
Transfer pricing changes in Italy

January 27, 2014

In brief

At the end of 2013 a number of changes were made to Italian tax law which impact transfer pricing.

In response to the current international debate on taxation of the digital economy, the Finance Act for fiscal year 2014 (Law no. 147/2013) introduced new rules relating to the determination of the arm's length value of intercompany transactions for companies that operate in on-line advertising or provide ancillary services. For such companies profit indicators based on cost will no longer be acceptable. Changes to VAT and payment rules also increase the possibility of close tax authority monitoring of such transactions.

The Finance Act also addressed a point that had previously been in doubt as to whether transfer pricing adjustments are subject to local tax – the Regional Tax on Productive Activities (IRAP) – as well as corporate income tax. It clarified that IRAP does indeed apply. Tax geared penalties for transfer pricing adjustments relating to fiscal years 2008 to 2012 will not take into consideration the additional IRAP unless the assessment was already final at 1 January 2014.

The above rules are already in force except for the VAT provision which will have effect from 1 July 2014.

The Government has also approved a Law Decree extending both the period for which an International Ruling (i.e. advance pricing agreement) applies and the potential scope – to also include the determination of whether a permanent establishment exists. Although the changes apply from 24 December 2013, they are not definitive until the Law Decree is converted into law (within 60 days) and are therefore still potentially subject to amendment or even cancellation.

In detail

On-line advertising services

Article 1, paragraphs 177-178 of Law no. 147 published in the Official Gazette no. 302 of 27 December 2013, and effective from 1 January 2014, introduced a limitation in the available profit level indicators that can be used in calculating transfer prices for MNEs that operate in the online advertising sector (literally “collection of on-line advertising”) or

undertake related ancillary activities.

For such companies the use of profit indicators based on cost is no longer permitted. Companies can only use cost-based indicators if they reach an APA with the tax authorities on this.

The article specifically provides that this is a change relating to transfer pricing methodology only and has no effect on any

permanent establishment considerations. .

To support the tax authority in monitoring such transactions changes have also been made in relation to VAT and payment methods.

The VAT requirements relate to purchases of on-line advertising services, sponsored on-line links and on-line advertising spaces appearing in the web pages of

search engines (search advertising services) that can be visualized in Italy, either online or on mobile devices. Article 1, paragraph 33 of the 2014 Finance Act provides that such advertising services can only be purchased from entities holding an Italian VAT registration number. A similar limitation applies where the services are bought through a media centre or other intermediaries. This provision will enter into force with effect from 1 July 2014, probably to allow time to verify its compliance with EU Law.

Payment must be made via bank or postal wire transfer or any other means of payment that allow full traceability of the transactions including the VAT identification number of the supplier.

The provisions may be seen as a specific country initiative in the light of the ongoing discussion of taxation of the digital economy fostered by the OECD project on Base Erosion and Profit Shifting.

Applicability of IRAP to transfer pricing adjustments

Italian corporate taxpayers are subject to two taxes on income – the main corporate income tax (IRES) and a regional tax, IRAP (*“Imposte Regionale sulle Attività Produttive”*), charged at a rate of 3.9%.

The rules relating to the definition of the taxable base for the calculation of IRAP were modified with effect from 2008 (Law 244/2007), and as a result there has since been uncertainty as to whether transfer pricing adjustments should be subject to regional tax. This uncertainty has caused an increase in

tax litigation, with taxpayers arguing that as the tax audit adjustment amounts were not recorded in the company's financial statements they were not relevant for the purpose of calculating IRAP.

Article 1, paragraph 281 of the Finance Act clarifies that transfer pricing adjustments arising on tax audit are also relevant for IRAP purposes for companies' financial years commencing on or after 1 January 2008.

The previous lack of clarity affected mutual agreement procedures (MAP). The Italian competent authority was of the opinion that the IRAP element of tax arising on transfer pricing adjustments could not be included in a MAP discussion due to the 2008 changes. This lack of consistency in tax authority approach meant that taxpayers faced assessments for IRAP on transfer pricing adjustments but were unable to apply for double tax relief. The new law should solve this problem.

Article 1, paragraphs 282-283 provides that penalties will not be levied in relation to the additional IRAP applicable to transfer pricing adjustments assessed by the tax authorities for the fiscal years from 2008 to 2012, unless the assessment has become final before January 1, 2014.

Modifications to International Ruling (APA)

The Law Decree 145/2013 has introduced two changes in the International Rulings procedure.

The first change relates to the duration of the agreement with the tax

authority. Article 8 of Law Decree no. 269 of 30 September 2003 originally provided that an APA would run for three years – the year it was signed and the two subsequent years. The Law Decree extends the duration of the APA to five years determined on the same basis. As well as providing taxpayers with a longer period of certainty, this change may free up resource in the International Rulings Office.

In addition, in respect of permanent establishments taxpayers will be able to request an APA on the issue of whether or not a permanent establishment exists, not just on how an admitted permanent establishment should be remunerated.

The Law Decree entered in force on 24 December 2014. It must be converted into Law within 60 days otherwise it will lapse. During the conversion procedure changes can be made or the provisions can be deleted altogether.

The takeaway

Companies operating in online advertising may need to review their transfer pricing model, possibly considering whether it is worthwhile applying for an APA.

The IRAP clarifications should speed up MAP proceedings and remove a potential issue of appeal to the tax court.

The APA changes make an APA potentially more attractive and provide an opportunity to achieve clarity on the existence or otherwise of a permanent establishment.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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