basis of presumptions or inadequate reasoning and proceeding directly to recalculate the arm's length range.

Transfer Pricing Penalties

The taxpayer who has prepared transfer pricing documentation that complies with the requirements (both formal and substantial) mentioned above, can benefit from the "penalty protection regime".

In Italy there are no specific transfer pricing penalties. Ordinary administrative penalties, equal to 70% of the higher tax assessed, can be applied¹.

Local Hot Topics and Recent Updates

During 2024, following the input of the Italian government, an extensive reform of multiple aspects of the tax system has been implemented.

Some of the main modifications include:

- ❖ Simplification of the overall tax system and reduction of the tax burden on enterprises;
- ❖ Mitigation of administrative penalties (applicable for transfer pricing purposes as well);
- ❖ Changes to relevant tax litigation rules;
- ❖ Publication of the Consolidated Text on Tax Penalties (Legislative Decree 05/11/2024) to put in order all administrative and criminal penalties in tax matters;
- ❖ Reduction of the IRES rate for companies investing and hiring new staff;
- ❖ Strengthening of the cooperative compliance rules (Tax Control Framework).

¹ Please note that the mentioned penalties are applicable for violations committed on or after September 2024. For prior violations, penalties ranging from 90% to 180% of the higher taxable income are applicable.



Documentation threshold

Master file	Not applicable
Local file	Not applicable
CbCR	€ 750 million

Submission deadline

Master file	Both Master file and Local File do not have to be submitted, but must have been prepared, signed and marked before sending the corporate income tax return.
Local file	The tax return is due by the end of the 9th month after the closing of the relevant fiscal year.
CbCR	To be submitted within 12 months following the last day of the multinational group's reporting fiscal year

Penalty Provisions

Documentation – late filing provision	Ineligibility for the “penalty protection regime”
Tax return disclosure – late/incomplete/no filing	Late or incomplete Tax Return is subject to a penalty of € 250 The omitted Tax Return is subject to a penalty ranging from € 250 to € 1,000, if no tax is due, or a penalty equal to 120% of the tax due ² .
CbCR – late/incomplete/no filing	Late, incomplete or no filing of CbCR is subject to a penalty ranging from € 10,000 to € 50,000.



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² Please see previous footnote. Note that the reported penalty is applicable for violations committed on or after September 2024. For prior violations, the penalty ranging from 120 to 240% is applicable.