

LEGAL INFORMATION NEWSLETTER

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We are pleased to provide you with the new issue of our legal information newsletter.

Topical legal questions are discussed and those related to issues that you might encounter.

We hope that you will find it of interest. We would welcome any comment you might have.

Domestic Rules on Transfer Pricing and Latest Developments about Country by Country Reporting Guidelines

Introduction – The Italian Ministry of Finance on 21 February 2018 released draft rules under a framework for implementing the base erosion and profit shifting (BEPS) Actions 8-10 that include transfer pricing guidelines.

Under article 110(7) of the Income Tax Unified Act – T.U.I.R., positive and negative items of income deriving from transactions between resident individual or corporate persons and non-resident persons must be determined based on conditions and prices that would have been agreed between independent parties acting on an arm's length basis and in comparable circumstances (domestic concept of "normal value") if the non-resident person:

- is controlled (directly or indirectly) by the resident person; or
- controls (directly or indirectly) the resident person; or
- is controlled (directly or indirectly) by the same person which controls the resident person.

DL 50/2017 grants the Ministry of Economy and Finance the authority to issue an implementing decree that will set forth the

guidelines for the application of the new rules, taking into account international best practices.

Even if the implementing decree has not been enacted yet, it is expected that it will reflect the most recent OECD Guidelines

and override the previous circular letters on transfer pricing which date back to 1980.

According to the Ministry of Economy and Finance, the definition of control encompasses all situations where a company may exercise a decisive influence over another, even if this influence is the result of circumstances other than the holding of shares or equity interests (e.g. contractual relationships, family links and other forms of decisive influence).

Economic double taxation caused by transfer pricing adjustments can be mitigated under Italy's income tax treaties that follow article 9(2) of the OECD Model or that contain other similar, appropriately worded provisions.

Within the European Union, cases of economic double taxation caused by a transfer pricing adjustment can also be dealt with under the Arbitration Convention (Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, 90/436/EEC).

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Documentation and disclosure requirements - From 2010, taxpayers are required to keep, and be prepared to provide, transfer pricing documentation evidencing how the transfer prices were set.

The documentation must comply with certain formal and content requirements set forth by the tax authorities (Commissioner's Regulation 137654/2010).

If, during the transfer pricing audit, the taxpayer provides duly kept and prepared transfer pricing documentation, no penalty will be charged even in the case of transfer pricing adjustments.

If the taxpayer fails to do so, he will have to pay, besides the tax due because of the adjustment, a penalty that can range from 100% to 200% of the tax due on the adjustment.

Italy introduced country-by-country (herein after "CbC") reporting rules. CbC reporting rules require multinational entities to report, by country, the amounts of gross profit, taxes paid and accrued, and other indicators of effective economic activities.

The Decree of the Ministry of Economy and Finance of 23 February 2017 provided implementing rules concerning reporting requirements and deadlines.

The CbC reporting requirements apply to the following entities:

- (a) an Italian resident ultimate parent company of an multinational enterprise group that:
 - is required to file group consolidated financial statements;
 - has a consolidated annual turnover for the fiscal year prior to the CbC reporting of at least EUR 750 million; and
 - is not controlled by any other entity (other than individuals); and

- (b) Italian resident companies that are controlled by a non-resident company that is required to file group consolidated financial statements in a country that:

- has not implemented CbC reporting;
- does not have a qualifying agreement (whether multilateral or bilateral) for the exchange of CbC reports with Italy; or
- does not comply with the obligation to exchange CbC reports under such an agreement.

CbC reports must be filed within 12 months of the last day of the reportable period.

The tax authorities issued Commissioner's Regulation 275956/2017 of 28 November 2017, which provides further detailed implementing rules.

Transfer pricing methods and practice -

The definition of normal value under article 9(3) of the TUIR is basically the same as the arm's length price.

In other words, the normal value is the average price or consideration paid for purchasing goods and services (i) of the same or similar kind, (ii) in free market conditions and at the same stage of the supply chain and (iii) at the same time and place as the goods and services at stake (or, if no such criterion is available, at the time and place nearest thereto).

The Ministry of Economy and Finance clarified (c. 32/9/2267 and c. 42/12/1587) that the method of the comparable uncontrolled price should preferably be used to determine the normal value or, if this may not be applied, the resale price or the cost-plus method.

If the traditional methods are not applicable, alternative methods will be taken into consideration.

The Ministry advised against the profit-split method since it is considered potentially

arbitrary and does not take into account market conditions.

Use of the profit-comparison methods is allowed but is subject to several limitations. Finally, determining transfer prices on the basis of the profitability of the invested capital is also not acceptable.

The aforesaid circulars deal more extensively with determining the normal value of interest, royalties and intra-group services.

Corresponding adjustments - Under article 110(7) of the TUIR, corresponding adjustments are authorized only if they are necessary to comply with mutual agreements concluded with the competent authorities of foreign countries pursuant to the special mutual agreement procedures set forth in double tax treaties.

The same applies in the case of mutual agreement reached under the EU Arbitration Convention 90/436EEC of 20 August 1990.

DL 50/2017 amended article 110(7) of the TUIR and improved the domestic rules on corresponding adjustments.

In particular, corresponding adjustments are also allowed if:

- the transfer pricing adjustment in the other state derives from activities of international cooperation whose results have been shared between the participant states; or
- the transfer pricing adjustment in the other state is final and complies with the arm's length principle, provided that there is a treaty in force between such state and Italy that allows an adequate exchange of information.

In this second case, the taxpayer must file a specific application with the Italian tax authorities to obtain the corresponding adjustment. The Italian tax authorities will issue regulations setting forth the procedure

for the filing of the corresponding adjustment application.

Secondary adjustments - Under Italian tax law, a transfer pricing adjustment does not give rise to secondary adjustments for capital or dividends.

A transfer pricing adjustment may anyway have negative implications on the availability of the exemption under the domestic legislation that implemented Directive 2003/49/EC as the interest withholding exemption does not apply to any interest that is deemed to be in excess of the arm's length interest (see section 7.3.4.2.).

Country by Country reporting -The Italian Tax Authorities (ITA) issued Protocol No. 288555 of 11 December 2017 providing further implementing rules with respect to the country-by-country (CbC) reporting obligation introduced by Law No. 208 of 28 December 2015.

In general, resident companies controlling a multinational enterprise group having at least EUR 750 million in consolidated revenue in the fiscal year prior to the reporting period are required to submit CbC reports within 12 months after the last day of the relevant fiscal year.

However, under certain circumstances, the reporting obligation may also be shifted to a resident subsidiary of the multinational enterprise group.

In particular, qualifying reporting entities had to submit CbC reports related to fiscal year 2016 (first CbC reports) within 60 days from the day of issuance of the Protocol, i.e. by 9 February 2018.

Reporting entities must electronically submit the CbC reports in both the Italian and English languages, through the ITA portal. Relevant information which must be provided in the CbC report includes:

Table 1: summary information with regard to each jurisdiction in which the entities of the multinational enterprise group are resident for tax purposes or the permanent establishments are located, including: revenues; profits (or losses) before tax; income tax paid; income tax accrued; stated capital; undistributed profits; number of employees; and value of tangible assets.

Table 2: summary information with regard to each entity of the multinational enterprise group, including: the name of the entity and the jurisdiction where the entity is a tax resident; the jurisdiction where the entity was incorporated, where it differs from the jurisdiction of tax residency; and the main business activity carried on by the entity.

Table 3: additional information, including the relevant fiscal year and the source of data reported.

On 21 February 2018, the Ministry of Economy and Finance launched a public consultation on transfer pricing legislation, following the amendments introduced by Law Decree No. 50 of 24 April 2017, converted, with amendments, by Law No. 96 of 21 June 2017.

In particular, the Ministry invites comments on the following documents:

- the draft Ministerial Decree providing implementing rules on the application of the amended article 110(7) of Presidential Decree No. 917 of 22 December 1986, in light of article 9 of the OECD Model (2017) and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; and
- the draft Protocol to be issued by the Director of the Italian tax authorities containing implementing rules on corresponding adjustments, as provided by the new article 31-

quarter of Presidential Decree No. 600 of 29 September 1973.

More specifically, the draft transfer pricing regulations include proposals for the following:

- Guidelines for use of the “arm’s length principle” with respect to inter-company transactions following BEPS changes (as per art. 110.7 of DPR 917/1986);
- Procedures for Italian voluntary, unilateral downward adjustments that can be claimed by Italian taxpayers following the finalization of transfer pricing assessments by a country or jurisdiction with which Italy has an income tax treaty that allows for the appropriate exchange of information (as per art. 31quarter 1.c of DPR 600/1973).

Along with the draft regulations, the Ministry of Finance also published an Italian language translation of the OECD transfer pricing guidelines.

Comments should be sent by 21 March 2018.

The draft documents and additional details are available on the website of the Ministry of Economy and Finance.

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