



cutting through complexity

Global Transfer Pricing Review

Italy

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TAX



Italy

KPMG observation

At this stage, there are no official observations from the Italian Tax Authorities on the Base Erosion and Profit Shifting (BEPS) initiative. Most of the comments from Italian tax and legal firms on the discussion drafts issued by the Organisation for Economic and Co-operation Development (OECD) emphasize the need to find a balanced approach between new requests for information deriving from the country-by-country report and the additional administrative burden on the taxpayer. In this regard, it is suggested that more certain and objective criterion are introduced to evaluate the materiality of intra-group transactions to be included in the new documentation requirements. In addition, some advice entrusting judgment on the adequacy of transfer pricing documentation to an independent arbitrator.

With regard to the UN Practical Transfer Pricing Manual for Developing Countries, it is observed that the report is consistent with the OECD Guidelines and offers adequate operational details on transfer pricing methods and comparability analyses. Therefore, it is deemed to represent a good opportunity to help developing countries in defining their transfer pricing policies. However, also in this regard, no public comments from Italian tax authorities are currently available.

Transfer pricing continues to be an area of focus in Italy. The number of multinationals under scrutiny for transfer prices persists on a steady increasing trend, following instructions by the Italian tax authorities on tax inspection activities and the introduction of transfer pricing documentation rules. The presence of transfer pricing documentation for Italian companies that are part of multinational groups, although not mandatory, is now considered as an ordinary requirement in practice during tax audits.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Not applicable
Legal requirements		●
Protection from penalties	●	
Reduce risk of adjustment	●	
Shifts burden of proof	●	

Basic information

Tax authority name

Ministero dell'Economia e delle Finanze (Italian Ministry of Economy and Finance).

Citation for transfer pricing rules

Basic transfer pricing rules are contained in Article 110 (7) of the Italian Income Tax Code (Presidential Decree of 22 December 1986, no. 917 and subsequent amendments).

The penalty protection regime for taxpayer preparing transfer pricing documentation is contained in Article 1, paragraph 2-ter of Legislative Decree of 18 December 1997, no. 471, introduced by Article 26 of Law Decree no. 78 of

31 May 2010, converted into Law no. 122 of 30 July 2010. Documentation rules are contained in the decision of the Commissioner of Italian Revenue Agency dated 29 September 2010. Clarifications on transfer pricing documentation rules were provided with circular letter no. 58/E, dated 15 December 2010.

Advance Pricing Agreement (APA) regulations are contained in Article 8 of the Law Decree no. 269/2003 converted with modifications into Law no. 326/2003 and in the related regulations issued on 24 July 2004.

Mutual Agreement Procedure (MAP) guidelines were provided by circular letter no. 21/E, dated 5 June 2012.

Effective date of transfer pricing rules

1 January 1988.

What is the relationship threshold for transfer pricing rules to apply between parties?

Ownership of greater than 50 percent, based on voting power, share capital, and parties that are under common control.

What is the statute of limitations on assessment of transfer pricing adjustments?

Four years from filing date of the relevant tax return. The exact term is 31 December of the fourth year subsequent to the one in which the tax return is filed. In the event of a violation implying criminal sanctions as provided for by the tax criminal law (legislative decree no. 74 dated 10 March 2000), the terms for an assessment of the tax periods during which the crime was committed are doubled.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. From FY 2010, taxpayers may choose to, but they are not obliged to, communicate the existence of the transfer pricing documentation every year in the tax return. Therefore, the preparation, as well as the disclosure, of transfer pricing documentation is not mandatory.

What types of transfer pricing information must be disclosed?

Information to disclose in the tax return include the existence of intra-group relationships and the amount of costs and revenues relating to intra-group transactions. A description and amount of intra-group transactions must also be indicated in the annual financial statements.

What are the consequences of failure to submit disclosures?

The failure in submitting disclosure of the existence of intra-group relationships and the amount of costs and revenues relating to intra-group transactions is subject to the ordinary tax penalties applying for formal inaccuracies (ranging from EUR251.73 to EUR1,006.91 pursuant to the provisions of Article 8 of Legislative Decree no. 471 of 18 December 1997.

However, an incorrect or missing disclosure of the existence of intra-group relationships could be considered an obstacle to the assessment activity performed by the Italian tax authorities and therefore may cause an increase in the penalties ordinarily applying in case of tax adjustments (ranging from 100 to 200 percent of additional taxes due).

The disclosure of existence of transfer pricing documentation is one of the conditions required to prevent application of the ordinary tax penalties that would apply in the case of transfer pricing adjustments. Therefore, a failure to prepare or submit disclosures would mean that penalties are applied to taxpayers.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

Yes. The documentation has to be filed in Italian. The only exception is for the Masterfile prepared by an EU holding company and submitted by an Italian sub-holding company, which can be drafted in English.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation

for Economic Co-operation and Development (OECD) Guidelines?

Yes. Nevertheless, in order to obtain penalty protection, the documentation must be prepared in accordance with the provisions of the above mentioned Article 26 that outlines a rigid formal structure and detailed information on the content of the transfer pricing documentation. The structure of the documentation makes also reference to the guidance provided by the European Union (EU) Code of Conduct on Transfer Pricing Documentation. Consequently, the documentation must follow the EU definition of "master file/country specific documentation" concept, depending on the qualification of the company (i.e. holding, sub-holding or subsidiary).

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 10 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

The documentation must be submitted in a timely manner, i.e. within 10 days from request. Supplementary information must be provided within seven days of request or in a longer time period depending on the complexity of

the transaction, to the extent that such period is consistent with the time of the audit. According to Italian law, tax audits must be finalized in a maximum of 30 working days, which can be extended by additional 30 days.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

Yes. The taxpayer may choose from a range of different dispute resolution options.

Agreement on the “note of inspection” (adesione al pvc), which implies accepting in full all the adjustments proposed subsequently to a tax inspection and paying the relevant taxes, penalties and interest due within 30 days. Under this procedure, penalties are reduced to one-sixth of the amount of taxes due.

So-called “voluntary assessment procedure” (accertamento con adesione), which implies a negotiation with the tax authorities, in order to reduce the amount of the adjustment and consequent additional taxes, penalties and interest. Under this procedure, the amount of penalties is reduced to one-third of the final amount of taxes resulting from the agreement. This procedure interrupts the terms for litigation and — if an agreement is reached — no further litigation is possible.

“Judicial conciliation” (conciliazione giudiziale), which consists of reaching an agreement with the tax authorities during the litigation phase but before the first hearing of the tax court. In this case, a reduction of penalties is granted up to 40 percent of the amount of taxes resulting from the agreement.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes. If the taxpayer does not qualify for the penalty protection regime, general tax penalties apply in an amount ranging from 100 to 200 percent of the additional taxes resulting from the transfer pricing adjustments.

To what extent are transfer pricing penalties enforced?

If the taxpayer does not qualify for the penalty protection regime, penalties are always applied in case additional taxes arise from transfer pricing adjustments.

What defenses are available with respect to penalties?

“Appropriate” documentation, as detailed previously. In cases where no documentation is prepared, or it is not be considered as “appropriate” to qualify for penalty protection, penalties can be reduced under the above described dispute resolution options (i.e. agreement on the note of inspection, voluntary assessment procedure, judicial conciliation).

In the case of tax losses in the current year or carried forward, they can offset the amount of the transfer pricing adjustment and, consequently, reduce the amount of taxes due and resultant penalties (however this only applies in respect to IRES (corporate income tax) and not for IRAP (local tax) purposes).

What trends are being observed currently?

The attention of tax authorities on intra-group transactions during tax audits continues to remain very high and the number of audits (i.e. inspections and assessments) on intra-group transactions within multinational groups has risen. Transfer pricing audits are usually performed every two to three years (particularly on large companies), and carried out by more skilled officials and/or specifically dedicated departments of the tax authorities. Sometimes the Italian tax authorities tend to adopt an aggressive approach, by requiring further documentation (in addition to that the company makes available at the beginning of a tax audit) with a very challenging deadline, exerting considerable pressure on personnel involved in the tax inspection.

Furthermore, the measure of the penalties due upon transfer pricing adjustments resulting in additional taxes is sometimes higher than the minimum (100 percent), ranging around 120-150 percent of the additional tax assessed. In addition, there are sometimes challenges on transfer pricing documentations by the Italian tax authorities, related to a tendency aiming

at trying to dispute the application of the penalty protection regime.

Additionally, with regard to the type of intra-group transactions analyzed during tax audits, there is a growing interest on intangibles and related royalty issues by the Italian tax authorities and financial transactions. In recent years the Italian tax authorities have focused more on “relocation abroad” (esterovestizione) and “permanent establishments” issues, including attribution of profits and free capital to permanent establishments.

Special considerations

Are secret comparables used by tax authorities?

No.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes. In principle, the presence of local comparables in a benchmarking set is preferred, although it is recognized that the choice between local comparables and broader sets depends on the comparability of economic circumstances, including characteristics of the market of reference for the transaction under analysis.

Do tax authorities have requirements or preferences regarding databases for comparables?

No. The database should be selected depending on whether the benchmarking study is performed in order to identify local comparables (Aida) or international comparables (Amadeus/Orbis).

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, always.

Does the tax authority have other preferences in benchmarking? If so, please describe.

When performing a TNMM analysis, the Italian tax authorities tend to focus on the interquartile values of the arm’s length range, as they are considered to be the most representative indicators of the potential comparable companies included in the final set resulting from the analysis.

In case of transfer pricing adjustments, i.e. when the tested party's margin does not fall within the interquartile range, the Italian tax authorities generally adjust the tested party's margin to the median of the range.

Additional preference is made towards Italian comparables for an Italian tested party. More specifically, when a Pan-European comparable search does not have a sufficient number of Italian comparables in the final set, the Italian tax authorities may reject it as acceptable for an Italian tested party and perform their own search, using the local Italian database.

What level of interaction do tax authorities have with customs authorities?

Low. The interaction appears to be very low in practice, although in principle it has been expressly admitted that in some cases the tax authorities may take into consideration the value defined for customs purposes in order to appraise the transfer prices.

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes. The deduction of management fees, in addition to compliance to transfer pricing rules, is subject to certain domestic rules requiring compliance to the so-called "inherence" requisite. Accordingly, apart from respect of the arm's length principle, deduction of management fees requires the demonstration of the actual provision of services and of the potential benefit for the recipient, to be provided by means of appropriate documentation, supplementary to transfer pricing documentation.

Are management fees subject to withholding?

No.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. In compliance with the so-called "inherence" principle, royalties paid for patents, trademarks, know-how and similar rights are deductible to the extent that they are strictly connected to the taxpayer's ordinary business and that they are determined in accordance with the arm's length principle.

The taxpayer should produce adequate supporting documentation in order to substantiate the situation, i.e. the respect of the "inherence" principle and that the intangible property received is capable to bring benefits to the company.

In addition, the transfer pricing studies supporting the determination of the royalty rate applied should be reviewed in the light of the pre-determined indicators provided by the Italian Ministry of Economy and Finance in 1980 and, in general, should be compliant with the Italian best practices.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. In principle year-end transfer pricing adjustments or true-ups are permitted. However, in managing such adjustments close attention should be paid as they are deeply scrutinized by the Italian tax authorities. Therefore, it would be preferable to support year-end adjustments with detailed documentation and by means of a specific provision in the relative agreements.

In addition, downward year-end adjustments must be recorded in the accounts to be tax deductible, whereas only upward adjustments can be made to taxable income in the tax return when they have not been recorded in the accounts. However, in this latter case, in order to support the reliability of the accounts, under local generally accepted accounting principles (GAAP), it is considered appropriate to make a specific note in the financial statements. VAT and customs implications need to be appropriately addressed and also Intrastat reporting fulfilments. Specific penalties may apply for failure to such accomplishments.

Other unique attributes?

The analysis on the arm's length nature of the intra-group transactions should be performed on a yearly basis and not on multiple year data. However, for benchmarking purposes, reference is made to comparable data of the last three years preceding the year under examination.

Some indications about arm's length royalty rates were provided by the Italian Ministry of Economy and Finance in 1980, which are still used as reference during tax audits and, in some cases, also by tax courts. However, their widespread application is under discussion and more complex analyses are now carried out by tax authorities on intangibles.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive.

If extensive, is the competent authority effective in obtaining double tax relief?

Frequently. It is generally effective within the EU under the EU Arbitration Convention. Outside the EU, competent authority procedures cannot be considered as effective. However, there are some signs of improvement.

When may a taxpayer submit an adjustment to competent authority?

The procedure is regulated in accordance with the applicable tax treaties (if any) either by referring to the corresponding adjustment provided by Article 9 (2) of the OECD Model Tax Convention or to the mutual procedure provided by Article 25 of the OECD Model Tax Convention. In addition, for adjustments between EU countries, the Arbitration Convention would apply.

May a taxpayer go to competent authority before paying tax?

Yes, if a competent authority procedure is started following a tax assessment, under the MAP suspension of payment of additional taxes due may be obtained.

Advance pricing agreements

What APA options are available, if any?

Unilateral, bilateral, multilateral.

Is there a filing fee for APAs?

No.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

No. The number of APAs under discussion in Italy has largely increased and the timing for the conclusion of an APA has significantly been reduced, according to the latest statistics (from 18-20 months, to 15 months on average, in the last three years).

KPMG in Italy

Gianni De Robertis

Tel: +39 06 8096 3563

Email: gianniderobertis@kpmg.it

Maria Eugenia Palombo

Tel: +39 06 8096 3584

Email: mpalombo@kpmg.it

Filippo Bertoletti

Tel: +39 02 6764 4712

Email: fbetoletti@kpmg.it

Samuel Marinelli

Tel: +39 02 6764 4712

Email: samuelmarinelli@kpmg.it

Stefano Rota

Tel: +39 02 6764 4708

Email: srota@kpmg.it

As email addresses and phone numbers change frequently, please email us at transferpricing@kpmg.com if you are unable to contact us via the information noted above.

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