Introduction
Transfer pricing has gained increasing attention in recent years in Italy. Until 2010 this was due to an ongoing relocation of manufacturing out of Italy to territories with low production costs, developed infrastructure, tax incentives and a skilled labour force as a long-term strategic response to the increasingly challenging business environment. In addition, highly centralised business model structures resulting from supply chain restructuring became more common within multinational enterprises with a concentration of high-value intangibles and entrepreneurial functions and risks in tax-advantaged jurisdictions.

In 2010, Italy introduced penalty protection documentation rules together with early recognition of the 2010 OECD Guidelines. Now Italy also requires reporting of the totals of inter-company transactions in the annual tax return. These latter developments have significantly enhanced the profile of transfer pricing in Italy with a much broader level of awareness and general interest. From the perspective of the Italian tax authorities transfer pricing has also become one of their key audit and tax adjustment areas in the past year.

Statutory rules
Statutory rules on transfer pricing are set out in Article 9 and Article 110 of the Italian Income Tax Code.

Article 110, paragraph 7, states that components of the income statement of an enterprise derived from operations with non-resident corporations that directly or indirectly control the enterprise, are controlled by the enterprise or are controlled by the same corporation that itself controls the enterprise should be valued on the basis of the normal value of the goods transferred, services rendered and services and goods received, if an increase in taxable income would arise thereby. Possible reductions in taxable income as a result of the normal value rule are allowed only on the basis of mutual agreement procedures or the European Union (EU) Arbitration Convention.

Article 9, paragraph 3, states that ‘normal value’ means the average price or consideration paid for goods and services of the same or similar type, carried on at market conditions and at the same level of business, at the time and place in which the goods were purchased or the services were performed. For the determination of the normal value, reference should be made to the extent possible to the price list of the provider of goods or services. In the absence of the provider’s price list, reference should be made to the price lists issued by the Chamber of Commerce and to professional tariffs, taking into account usual discounts.
Other regulations

The translation of the above statutory rules into operating guidelines was effected through the Ministry of Finance instructions in Circular Letter No. 32/9/2267, dated 22 September 1980. The Circular Letter provides principles and methods to be used in determining normal value. As it is based on the 1979 OECD Transfer Pricing Report, and the transfer pricing documentation provisions introduced by Law Decree 78 of 31 May 2010 make clear reference to the 2010 Organisation for Economic Co-operation and Development (OECD) Guidelines, its current status is now unclear. Tax auditors have used the Circular Letter for many years and may continue to do so, although this is discouraged by the International Office of the Italian Tax Authority. In some cases, local practice in the field continues to vary from the most up-to-date OECD position.

Transfer pricing documentation provisions have been included in Law Decree 78 of 31 May 2010, which was converted into law on 30 July 2010. The law provides a penalty protection regime for companies which comply with the documentation requirements, including the detailed format as set out in a Regulation dated 29 September 2010 and who notify possession of documentation when they file their tax returns. The provision of compliant documentation relieves taxpayers from the normal regime of tax geared penalties on adjustments insofar as the adjustment relates to a transfer pricing matter.

Legal cases

In recent years, there have been a number of court decisions relating to transfer pricing. The most important cases are summarised below; they provide general principles on various points (i.e. concept of free competition, arm's-length definition, burden of proof, and necessary documentation for deducting inter-company service charges). Decisions from the Supreme Court represent the final judgment in an Italian tax case. Provincial and regional tax court decisions represent first and second instances.

Judgment No. 13233 of the Supreme Court, fiscal division (October 2001)

Judgment No. 13233 deals with the concept of ‘free competition’. The Italian company subject to assessment (ITCO) purchased goods from its foreign parent. The Italian tax authorities (ITA) adjusted the purchase price on the grounds it was not at arm's length. ITCO appealed to the court and claimed that transfer pricing provisions were not applicable in its case due to the absence of free competition in this sector in Italy; only one other Italian company produced the same product, and this was under licence from its foreign parent. The court determined that in order to speak of ‘free competition’, it is enough that a similar product is sold in Italy without any legal restriction on pricing. There is no need to have ‘ideal’ free competition. For this reason, the court rejected the appeal.

Judgment No. 130 of the Tax Court of Tuscany (January 2002)

Judgment No. 130 concerns the definition of ‘arm’s-length value’. The tax court stated that normal value can be determined by reference to average data from the sector in particular, data provided by the trade association to which the Italian resident company belongs, or data confirmed by financial statements from Italian companies in the same sector.
Judgment No. 253 of the Tax Court of Ravenna (November 2002)
Judgment No. 253 concerns a non-interest-bearing loan made to a controlled non-resident company.
ITCO granted a non-interest-bearing loan to a controlled company resident in Luxembourg. The ITA assessed interest income at the ‘normal value’ based on the Italian Bankers Association (ABI) prime rate. ITCO was not able to justify the reasons for having granted a significant non-interest-bearing loan to its foreign affiliate when ITCO bore interest costs on its own external debt. The tax court recognised that the inter-company loan should have generated interest receivable for the Italian company as argued by ITA.

Judgment No. 1070 of the Tax Court of Vicenza (February 2003)
Judgment No. 1070 concerns inter-company sales made without mark-up.
The ITCO sold raw materials to a German related company at a price equal to purchase price without any mark up. Based on data in the company’s financial statements, ITA derived an average mark-up on costs realised by ITCO in its other operations (38%) and applied this mark-up to the sale of raw materials.
The tax court determined that the assessment should be cancelled for the following reasons:
• The operation under review was of negligible value compared with the volume of purchases and sales made by ITCO as a whole.
• The operation was not comparable with the company’s usual inter-company transactions (ITCO’s business activity consisted of sales of finished products).
• The operation was undertaken for the purpose of allowing the German company to produce a particular product for sale to an important Italian client. The aim was a significant increase of ITCO’s overall business.

Judgment No. 13398 of the Supreme Court, fiscal division (September 2003)
Judgment No. 13398 concerns the burden of proof.
ITCO (in a tax loss position) applied to sales made to its French parent company a 6% rebate once a certain sales threshold was reached. The ITA considered the rebate had not been justified by reference to costs and risks borne by the French company and consequently determined an adjustment on ITCO, arguing that the company should have demonstrated that the rebate was justified by reference to distribution costs and risks borne by the parent company and consequent savings for ITCO. A matching of savings and rebates was considered necessary to show that the prices applied were in line with those applied to the third parties.

The court decided that in the absence of the required benefits demonstration, the ITA adjustment was correct.

Judgment No. 158 of the Tax Court of Milan (June 2005)
Judgment No. 158 concerns the documentation necessary to support the deductibility of inter-company services charges.
The ITCO received charges from its foreign parent company under a multilateral service agreement. These charges were considered non-deductible by the ITA due to alleged lack of documentation.
The Milan Tax Court decided in favour of ITCO, judging that it had presented sufficient documentation to show the certainty of the costs sustained and that the costs were related to ITCO’s business, including:

- Written agreement describing the services provided.
- Comfort letter issued by a major audit firm attesting that the cost allocation had been correctly performed and that the attribution of costs to the various group entities had been made on the basis of the benefits they received.
- Invoices containing a detailed description of the services performed.
- Demonstration that the costs borne, with reference to the services received, were correctly recorded in the accounting records and included in the financial statements of the Italian company.
- Documentation describing, for each type of service, the nature of the activity performed and the advantage received by the Italian company.

**Judgment No. 22023 of the Supreme Court, fiscal division (October 2006)**

Judgment No. 22023 sets out the important principle that the inappropriateness of a company’s transfer pricing must be proved by the ITA, which bears the burden of proof that the company does not comply with the arm’s-length principle.

The ITCO, which purchased cars from foreign related companies, bore repair and maintenance costs on new cars, without adequate remuneration. The ITA argued that this caused a reduction in the Italian tax base and an increase of profit for related companies resident in low-tax jurisdictions but did not provide any real evidence of this.

The court decided in favour of ITCO because the ITA did not demonstrate that the group’s transfer pricing was unfair. The court referred to the OECD Guidelines, which expressly state that if the local jurisdiction provides that the tax authorities should set out the reasons for any adjustment, the taxpayer is not obliged to prove the correctness of its transfer prices unless the tax authorities have first demonstrated (at least prima facie) that the arm’s-length principle has not been observed.

**Judgment No. 52 of the Tax Court of Pisa (February 2007)**

Judgment No. 52 concerns the applicability of the CUP methodology.

The ITA issued a notice of assessment on the ITCO, a company operating in the garden pumps market, to cover revenue resulting from the sale of products to a French related party at a price lower than normal value. The ITA compared the sale prices applied to third parties with those applied to the French related company, observed that the inter-company prices were lower by about 10%, and assessed the difference.

However, the court agreed with the arguments of the taxpayer, which demonstrated that the transactions taken by the ITA were not comparable as regards to the stage of commercialisation, the volumes involved, and the number of shipments. These differences would have been sufficient to justify a 10% difference in the sale price. The court stated that the ITA should at least have carried out an analysis of the tax rates in force in the two countries and of the comparable transactions.
Judgment No. 9497 of the Supreme Court, fiscal division (April 2008)
Judgment No. 9497 concerns the power of the ITA to verify the appropriateness of compensation agreed between Italian resident companies.
ITCO had an existing contract with its directly controlled Italian refinery for the receipt of certain refinery oil services. The refinery compensation was guaranteed to cover all the plant’s fixed costs and variable costs and provide a fair profit margin.

Both the ITA and the provincial tax court disallowed the profit margin paid by ITCO to the refinery. However, the regional tax court decided that the service received by ITCO was definitely related to its own operations, and any requirements in transfer pricing and anti-avoidance provisions that would allow the ITA to disregard the agreement between the parties were not met.

The Supreme Court revoked this judgment, determining that the ITA may verify the amount of costs and profit in financial statements or tax returns and make relative adjustments where there are no accounting irregularities or errors in legal documents. The ITA may deny deductibility, in whole or in part, where a cost is considered to be without foundation or is disproportionate. Therefore, the ITA is not bound to the values or the compensation arrived at in company decisions or contracts.

Judgment No. 20 of the Regional Tax Court of Bologna (April 2008)
Judgment No. 20 concerns the deductibility of management costs derived from a written contract between the parties prior to the cost recharge and the use of a percentage of turnover mechanism.
ITCO was charged certain management costs by its parent based on a lump sum linked to estimated turnover. The ITA disallowed the deductibility of these costs as there had been no analysis of their nature and, therefore, it might be assumed some were not relevant to ITCO’s business.

ITCO argued that although it was part of a group, it was not wholly controlled, as there was a 35% minority interest. The services were agreed and performed on the basis of a written agreement signed before the fiscal year in question. The contract stated remuneration for these services (equal to 2.86% of turnover), which should be considered arm’s length.

The regional tax court agreed with the taxpayer arguments taking into account the fact that the ITA’s case was based on mere assumption. The ITA did not prove the absence of services or that the services had no bearing on ITCO’s business.

Judgment No. 87 of the Regional Tax Court of Milan (March 2009)
Judgment No. 87 concerns the application of the arm’s-length principle to inter-company sales in a multinational group.
The ITA issued a notice of assessment on ITCO (a contract manufacturer) for fiscal year 2003, on the basis that ITCO had sold finished goods to a Swiss related company at a price lower than the arm’s-length price in order to transfer income to Switzerland. The ITA’s challenge was based on the fact that the Swiss company sold the same products to an Italian reseller in the group at a higher price.

The ITCO claimed the higher price charged by the Swiss company to the Italian reseller was justified for the following reasons:
• The Swiss company owned the trademarks and patents; performed research and development; and bore the foreign exchange, credit, and inventory risks.
• ITCO performed manufacturing for the Swiss company and did not bear any inventory risk as a contract manufacturer.
• The Italian reseller performed finishing activities based on local market preferences and managed the sales network.

The court cancelled the assessment, as it did not consider the ITA had discharged the burden of proof to show the prices to be non-arm’s length. Moreover, the court considered that the sales prices from ITCO to the Swiss company were in line with those applied by the Swiss company.

**Judgment No. 5926 of Supreme Court, fiscal division (March 2009)**

Judgment No. 5926 concerns the deductibility of inter-company costs charged by a non-resident entity to its permanent establishment in Italy.

The case dealt with the determination of certain overhead costs (administrative expenses, flight operations, and maintenance of the fleet) related to the international airline business and paid by a company resident outside Italy also for its permanent establishment in Italy.

The ITA issued a notice of assessment on ITCO for 1998, disallowing costs that it considered undocumented. The provincial tax court confirmed the ITA's position. ITCO appealed to the Supreme Court, claiming that it was not possible to make a detailed individual analysis of costs as they were incurred by the overseas company and charged pro rata to the branches based on the latter’s sales. The financial statements and the auditor’s report were appropriate to support the non-resident company costs charged to Italy, unless the tax office could show error committed by the auditor.

The Supreme Court agreed with the taxpayer and confirmed that the auditor’s report on the financial statements was sufficient to support the costs registered in the annual financial statements.

**Judgment No. 396 of the Provincial Tax Court of Milan (January 2010)**

Judgment No. 396 concerns the transfer of functions and risks from an Italian company to another firm of the group for registration tax purposes.

The case dealt with the conversion of an Italian entity operating as a fully fledged manufacturer into a toll manufacturer with the relocation of certain functions and risks to a Swiss related company. The ITA argued that this operation represented a transfer of a going concern, subject to registration tax.

The ITA issued a notice of assessment, which was challenged by ITCO. The Provincial Tax Court of Milan determined that the mere transfer of risks and functions does not represent a business transfer and therefore no registration tax was due.

**Judgment No. 7343 of the Supreme Court, fiscal division (March 2011)**

Judgment No. 7343 concerns the application of rebates on inter-company sales.

The case regards the application of discounts granted by ITCO on sales to inter-company entities. The ITA made a transfer pricing adjustment disallowing the discounts on the grounds that no discount was granted on sales to third parties. ITCO argued that the transactions were not comparable since the goods sold to related
parties were at a different stage in the production/distribution chain. The Supreme Court confirmed the ITA view rejecting ITCO’s arguments as to lack of comparability.

**Judgment No. 134 of the Provincial Tax Court of Reggio Emilia (March 2011)**

Judgment No. 134 concerns the possibility that the taxpayer is exempted from the burden of proof. The court stated that the burden of proof in transfer pricing cases is on the ITA, which has to demonstrate that the inter-company transactions, as implemented by ITCO, were not at arm’s length. The ITA has to determine the ‘normal value’ of the transaction and demonstrate that a tax advantage was achieved by ITCO (i.e. taxation in the counterparty’s country was lower than in Italy).

**Judgment No. 580 of the Tax Court of Lazio (September 2011)**

Judgment No. 580 concerns the application of a different transfer pricing method by the ITA compared to the method selected by ITCO for its inter-company transactions. The taxpayer calculated its inter-company prices based on the return on capital employed (ROCE). ITA argued that the ROCE was not the appropriate ratio and made a transfer pricing adjustment based on what is described as TNMM but without further reference to the ratio.

The Tax Court of Lazio rejected ITA’s challenge based on the following reasons: ITA should have demonstrated both the lack of economic reasons underlying the ROCE and that ITCO was pursuing a tax avoidance strategy. The Court stated that since ITA did not provide the above evidences and ROCE is an indicator provided by OECD, the application of an alternative method compared to the one chosen by the taxpayer was not legitimate. The Tax Court also commented on the benchmark analysis performed by ITA recognising the lack of comparability of some comparables found by the Office.

**Judgment No. 129/19/2011 of the Tax Court of Lombardia (October 2011)**

Judgment No. 129 concerns the burden of proof in relation to transfer pricing disputes. This case concern the prices applied by an Italian manufacturer to the Group Swiss Principal. In particular ITA compared these prices with the prices at which the principal sold the same goods to an Italian related distributor. This approach resulted in an adjustment since the prices between the principal and the distributor were higher than those applied by the manufacturer to the principal. The Tax Court rejected ITA’s adjustment for the following reasons: the prices between the principal and the distributor, as inter-company prices, do not represent a market comparable; the company demonstrated the business reasons of the principal structure; ITA did not challenge any violation of tax law in Switzerland or Italy; the fact that both the manufacturer and the distributor are resident in Italy and their premises are close to each other is not relevant since the whole business model underlying the transactions needs to be considered.

**Judgment No. 80/27/12 of the Tax Court of Lombardia (June 2012)**

Judgment No. 80 concerns the deductibility of inter-company services charged. The case relates to a challenge by the ITA to the deduction of costs charged by its French parent to ITCO for administrative, legal, accounting and fiscal services and
the costs related to the implementation and maintenance of operating software. In particular ITA challenged that these costs were not deductible because the taxpayer did not demonstrate that these were relevant to its business activity (art. 109, par. 5 Italian Tax Code).

ITCO, in order to prove the deductibility of the costs, produced: the inter-company contract signed before the services were provided, describing the nature of services provided; the monthly reports summarising the activities performed by the service provider; spreadsheet showing the costs incurred by the service provider and the allocation of these costs to the Group recipients.

The Regional Tax Court stated that the evaluation of the deductibility of service costs should be made applying the transfer pricing principles stated by the OECD, particularly regarding the analysis of the benefit provided to the recipient. According to the Tax Court, the existence of the above mentioned documentation and, in particular, the consistency between the contractual provision and the services actually supplied, was sufficient to demonstrate the actual provision of the services and the benefit for the recipient. Therefore the Tax Court acknowledged the deductibility of the service costs.

Judgment No. 11949 of the Supreme Court, fiscal division (July 2012)

Judgment No. 11949 concerns the burden of proof in case of adjustment of costs. ITCO was an Italian distributor of software purchased from a UK related party. Close to the year-end ITCO received a transfer pricing adjustment from the UK entity increasing the transfer prices of the goods supplied during the year. ITA challenged the deduction of this year-end adjustment. It is worth mentioning that the Regional Tax Court denied the ITA challenge. The Supreme Court acknowledged that the arm’s-length principle (Art. 110, paragraph 7 of the Italian Income tax code) is an anti-avoidance provision and, accordingly, the burden of the proof of the taxpayer’s avoidance aims lies with the tax authorities. However since the challenge considered here related to inter-company costs incurred by the Italian taxpayer, the latter has to demonstrate that the costs are necessary for its business activity and resulted in a benefit for the Italian taxpayer. The Supreme Court stated that the ITCO did not provide evidence of the benefit deriving from the costs challenged particularly regarding the year-end adjustment; the transfer pricing study prepared by the company to support its transfer pricing was not considered sufficient.

Burden of proof

The general principle is that the burden of proof lies with the ITA; however, the taxpayer is expected to demonstrate the fairness of its inter-company transactions in the event of an assessment by the tax authorities. This general principle also has been confirmed by the above Supreme Court’s decision dated October 2006; by Judgment No. 52 of Tax Court of Pisa, dated February 2007; by Judgment No. 134, dated 21 March 2011, of the Provincial Tax Court of Reggio Emilia; by Judgment No. 11949, dated 13 July 2012, of the Supreme Court.

Particular rules apply to cross-border transactions involving counterparties (including third parties) resident in tax havens. The Italian taxpayer, in order to deduct the relevant costs, must provide evidence:

- that the foreign party is a genuine commercial undertaking, and
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• that the transactions were effected in connection with a real economic interest and that the relevant transactions actually took place.

The costs must be disclosed in the company’s tax return; otherwise, penalties will apply. The rules relating to such costs (‘Black List’ transactions) are independent of Italian transfer pricing rules.

**Tax audit procedures**

*Selection of companies for audit*

The ITA focuses its attention on major taxpayers and hence on multinationals. From 2002, taxpayers with turnover above approximately 26 million euro (EUR) are expected to be systematically audited at least once every two years. Also from 2002, taxpayers with turnover exceeding EUR 5.2 million will be systematically audited at least once every four years. These audits may be complete and extensive or focus just on specific items such as transfer pricing. Even if these parameters, introduced by Article 42 of Law 388/2000, are not consistently met, they are considered as a general guideline for tax audits, as stated by Revenue Office Circular (hereinafter Circular) 6/E, dated 25 January 2008.

Provisions concerning ‘large taxpayers’ were introduced by Law Decree n. 185/2008 (the so-called anti-crisis decree), converted into Law n. 2, dated 28 January 2009. The decree provides that companies with turnover exceeding EUR 100 million will be audited by dedicated tax offices, so-called ‘Large Taxpayer Offices’. As also confirmed by Circular Letter 21/E of 18 May 2011, ITA should focus attention on large taxpayers.

Law Decree n. 185/2008 also provided that companies with revenue exceeding a certain threshold will be subject to substantial checks on their income tax and VAT returns in each fiscal year following that in which the filing has been made (so-called ‘tutoraggio fiscale’). The threshold was originally fixed at EUR 300 million but has been reduced to EUR 150 million from 2011. It should be further reduced to EUR 100 million by the end of 2011.

With limited exceptions, corporations that usually are repeatedly in tax loss position should be subject to specific controls.

The ITA is also increasing the level of exchange of information with foreign tax authorities.

*The provision of information and duty of the taxpayer to cooperate with the tax authorities*

Transfer pricing documentation provisions were included in Law Decree 78 of 31 May 2010, converted into law on 30 July 2010, with effect from 2010. Detailed specification about the form and content of this documentation are contained in the Regulation of 29 September 2010.

The Regulation is based on the EU Code of Conduct for Transfer Pricing Documentation and uses the concept of master file and country file. Italian-based groups which include non-Italian subsidiaries must produce both a master file and a country file; Italian subsidiaries/branches need produce only a country file. An Italian sub-holding company with at least one non-Italian subsidiary must produce a sub-holding master file as well as a country file, although it can choose to produce
the group master file if compliant as to form and content. This requirement of a sub group master file also applies to an Italian branch of a company that has non Italian subsidiaries regardless of whether the investments are held by the Italian branch.

Both documents must be prepared in Italian, but an Italian sub-holding company can produce a master file in English provided the file is for the entire EU-based group. Annexes can be in English.

While documentation is not mandatory, the regulation indicates that whether or not a company has communicated the existence of such documentation will influence the tax authorities in their risk assessment and as an indication of taxpayer transparency and willingness to cooperate. Documentation which is considered to meet the requirements of the regulation will protect taxpayers from tax-girded penalties on any transfer pricing adjustments. The format is prescribed in detail and is mandatory. Although a number of interpretative points still remain unclear, further guidance was provided on tax authority expectations in Circular Letter 58 issued on 15 December 2010.

The penalty protection is also applicable to past open years if the taxpayer has notified possession of such documentation by 28 December 2010 or at any point thereafter until a tax authority audit or visit takes place. However, once an audit has begun, the opportunity has passed.

On tax auditor request, the documentation must be produced within 10 days. Taxpayers have a further seven days to produce additional supplementary information if requested. If the taxpayer is unable to meet these deadlines, penalty protection is lost.

Transfer pricing documentation must be produced annually and on a company-by-company basis, although large companies may produce divisional files. Small and medium companies (defined as those with a turnover of less than EUR 50 million) need to perform the method selection and economic analysis part of the documentation only every three years, provided there has been no significant change in the business and that the economic analysis is based on publicly available databases.

Documentation must be submitted electronically, and it needs to be signed on each page by the company’s legal representative.

The regulation does not impose specific methodologies but refers in general to the 2010 OECD Guidelines and emphasizes the preference for traditional transaction-based methods. Transaction profit-based methods are acceptable provided there is sufficient justification, in the presence of potential traditional transaction-based methods, of the reasons why the latter are not used.

General rules on tax documentation also continue to apply to inter-company transactions. Accordingly, the company should be able to adequately substantiate all income and expense items.

The ITA may require taxpayers to produce documents or other information (also in the form of answers to questionnaires) during an audit. In this case, taxpayers are obliged to comply with the requests. If a taxpayer fails to submit documentation within the time frame provided in the tax authorities’ request, an assessment may be made based on the tax authority’s assumptions.
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The audit procedure
Tax audits in Italy are normally carried out on the taxpayer’s premises. The audit visit may be preceded by a formal request for information by the tax authorities, but normally tax audits are not announced in advance.

Apart from exceptional cases, the duration of an on-site tax audit may not exceed 60 days of presence at the taxpayer premises. At the end of the audit, the authorities release a report with findings and proposed adjustments.

The company may file a defence brief or rebuttal against the tax audit report with the relevant tax office within 60 days. Until the 60 days have elapsed, the tax office may not issue a tax assessment. The tax authorities will not necessarily issue an assessment immediately after the 60 days expire, and the formal assessment may not appear for some time.

Tax issues, including transfer pricing, may be settled with the tax authorities without litigation. The relevant procedure was introduced by Decree 218/1997 and is termed accertamento con adesione. If an agreement is reached, an official report is drawn up showing the amount of taxes, interest and penalties due. In the event a settlement is reached, penalties are reduced to 33% of the total amount due.

Once litigation commences, the company and the tax authorities may still settle the dispute out of court. Indeed, they are required to consider this option if they have not already done so. The procedure, introduced by Article 48 of the Decree 546/1992, is called the judicial settlement procedure. In the event a settlement is reached during the judicial settlement procedure, penalties are reduced to 40% of the total amount due.

If the dispute is decided in court against the taxpayer, penalties are applied in full. There are three stages before a final judgment is reached with no further prospect of appeal: First Instance (provincial), Second Instance (regional) and Supreme Court, or Corte di Cassazione. Unless a suspension is obtained while the dispute is pending, the tax authorities are allowed to collect 50% (reduced to 33% by Law Decree 70/2011) of the tax assessed before the first instance decision is given; two-thirds of the tax (and penalties) due following the first-degree judgment; and the total taxes (and penalties) due following the second-degree judgment.

Additional tax and penalties
Italian tax law requires taxpayers to file tax returns, maintain tax books and records, withhold tax at source, etc. If the taxpayer does not fulfil these obligations, then administrative – or in certain cases, criminal penalties – may be imposed. The general penalty regime applies to transfer pricing.

Administrative penalties range from 100% to 240% of the amount of tax unpaid. Special rules apply where similar violations are repeated over various fiscal years. Administrative penalties arise because of an adjustment. There is no need for the tax authorities to adduce negative taxpayer behaviour for penalties to arise.

Penalties may be reduced as follows:

• To one-eighth of the minimum (i.e. 12.5% of tax on adjustment) for spontaneous disclosure (without any tax audit in place).
• To one-third of the minimum (i.e. 33%) if the taxpayer agrees to pay the taxes assessed within 60 days from issuance of the official notice of assessment. The penalty is reduced even further to one-sixth but only if the taxpayer agrees to all adjustments proposed at the end of the audit within 60 days and before the issue of a formal assessment.
• To one-third of the minimum (i.e. 33% of tax agreed) for a negotiated settlement following the issue of a tax assessment (Accertamento con Adesione).
• To 40% of tax agreed in the event of the judicial settlement procedure as described above.

The tax office has four years from the end of the year in which the tax return was filed to issue assessments for additional tax. This period is increased to five years if no return was filed (Art. 43 DPR 600/1973) and to eight years if a criminal report is issued.

Based on Legislative Decree n. 74 dated 10 March 2000, transfer pricing adjustments may also trigger criminal penalties in addition to the administrative sanctions outlined above as related to issues of ‘valuation.’ Although it is arguable that the concept of valuation in the legislative decree should not cover transfer pricing, the Italian tax authorities do tend to notify the outcome of a transfer pricing assessment to the local public prosecutor when the adjustment amount exceeds the relatively low threshold for notification (approx EUR 2 million).

In cases of a transfer pricing adjustment, no administrative penalty should apply if the taxpayer has prepared documentation to support its inter-company transactions drawn up in accordance with the 29 September 2010 Regulation and had notified possession on its tax return. If during a tax audit a taxpayer is not able to deliver documentation for which a formal notification had been made, the tax authorities may take account of such behaviour in the event of a transfer pricing adjustment to determine the suitable level of penalties applicable. The implication is that the level of penalty would be set higher in the range (100% to 200% with reductions for early settlement) than would otherwise apply.

**Resources available to the tax authorities**

There are units dedicated to transfer pricing, and the number of audits has increased in recent years. There are more qualified personnel performing audits, and staff members in local offices also have received transfer pricing training. There is an improved level of preparation and appreciation of resources that can be used in conducting transfer pricing audits.

The Italian administrations have created specific task forces to monitor larger companies on all their tax issues, with particular emphasis on transfer pricing and permanent establishments where appropriate.

**Use and availability of comparable information**

**Use**

To support their transfer pricing policy, a taxpayer’s documentation is expected where appropriate to include a benchmark analysis showing that the results earned by the company fall within the arm’s-length range of results realised by comparable companies. Under the penalty protection rules the Italian tax authorities have indicated that, except for small and medium sized enterprises (turnover less than
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EURO 50 million), they expect to see a new benchmark (including new company selection) each year.

**Availability**

Italian companies are required by law to file their financial statements with the local Chamber of Commerce. In this respect, it is possible to obtain detailed data on the results of other companies, including extensive notes in many cases. These can be accessed online both by taxpayers and the tax authorities. There are databases allowing research of comparable companies at the European and Italian levels. The Italian tax authorities have access to these.

**Risk transactions or industries**

In 2008, the Italian tax authorities (*Agenzia delle Entrate*) issued Circular Letter n. 6/E, dated 25 January 2008. The circular highlights for consideration international transfer pricing as well as inter-company transactions between resident Italian companies when an internal transfer pricing issue could occur because of the presence of a favourable tax regime. The focus on transfer pricing was confirmed by Circular Letter n. 13/E of 9 April 2009 and Circular Letter n. 20/E of 16 April 2010.

The Italian Tax Police (Guardia di Finanza) issued Circular Letter n.1/2008 containing guidelines to be followed by its officers when performing tax audits. Chapter 6, titled 'International Tax and Tax Audits Methodologies', provides specific operative guidelines for tax officers when they assess companies on transfer pricing and permanent establishment issues.

The circular provides specific criteria for officers to identify Italian companies whose inter-company transactions warrant particular attention. The following are specifically mentioned and are typical of the type of transaction where emphasis is placed in practice:

- Transactions with foreign-related companies in jurisdictions where they benefit from favourable tax regimes.
- Transactions concerning intangible assets (such as royalties) and services (management fees).
- Transactions where the Italian company acts as a mere intermediary (commissionaire, agent) and receives a commission-based remuneration.
- The sale of high-value intangible properties by the Italian company to foreign entities.

**Limitation of double taxation and competent authority proceedings**

Italy has begun to use the EU Arbitration Convention and has given an impetus to mutual agreement procedures for intra-EU issues. Based on our experience, use of the competent authority process to obtain correlative adjustments has not been common in Italy in other circumstances to date. Some aspects of the mutual agreement procedure have been clarified by the Italian Tax Authority in Circular No. 21/E of 5 June 2012.

Some key points of the Circular are:

- It is not possible for an agreement under MAP or the Arbitration Convention to override an Italian court judgement or any negotiated settlement between
the Italian tax authorities and an Italian taxpayer. Hence a court judgment or an out of court settlement will preclude any alternative outcome in Italy at competent authority.

• An Italian taxpayer must appeal the tax assessment in order to apply for MAP under a bilateral tax treaty. For an Arbitration Convention procedure to go ahead, however, the taxpayer must be prepared to withdraw from the tax appeals procedure.
• It is possible to continue with appeals on other matters not covered by MAP or the Arbitration Convention at the same time as embarking on the mutual agreement procedure for transfer pricing issues.
• The process for requesting that the collection of tax assessed in Italy be suspended varies between MAP and the Arbitration Convention. However the implication is that suspension should be granted in both cases.
• Concerns that the automatic referral in Italy of a tax adjustment above a certain (low) threshold for consideration in the criminal courts constitutes a ‘serious penalty’ and hence prevents access to the Arbitration Convention are confirmed to be groundless. This should be evaluated on a case by case basis.
• If an agreement under MAP is successfully concluded and the circumstances have not changed, the Circular recognises the possibility of also applying the terms for the years immediately subsequent to those of the MAP.

**Advance pricing agreements (APAs)**

On 23 July 2004, an official procedure was published for a so-called ‘International Ruling’, which had been introduced by Article 8 of Law Decree No. 269 of 30 September 2003. This advance ruling is unilateral, although it is possible to achieve a bilateral effect by using two unilateral agreements. From the latter part of 2010, particularly the ITA has increased the number of instances where a bilateral process with other countries is followed.

The procedure involves companies engaged in ‘international activity’ and may cover transfer pricing, dividends, royalties and interests. The following may apply:

• Italian resident enterprises that have transactions that fall under the Italian transfer pricing rules and/or entities that are owned by non-resident shareholders or themselves own non-resident entities and/or enterprises that receive or pay dividends interest or royalties to or from non-Italian persons.
• Any non-resident company carrying on activity in Italy through a permanent establishment.

The application for a ruling must be submitted to one of the competent offices (i.e. Milan or Rome office, on the basis of company or permanent establishment tax residence, although any application interested in invoking a bilateral approach needs to be made to Rome). The information to be included in the ruling application, under penalty of non acceptance, is as follows:

• General information concerning the company, such as the name, its registered office, its tax and VAT identification number, and so on.
• Documentation that proves the eligibility requirements.
• Scope of the application and the purpose of the ruling request.
• The signatures of the legal representatives.
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Within 30 days from receipt of the application or from the completion of any inquiry activity, the relevant rulings office may notify the taxpayer to appear to verify the accuracy of the information provided and to define terms and conditions for the subsequent negotiations. The full procedure should be completed within 180 days from the filing of the request, but the parties may agree to extend the deadline. In practice, the APA negotiation procedure is fairly lengthy.

Once an agreement has been reached, it remains in force for three years (the year in which the agreement is signed and the two following years). There is no formal rollback provision either for years before the application was made or for years subsequent to the application but before the agreement was signed.

Within 90 days before the expiry of an existing APA agreement, the taxpayer may ask for a renewal. The Revenue Office must approve or decline a renewal at least 15 days before the agreement expires.

In 2010, the ITA issued a report of the number of APAs achieved and in process as at 31 December 2009, with some analysis of time taken, methods used, etc. The number of applications has increased significantly since that date.

**Anticipated developments in law and practice**
The ITA has indicated on more than one occasion that it hopes to establish a framework for bilateral APAs under the relevant tax treaties. As indicated above, it appears that the ITA is now doing this on a wider basis even though there has been no formal announcement of change.

**Liaison with customs authorities**
Administrative rules enable the exchange of information between direct tax and customs authorities, and recent experience suggests that such exchanges do occur (in particular as regards importation of goods from tax haven jurisdictions).

**OECD issues**
Italy is a member of the OECD and uses the OECD Guidelines in bilateral dealings with other tax authorities. In the absence of detailed and up-to-date local regulations, reference has been often made to the 1995 OECD Guidelines by taxpayers, but the 1980 Ministerial Circular still tends to be a tax auditor’s first point of reference until the law changes.

The Italian courts have recognised the 1995 Guidelines as persuasive. It is also important to note that in relation to other OECD material (e.g. the OECD Model Treaty Commentary) in three identical decisions relating to a permanent establishment case, all in 2006, the Supreme Court limited the role of the OECD Commentary. This was held not to have legislative value but to represent, at the most, a recommendation that may not override local law.

The 29 September 2010 regulation on transfer pricing documentation explicitly refers to the 2010 OECD Guidelines and to the EU Code of Conduct as the basis underlying Italian documentation and to the transfer pricing methodologies of the OECD Guidelines.
Joint investigations
On 1 May 2006, Italy became the 12th party to the joint OECD Council of Europe/OECD Convention on Mutual Assistance in Tax Matters. As a party to the convention, Italy enhances its ability to combat tax evasion and avoidance through exchange of information on a wide range of taxes.

The other parties to the convention are Azerbaijan, Belgium, Denmark, Finland, France, Iceland, the Netherlands, Norway, Poland, Sweden and the United States. A key feature of the convention is the ability to take part in simultaneous multilateral examinations. Some joint investigations have been carried out.

Deductibility of interest payable
The 2008 Finance Act (24 December 2007 Law no. 244) replaced the previous limitations on interest deduction (i.e. thin capitalisation and pro rata rules).

The new rule states that interest payable and similar charges are wholly deductible, in each fiscal year, to the extent of interest receivable and similar income. In addition, any excess of interest payable over interest receivable is deductible up to 30% of EBITDA. The non-deductible amount may be carried forward without any time limit.

The new interest deduction limitation does not apply to certain taxpayers, including individual entrepreneurs, partnerships, banks, financial entities and insurance companies, and their holdings. It does apply, however, to holdings of industrial and commercial groups. The rule applies to interest due both to related parties and to third parties.