

Italy: Tax authorities' guidelines on transfer pricing documentation

Article 26 of the decree No. 78 of May 31, 2010 provides that, in case of a transfer pricing assessment, no penalties (usually ranging from 100% to 200% of the higher tax to be applied on the adjusted prices) will be levied if the taxpayer both complies with specific documentation requirements and a specific communication is filed with the Italian tax authorities.

The documentation requirements and the content and terms of the communication have been set forth by the Italian Revenue Agency on September 29, 2010

For comments on the documentation requirements and the content and terms of the communication please refer to our Tax Connect Flash of October 14, 2010. In a nutshell:

- each company belonging to a multinational enterprise should prepare a Master and a National File to prove compliance with the arm's length principle in intercompany transactions. Such Files should be updated on a yearly basis and made available within 10 days from the request made by the Italian tax authorities;
- a communication should be filed in order to inform the Italian tax authorities that such documentation is available. The communication is filed together with the annual tax return, i.e., by September 30 of each year for calendar-year companies. With respect to taxable periods prior to 2010, the communication should be sent by December 28, 2010. However, communications sent after that date will be valid provided that no tax audits have started.

The Italian tax authorities have provided guidelines on transfer pricing documentation by mean of the Circular letter No. 58/E of December 15, 2010. We summarize here-below the main indications contained therein.

The circular letter No. 58/E of December 15, 2010

1. *Bona fide* cooperation

The Circular letter highlights the importance of *bona fide* cooperation between taxpayers and tax authorities, also in light of the principles laid down by the "Statute of Taxpayer". Namely, according to the Italian tax authorities the preparation of the documentation in compliance with the communication of September 29, 2010, shall be seen as a sign of positive attitude of taxpayers to be taken into account for tax audit purposes and in order to establish the degree of tax risk attached to the taxpayer itself.

2. Eligibility of the documentation

The Italian tax authorities confirm that, in order for the taxpayer to claim penalty protection, the documentation should be appropriate, i.e., comply, not only from a pure formal standpoint, with the content of the National and (if any) the Master Files as depicted in the communication of September 29, 2010. However, the lack of documentation for not material transactions should not jeopardize penalty protection.

3. The Master File and the National File

The Circular letter makes clear that both the National and (if any) the Master Files shall be compulsory divided in chapters, paragraphs and sub-paragraphs as indicated in the communication of September 29, 2010. Minor changes and supplementary information are allowed only to the extent that they are necessary for a better understanding of the Files.

The Circular letter provides detailed guidelines on the content of the chapters, paragraphs and sub-paragraphs. Should any doubt arise as to the content of each chapter, paragraph or sub-paragraph, reference should be made to the OECD Transfer Pricing Guidelines.

Two specific annexes to the National File are also mandatory: annex 1, i.e., the flow chart aimed at describing the flows of the operations, including those related to extraordinary transactions; annex 2, i.e., copy of the written contracts under which the transactions are regulated. The annexes must be drafted either in Italian or in English language.

4. Tax audits in progress

The Circular recognizes that companies under investigation by the Italian tax authorities can claim penalty protection if no formal notice of assessment has been issued before filing the communication of transfer pricing compliance within 28 December 2010. As a matter of fact, even if a tax assessment has already been formalized, the Revenue Agency may also discretionarily grant penalty protection to taxpayers that have proven *bona fide* and cooperative behaviour during the tax audit.

5. Tax audits that will start between December 28, 2010 and June 30, 2011

Pursuant to the Circular letter, taxpayers may submit the communication regarding the availability of documentation within 28 December 2010 even if the paragraphs relating to the selection of the transfer pricing method have not been yet completed. In such a case, the documentation will be deemed appropriate as long as the information is submitted within 15 days from formal request (instead of the ordinary 10 days term).

This rule applies to tax audits that will start between 28 December 2010 and 30 June 2011 only.

6. Local income tax (IRAP)

Finally, the Circular letter clarifies that penalty protection applies both for corporate (IRES) and local income tax (IRAP) purposes.

How we can help

CMS has a network of international tax specialists that can help you in reviewing, from each side of the deal, the documentation supporting cross-border transactions.

In addition CMS has a litigation department specialized in supporting the defense of tax audits at all levels, including the Italian Supreme Court and the European Court of Justice.

For further information on this tax analysis and thought, please contact:

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