

# **Russian and international taxation: development, challenges, solutions**

## **Transfer pricing news in Italy**

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Fabio Aramini, LL.M., partner, Milan / Rome  
CMS Adonnino Ascoli & Cavasola Scamoni

# Agenda

I. Tax audit trends

II. Transfer pricing documentation requirements

III. Statistics on APA

# I. Tax audit trends

## Historical overview of TP in Italy

- ✓ Little focus on TP by Tax Authorities historically
- ✓ Only one (main) administrative practice → 1980 circular letter
  - ✓ Tax inspectors looked at TP as very complex matter
- ✓ General 100% - 200% penalty regime was applicable
  - ✓ Few cases before the Courts
    - ✓ Negotiations with penalty reduction down to at least 25%
    - ✓ Tax amnesties

## What changed over time

- ✓ Increased attention at OECD and EU levels resulted in:
  - ✓ Enhanced training programs for Italian Tax Auditors
  - ✓ Increased enforcements
    - ✓ Italian Revenue Agency tax assessments guidelines
    - ✓ Tutoring for large taxpayers ( $\geq 100$  m Euro) led to an increased focus on TP
  
- ✓ Criminal law ramifications

## Two instruments to reduce the risk

- ✓ Documentation requirements (2010)
  - ✓ Valid for the **past**
    - ✓ 4 years period of assessment from the date of filing of the tax return
  - ✓ General penalty regime no more applicable
  
- ✓ (Unilateral) advance pricing agreements – APA
  - ✓ Valid only for the **future**
  - ✓ Introduced in 2003
  - ✓ Bulletin released on 21 April 2010

## II. Transfer pricing documentation (TPD) requirements

## The new Italian TPG

### A new law...

- ✓ Art. 26 of the Law Decree No. 78 introduced, for the first time, specific TPD requirements
- ✓ On September 29, 2010 Operational Instructions were issued by the Italian Revenue Agency

### ... to address the risk in case of transfer pricing assessments

- ✓ In case of compliance with the new Italian TPD requirements **no (administrative) penalties** will be levied on TP adjustments
  - ✓ Possible impact on criminal law ramifications

## To avoid penalties taxpayers shall

### ✓ Before 2010

- ✓ File a notice to the Italian Revenue Agency on the existence of the TPD within December 28, 2010 **or later** but, in any case, prior to the beginning of a tax inspection

### ✓ Going forward

- ✓ Communicate to the Italian Revenue Agency on the existence of the TPD for the current year by **checking a box** in the tax return

### ✓ **Absent the communications (administrative) penalties will apply**

## (Administrative) penalty scenario

Documentation	Communication to the tax authorities	Administrative Penalties
Not prepared	N/A	100% - 200% of the additional tax due
Prepared	Not filed	100% - 200% of the additional tax due
Prepared but not in compliance with the Italian TPG	Filed	100% - 200% of the additional tax due
<b><u>PREPARED AND COMPLIANT WITH THE ITALIAN TPG</u></b>	<b><u>FILED</u></b>	<b><u>FULL PENALTY RELIEF</u></b>

## Obviously...

- ✓ **No penalty protection is granted when:**
  - ✓ Notwithstanding the compliance with the formal structure, the documentation delivered in the course of the tax audit is not complete and consistent with the Italian TPG
  - ✓ The information provided for in the documentation is only partially true or completely untrue

## Different documentation requirements

<u>Taxpayer</u>	<u>Masterfile</u>	<u>Country-specific File</u>
<u>HOLDING</u>	Yes	Yes
<u>SUB-HOLDING</u>	May be used the one prepared by the foreign holding company in English language	Yes
<u>AFFILIATE-COMPANY</u>	N/A	Yes

## Small and medium-sized enterprises

- ✓ Same rules BUT
- ✓ Are not required, under certain circumstances, to update the benchmark/economic analysis for the two FYs subsequent to the one for which the documentation is prepared

# The Master File

1. General description of the multinational group
2. Group structure of the Multinational Group
3. Business strategies pursued by the Multinational Group
4. Transaction flows
5. Intra-group transactions
6. Functions performed, assets used and risks assumed
7. Intangible assets
8. Transfer Pricing policy of the Multinational Group
9. Relationships with the tax administrations of the Member States of the EU regarding the APAs and transfer pricing rulings

# The Country-specific documentation

1. General description of the enterprise
  2. Business sectors
  3. Enterprise's organization chart
  4. General business strategies pursued by the enterprise and potential changes compared to the previous tax year's
  5. Controlled transactions
  6. Intra-group transactions (Cost Contribution Arrangements or "CCAs" to which the enterprise is part of)
- ANNEX 1 Flowchart describing the transaction flows
- ANNEX 2 Copy of written contracts on the basis of which the transactions referred to at chapters 5 and 6 are regulated

## Other conditions to avoid penalties

- ✓ TPD shall be in Italian language
  - ✓ English language allowed for Annex and, under certain circumstances, the Masterfile
- ✓ TPD shall be signed by the legal representative
- ✓ TPD shall be made available in electronic format
- ✓ TPD shall be made available to the tax auditors within 10 days from their request

### III. Statistics on APA

## Subject of the APA

- The international ruling procedure is addressed to companies with international activity that intend to agree in advance with the Italian tax authorities:
  - The transfer pricing methodology applicable to transactions carried on with related parties in the form of unilateral APAs
  - The application of tax treaties distributive rules to specific cases
  - The attribution of profits to permanent establishments

## **(Obviously) not a mandatory proceedings**

- Access to the international ruling procedure is made, on a voluntary basis and free of any charge, by mean of an application sent to the International Ruling Office – International Division – Central Directorate for Tax Assessment of the Revenue Agency, which is organized into two branches based in Rome and Milan

## Timing

- Within 30 days from the receipt of the application, the International Ruling Office schedules a first meeting with the taxpayer in order to define the terms and developments of the procedure
- The procedure should be completed within 180 days from the date in which the application is filed. Nevertheless, as this term is merely formal, according to circumstances, the parties may agree to extend the procedure

## Outcome

- The procedure ends up, possibly but not mandatorily, with a 3 years binding agreement between the taxpayer and the Italian tax authorities which sets out the criteria and methods for calculating the normal value of the transactions to which the application refers to, or, in other cases, the criteria for application of the concerned legislation

## What happen during the 3 years period?

- During the 3 years period the Revenue Agency, and more specifically the International Ruling Office, verifies that the terms of the agreement are complied with and also ascertains whether any changes have occurred to the *de facto* or *de jure* conditions which constitute the assumptions on which the clauses of the agreement are based
- This activity is carried out also by means of one or more agreed visits to the premises where the enterprise carries on business

## Renewal

- At the end of the 3 year period of validity, and at least 90 days before it expires, the taxpayer may submit an application for renewal
- At least 15 days before the expiration date the Revenue Agency communicate to accept or not the renewal

## Inputs from statistics

- A bulletin released on 21 April 2010 summarizes, for the first time, for statistical purposes and anonymously, the outcome of the requests for the international ruling procedure made under Italian tax law

## Number of applications

- The data provided in Table 1 shows that 52 applications have been submitted in the period 2005-2009 with an average of 9 per year
- However, out of the 45 out applications not rejected only 19 ended up in a binding agreement between the taxpayer and the Italian tax authorities with an average of 3 per year

**Table 1**

Applications for the international ruling procedure in 2004-2009

Applications submitted	52
International ruling granted	19
Procedures in process as at December 31, 2009	17
Applications rejected due to the lack of subjective or objective elements	7
Applications withdrawn	9

## Duration of the procedure

- Table 2 shows the procedures concluded in relation to the number of months necessary to be signed
- The duration has been calculated as the difference between the date of signature of the agreement and the date of submission of the application. Calculation of this difference excludes any suspension periods due to the lack of essential elements to reach the agreement. Instead, the duration of the procedure includes periods of inactivity or delay in providing documentation or information from the taxpayer
- The average time, approximately 20 months, is calculated as a simple average of the total number of months necessary to sign the agreements

**Table 2**

International ruling procedure completion time

months	number of agreements signed
1-6	2
7-12	3
13-18	5
19-24	4
25-30	2
31-36	2
37 or more	1

## Transfer pricing method

- Table 3 shows the methods used in determining APAs
- It is split in two parts, the first one relevant to traditional methods and the second one relevant to alternative methods
- Surprisingly, alternative methods have been very much adopted

**Table 3.1**

Traditional methods used for determining APAs

CUP - Internal comparables	1
CUP - External comparables	0
Cost Plus - Internal comparables	2
Cost Plus - External comparables	1
Resale Price - Internal comparables	0
Resale Price - External comparables	0

**Table 3.2**

Alternative methods used for determining APAs

TNMM – mark up on total cost	7
TNMM – return on sales	3
Profit Split – contribution analysis	0
Profit Split – residual analysis	5

## Taxpayers

- Table 4 shows data relating to taxpayers, divided into classes according to turnover, who signed an agreement or whose procedure was still pending as of 31 December 2009
- The data shows that the majority of taxpayers submitting applications (approximately 52%) have a turnover of more than 100 million Euro, and 37% of these fall into the class of taxpayers with turnover of more than 300 million Euro

**Table 4**

Classes of taxpayers by turnover

Taxpayers' turnover	Number of taxpayers	%
< 100 MEuro	13	48,15%
from 100 to 300 MEuro	4	14,81%
> 300 MEuro	10	37,04%

## Relationships between the parties

- Tables 5 highlights the ruling procedures which were concluded with an agreement distinguished on the basis of the relationships between the associated parties
- It shows roughly the same number of companies which are controlled by non-resident subjects and companies which carry out transactions with subsidiary companies abroad
- The total number of agreements given in Table 5 does not coincide with the number of ruling agreements concluded during the 2004-2009 period as the scope of an agreement may also include more than one kind of relationships between related parties.
- The concept of control within the context in question includes both direct and indirect control

**Table 5**

Relationships between associated parties

Non-resident parent company – Italian subsidiary	9
Italian parent company – non-resident subsidiary	8
Italian related company – non-resident related company	6
Italian PE – non resident head office	2
Non-resident PE – Italian head office	0

## Type of transactions

- Tables 6 highlights the ruling procedures which were concluded with an agreement distinguished on the basis of the type of transactions covered by ruling agreements
- It shows a predominance of agreements concerning the sale of tangible goods from Italy (50% of total transactions)
- The total number of agreements given in Table 6 does not coincide with the number of Ruling agreements concluded during the 2004-2009 period as per Table 1, since an agreement may also include more than one kind of transactions between related parties

**Table 6**

Cases of transactions in the agreement signed

Sale of tangible property into Italy	11
Purchase of foreign goods	4
Performance of services by Italian entity	3
Performance of services by non-Italian entity	0
Cost sharing agreements	1
Transactions involving intangible property	1
Attribution of profits to a PE	2

## Contact details

### **Fabio Aramini, LL.M.**

Partner

International Tax, Transfer Pricing, EU Law

CMS Adonnino Ascoli & Cavasola Scamoni

E-mail: [fabio.aramini@cms-aacs.com](mailto:fabio.aramini@cms-aacs.com)

#### **Milan**

Via Michelangelo Buonarroti, 39

T: +39 02 4801 1171

F: +39 02 4801 2914

#### **Rome**

Via Agostino Depretis 86, 00184

T: +39 06 478 151

F: +39 06 483 755