
Italy amends transfer pricing and patent box rules to follow OECD approach

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In brief

The tax provisions of Law Decree April 24, 2017, No. 50 (the Decree) include a number of measures relating to transfer pricing, which generally are designed to align Italian law more closely with the standards set out by the Organisation for Economic Co-operation and Development (OECD).

These amendments cover:

- the replacement of the Italian concept of ‘normal value’ with a specific reference to the arm’s-length principle;
 - an extension of the range of procedures available for obtaining a corresponding adjustment in Italy; and
 - the exclusion of trademarks from the scope of the Italian patent box regime.
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In detail

The Decree was approved by the Italian government on April 24, 2017 and has entered into force with immediate effect.

However, normal procedural rules require that it is converted into law by Parliament within 60 days, while it remains possible that amendments could be made during this process, changes are considered unlikely on these specific provisions.

The individual transfer pricing related measures in the Decree are outlined below. Further official guidance is to be issued both on the application of the OECD concepts and on the new

option for Italian companies to obtain a corresponding adjustment where a counterparty to a transaction has been subject to a transfer pricing adjustments by a foreign tax authority.

Replacement of the Italian concept of ‘normal value’ by specific reference to the arm’s-length principle

For many years, Italian transfer pricing law has used the concept of ‘normal value’ (valore normale) as the basis for pricing intercompany transactions. This concept was similar to the OECD arm’s-length principle, although not precisely the same

and potentially open to various interpretations. The new definition formally endorses the OECD standard by providing that intercompany transactions are determined based on the "conditions and prices that would have been agreed in comparable circumstances between independent parties acting at arm's length."

Observation: The Ministry of Finance is expected to issue a decree on the application of the new rules based on international best practice and reflecting recent OECD developments. Although the Italian tax authorities often apply current OECD transfer

pricing concepts and practice and reference to the OECD is included in recent pronouncements on transfer pricing, Italian guidance dating from 1980 still can be used as a point of reference, and an official update would be appreciated.

Enlarging the range of options to obtain a corresponding adjustment

The Decree contains a new provision that extends the range of possibilities available to Italian taxpayers to mitigate double taxation arising from transfer pricing adjustments by introducing Article 31-quater of Presidential Decree No. 600/1973, the Italian code governing tax assessments.

Before the Decree, obtaining corresponding adjustments was possible only through the mutual agreement procedure (MAP), including the EU Arbitration Convention. Now it is also possible to obtain a corresponding adjustment in two further circumstances:

- on the conclusion of tax audits performed under international cooperation procedures, where the results are agreed by the tax authorities involved; and
- through a specific application filed by an Italian taxpayer where a final adjustment has been made based on the arm's-length principle in a country which has a double tax treaty in place with Italy that allows an acceptable level of information exchange. A specific regulation will be issued by the Italian Revenue Agency setting out the way in which this procedure will operate.

Exclusion of trademarks from the scope of the patent box regime

The [Italian patent box regime](#) allows taxpayers to elect to exclude a percentage of the income derived from the use and/or the transfer of ownership of relevant intangibles from the tax base declared for both corporate income tax (IRES) and regional tax (IRAP) purposes. The rules governing the regime's current operation were discussed in Tax Insight dated December 8, 2015 entitled *Italy patent box operational guidelines issued – election by year-end may be advisable in light of likely future benefit restrictions*.

Although the Italian regime largely reflected the OECD Final Report published in October 2015 in relation to Action 5 of the OECD programme on Base Erosion and Profit Shifting (BEPS) "*Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*," it differed in two main points. Under that regime, trademarks and know-how were included as eligible intangibles, while Action 5 excludes trademarks and allows know-how only for small enterprises.

With the aim of following the OECD recommendations, the Decree expressly removes trademarks from the list of eligible intangibles. No restrictions have been introduced for know-how, which remains an eligible intangible under the Italian regime for qualifying taxpayers regardless of their size.

Taxpayers wishing to take advantage of the patent box regime need to make an election by the end of the first financial year for which the regime is to apply, followed up where necessary

by an application for the advance pricing agreement specific to the patent box regime. The election remains in force for five years (i.e., the year in which the application is filed and the following four financial years).

The exclusion of trademarks applies to applications filed after December 31, 2016. The restriction applies slightly differently depending on whether the taxpayer has an accounting period that corresponds with the calendar year:

- For taxpayers with an accounting period corresponding to the calendar year, trademarks are not admissible in applications filed after December 31, 2016. This means that the last year for which it is possible to apply for trademarks is 2016;
- For taxpayers with an accounting period that does not have a calendar year-end, trademarks are not admissible in applications filed after December 31, 2016 that relate to the third accounting period following the one in course at December 31, 2014. For example, for a taxpayer with an accounting period ending on June 30, applications filed after June 30, 2017 are not admissible.

Applications not subject to this restriction remain valid for five years, but in any case not beyond June 30, 2021 in compliance with the grandfathering rules in the BEPS Action 5 Report.

An inter-ministerial decree is expected to provide specific guidelines to adapt the patent box regulation to the new amendment and to regulate

the voluntary exchange of information regarding the options concerning the trademarks.

The takeaway

The provisions in the Decree represent further steps in aligning Italian tax rules with the OECD standard.

The new possibilities for claiming a corresponding adjustment represent a

welcome simplification for multinational groups that become subject to upward tax adjustments based on the arm's-length principle in countries other than Italy, resulting in double taxation involving an Italian related party. In certain circumstances, corresponding adjustments may be obtained in Italy without the need to enter into the MAP process.

Limitations to the Italian patent box regime for trademarks were expected. Most taxpayers affected will already have applied to enter the regime before the deadlines after which the restriction applies, and so will be protected for the initial five-year period. So far, no limitation has been introduced for know-how regardless of the size of the taxpayer.

Let's talk

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

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