La pianificazione fiscale

La pianificazione fiscale: una definizione

✓ **Tre elementi**
- E’ intenzionale
- E’ finalizzata a ridurre e/o differire il carico fiscale
- E’ legittima

✓ **Fiscale** → riguarda tutti i tributi

✓ **Pianificazione** → prevedibile
- Legge vs. prassi e giurisprudenza
- Legge vs. profilo Paese (contesto ambientale)

Uno strumento per realizzare la missione aziendale

Price earnings ratio = *Value per share on the stock exchange* / *Earnings per share (i.e., net earnings)*

$$\text{Price earnings ratio} = \frac{\text{Value per share on the stock exchange}}{\text{Earnings per share (i.e., net earnings)}}$$

EBIT(DA)

$$\text{Cash flow per share} = \frac{\text{Positive cash flow per share}}{\text{Value per share}}$$

(Projected) discounted cash flow

$$\text{Solvency ratio} = \frac{\text{After tax net profit + depreciation}}{\text{Long term liabilities + Short term liabilities}}$$

Esiste spesso un *trade off* tra pagare oggi e risparmiare domani

La valutazione dei risultati ottenuti da *tax department*

- ✓ *WWETR =* $\dfrac{\textit{Provisions for taxes in P\&L}}{\textit{Commercial profits before tax in P\&L}}$

I limiti del WWETR: le modalità di contabilizzazione

Descrizione	Società A	Società B
Ricavi	300	300
Ammortamento (solo civilistico)	200	160
Utile ante imposte	100	140
Utile fiscale	300	300
Imposte (es. 30%)	90	90
Utile di bilancio	10	50
WWETR	90%	64,3%

I limiti del WWETR: la mancanza di potere decisionale

Descrizione	*Share deal*	*Asset deal*
Avviamento	1.000	1.000
Ammortamento	200	200
Risparmio fiscale sull'ammortamento dell'avviamento (es. 40%)	0	80
EBITDA (per ipotesi)	500	500
Utile ante imposte	300	300
Utile fiscale	500	300
Imposte (es. 40%)	200	120
Utile di bilancio	100	180
WWETR	66,67%	40%

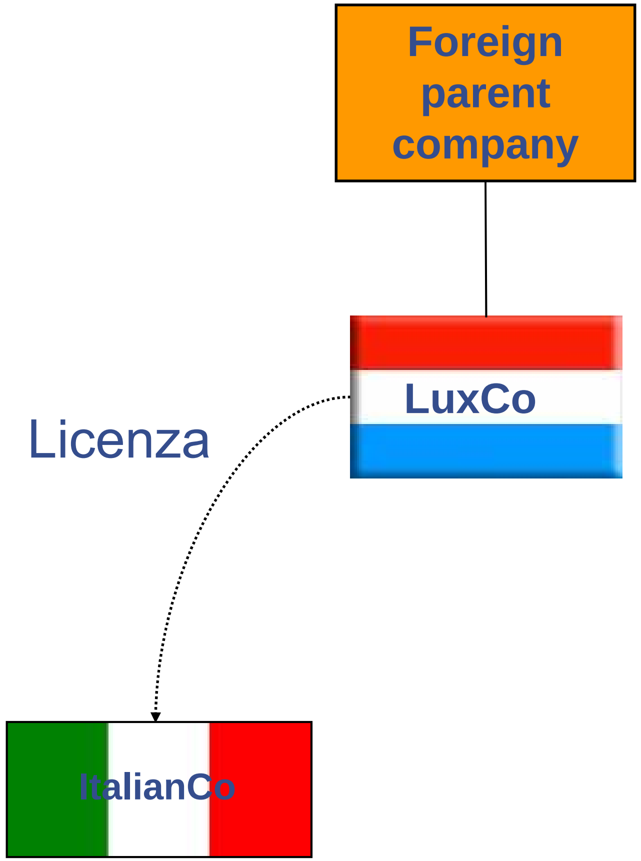
I limiti del WWETR: la giurisdizione in cui il reddito è prodotto

- La pianificazione fiscale incide normalmente sulla base imponibile e non sull'aliquota salvo eccezioni

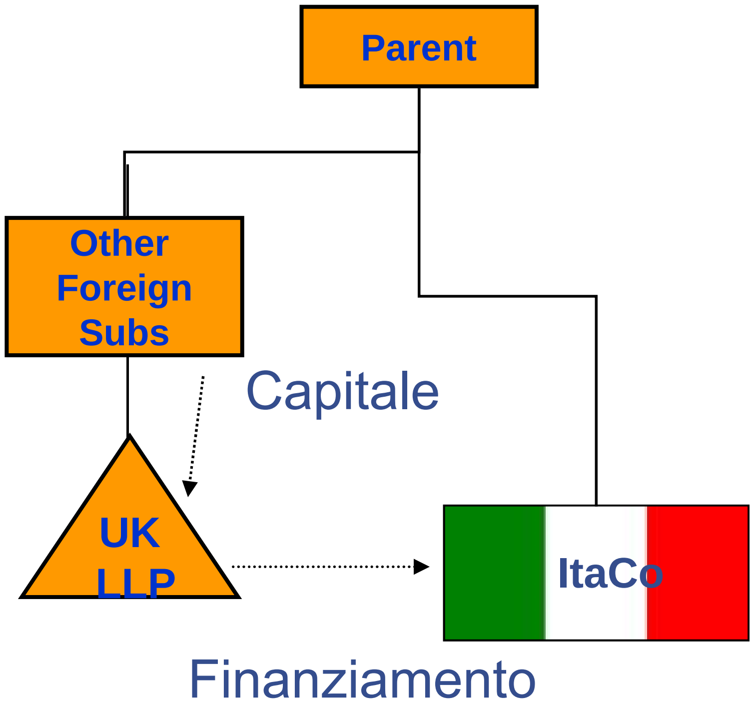
I *key driver* della pianificazione fiscale

- Funzioni
  - Amministrazione
  - Finanza
  - Marketing
  - R&D
- Beni
  - Marchi
  - Brevetti
- Rischi
  - Rischio di credito
- L'arbitraggio fiscale
- Le asimmetrie impositive
- La riqualificazione del reddito

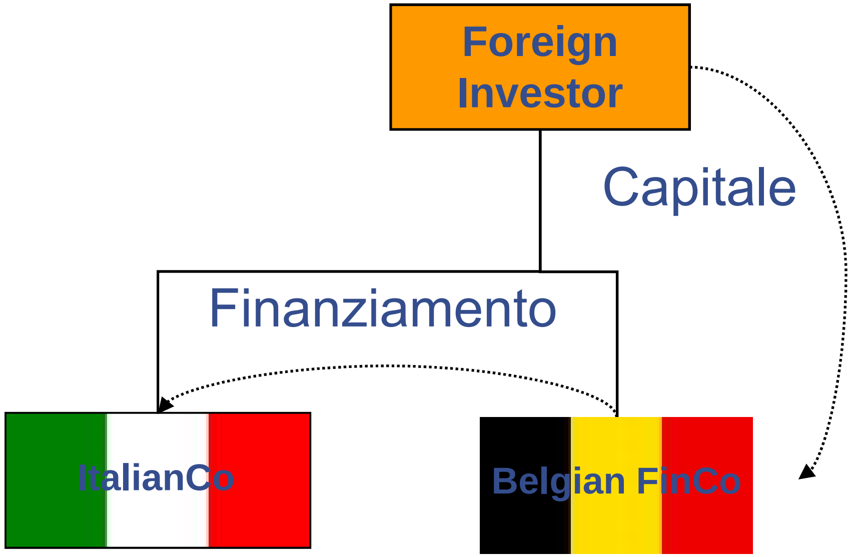
L’arbitraggio: es. *Lux IP Regime*



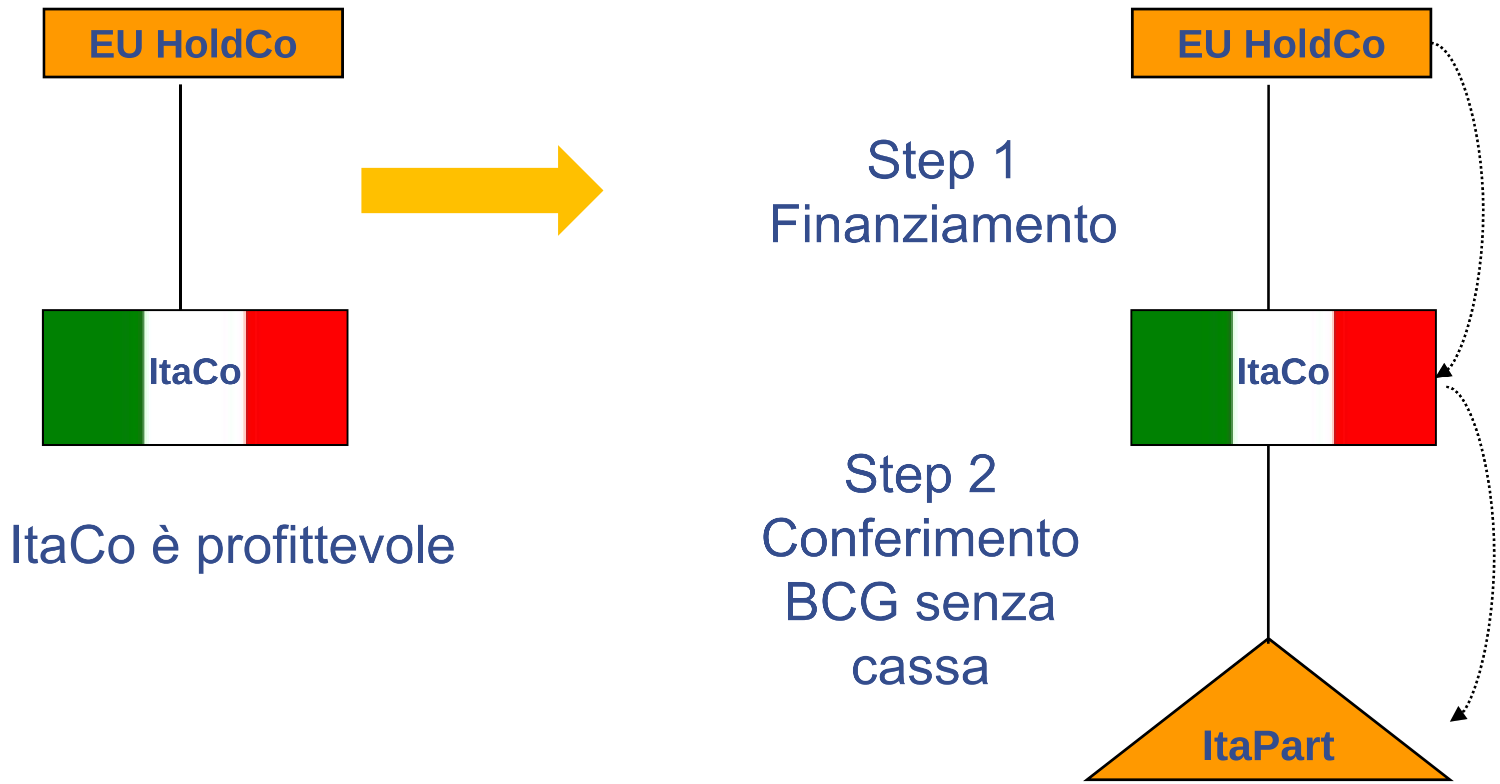
Le asimmetrie impositive: es. *UK/US partnerships as finance vehicles*



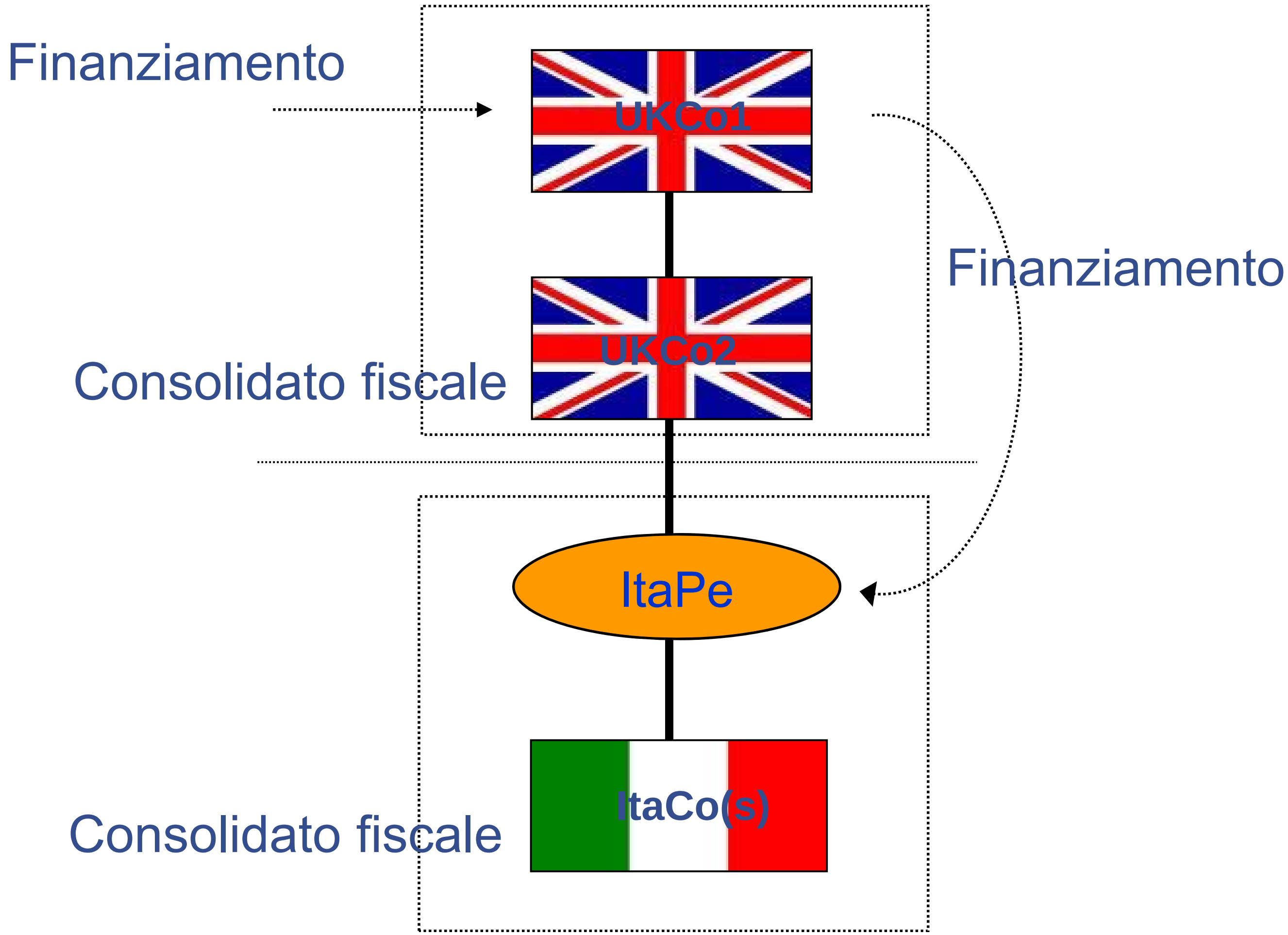
L’arbitraggio: es. *Belgiam NID regime*



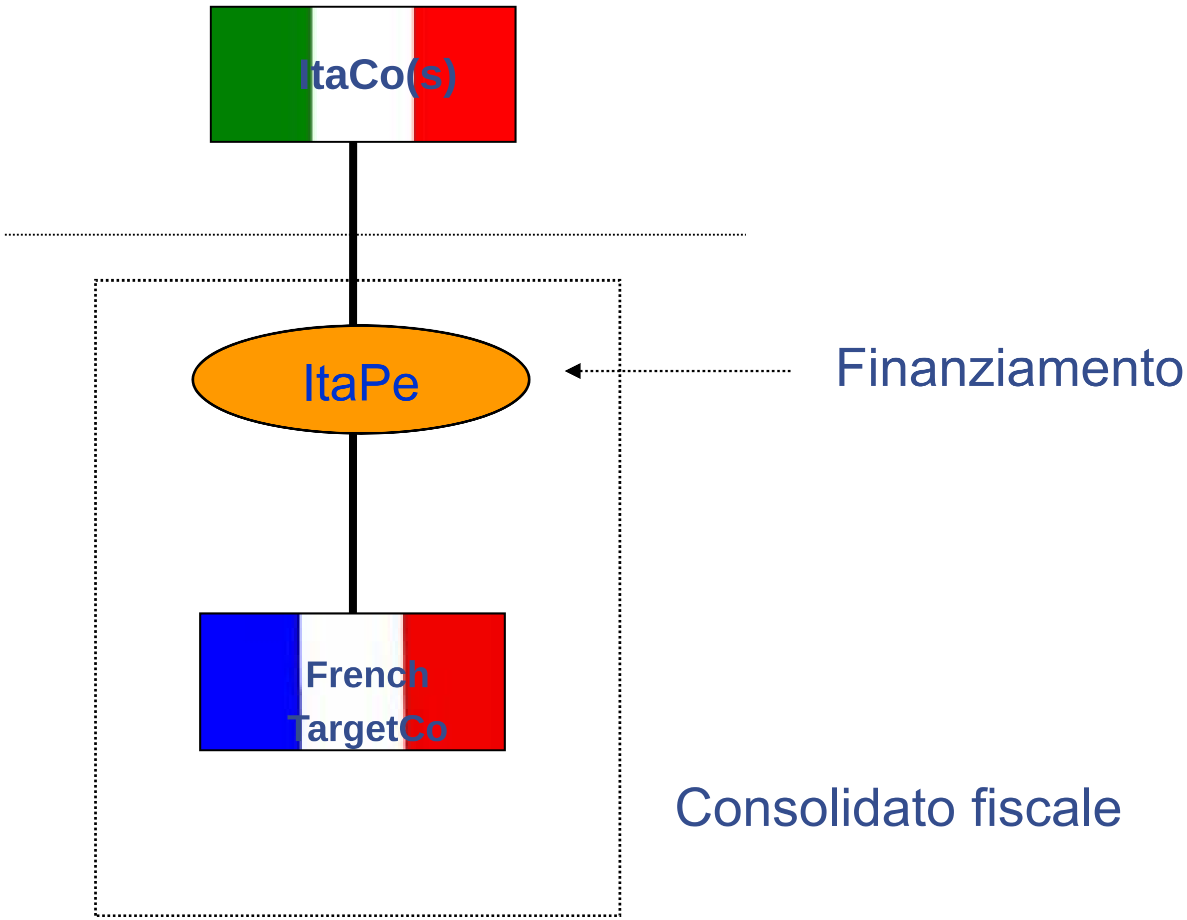
L’arbitraggio: *leveraging Italian operations*



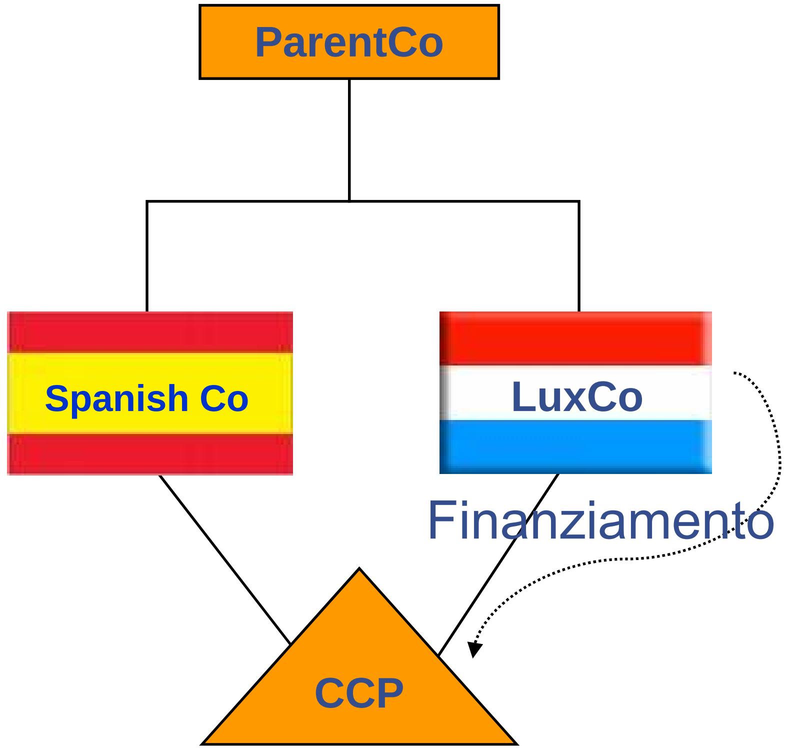
Le asimmetrie impositive: es. *Italian branch double dip*



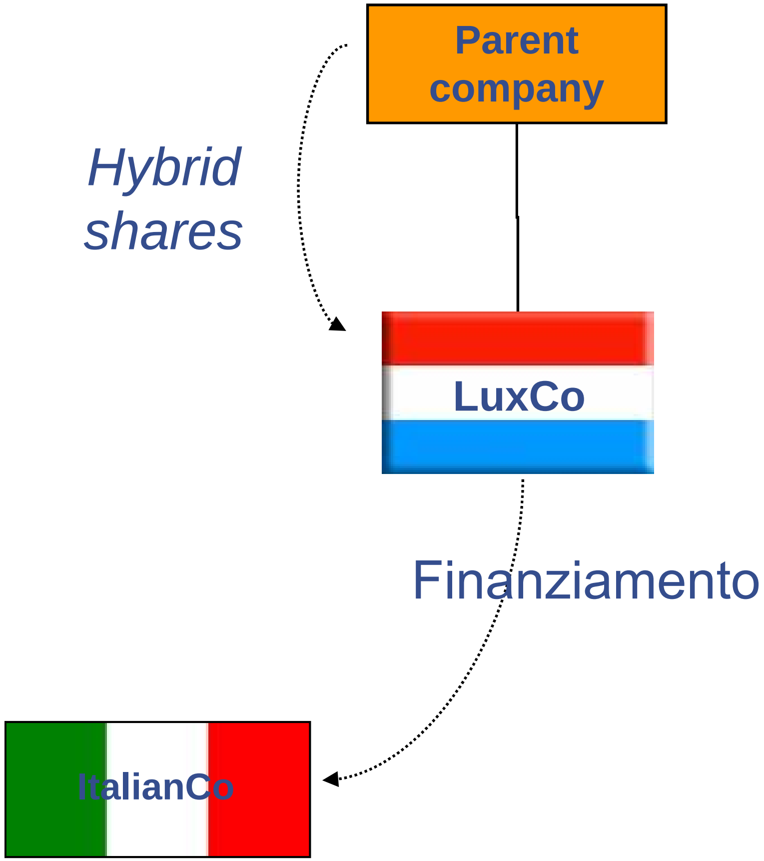
Le asimmetrie impositive: es. *French pe double dip – acquisition financing*



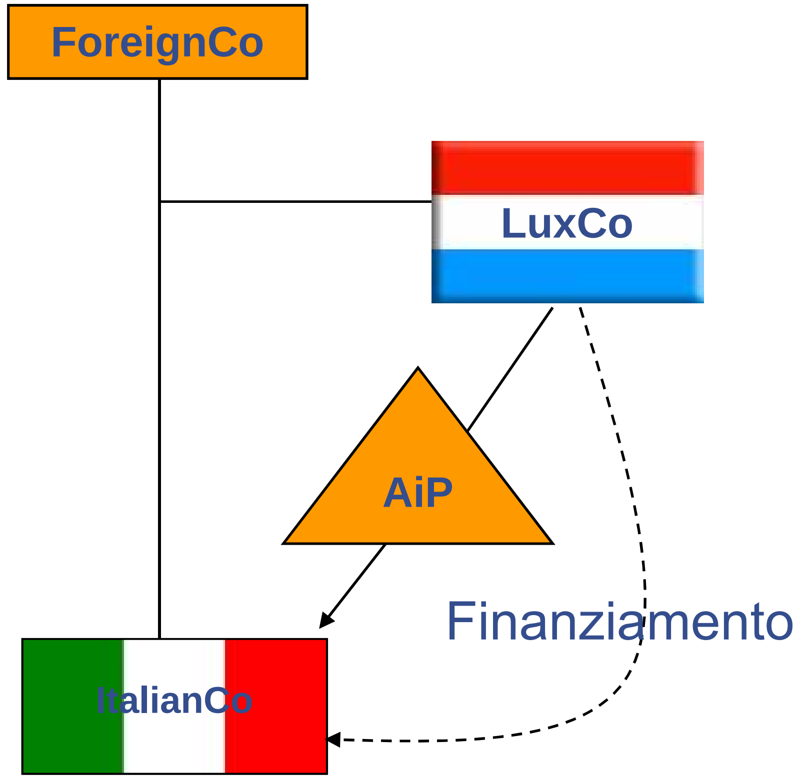
La riqualificazione del reddito: es. *Spanish CCP silent partnership arrangement*



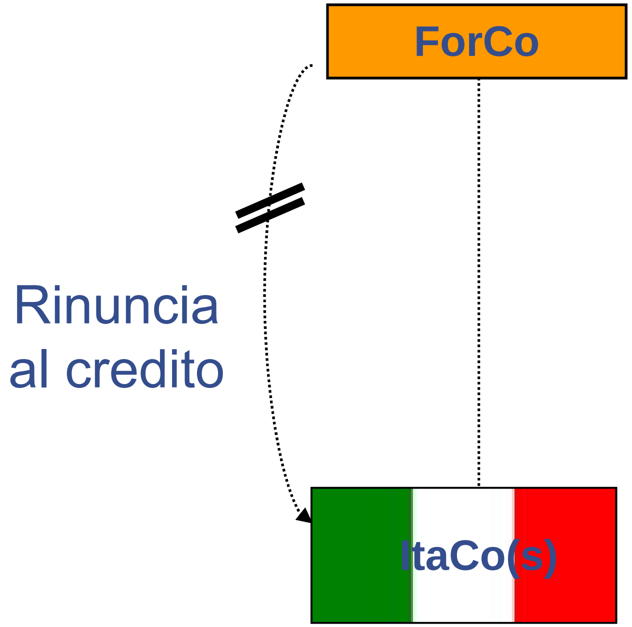
La riqualificazione del reddito: es. *Hybrid shares combined with EU or US Company*



La riqualificazione del reddito: es. *Italian Super AiP*



La riqualificazione del reddito: es. *Italian shareholder's debt forgiveness*



Uno schema operativo

1. Dove investire?

2. Come investire?

3. Quali sono le *cash repatriation technique*?

4. Quali sono le *exit strategy*?

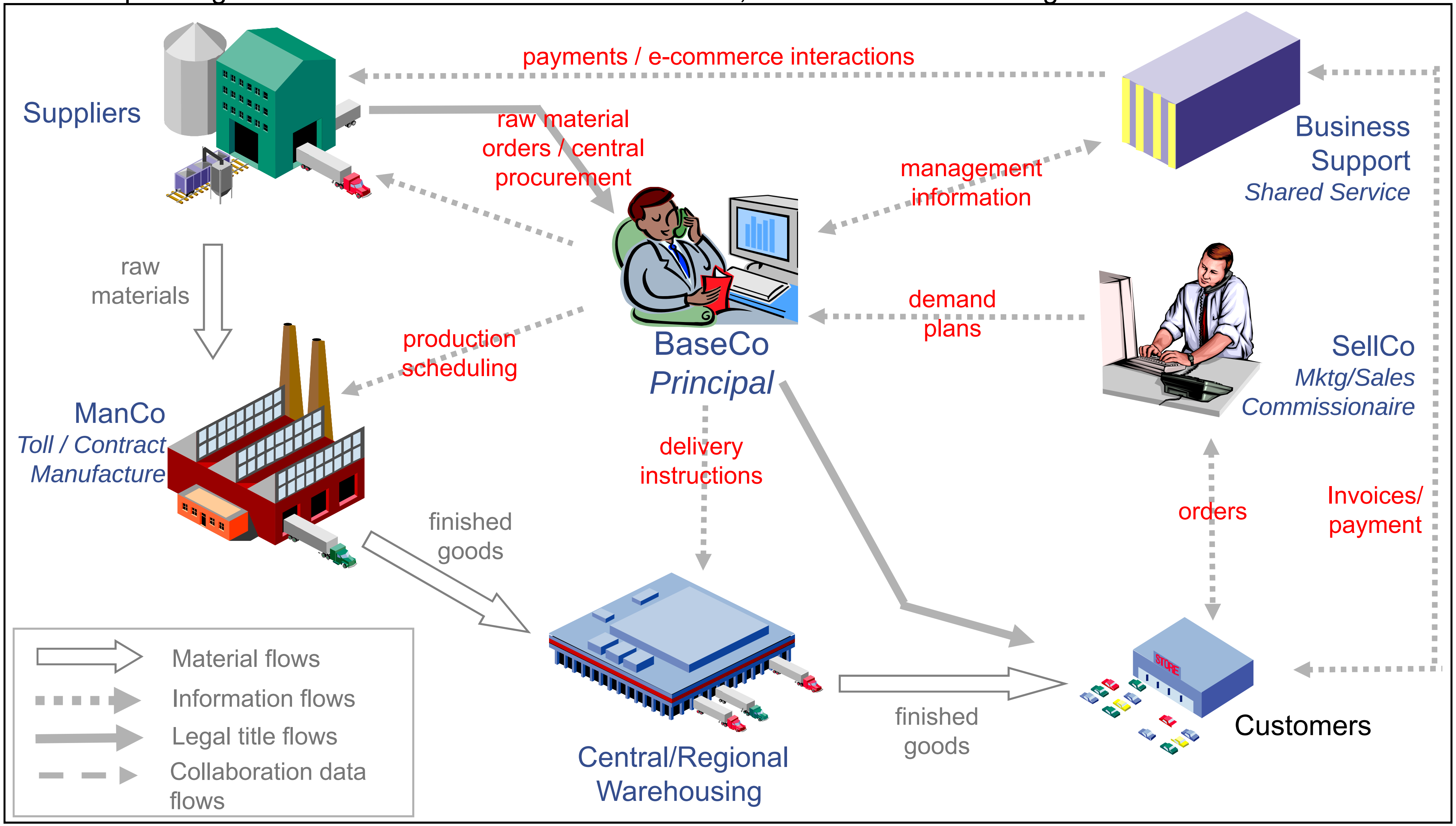
1. Dove investire?

- ✓ **Tipicamente una scelta di *business***

- ✓ **Eccezione** → funzioni, beni, rischi collocabili facilmente in diverse giurisdizioni
  - ✓ *Holding company, trading company, IP company, finance company*

- ✓ **Eccezione** → *business restructuring*
  - Cambiamento del modello organizzativo (es. TESCM)
  - Cambiamenti normativi (es. *thin capitalization*)
  - Criticità fiscali sopravvenute (es. perdite in scadenza)

Operating model entities and the flows of materials, information/date and legal titles between them



Reward belonging to the Principal - benefits increase further to the right

Fully-fledged Manufacturer

- Full risk
- Owns inventory
- May own IP
- Stand-alone decisions

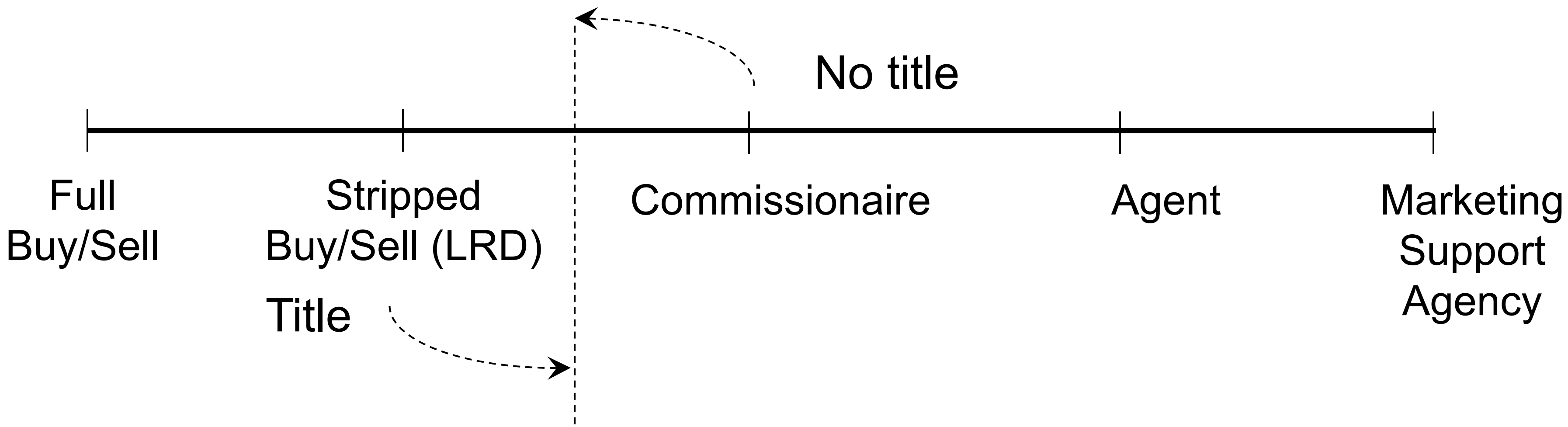
Contract Manufacturer

- Purchases raw materials
- Owns inventory
- Follows orders

Toll Manufacturer

- No inventory
- No strategic control
- Follows orders

Reward belonging to the Principal - benefits increase further to the right



Full Buy/Sell

- Autonomous
- Business driven

Stripped Buy/Sell (LRD)

- Buys products at cost + mark up

Commissionaire

- Sells in its own name on behalf of Principal
- Inventory & bad Debt borne by Principal

Agent

- Sells in name of Principal
- Inventory & Bad Debt borne by Principal

Marketing Support Agency

- Performs marketing services for Principal
- No sales
- Paid a fee

2. Come investire?

1. Pre-acquisition

2. Transaction

3. Acquisition

2. Come investire? *Pre-acquisition*

✓ ***Structuring***

- Stabile organizzazione vs. società
- Debito vs. capitale
- *Asset deal vs. share deal*
- Quali sono le *cash repatriation technique*? (rinvio)
- Quali sono le *exit strategy*? (rinvio)

2. Stabile organizzazione vs. società

Stabile organizzazione	Società
- Flessibilità civilistica	- Regole civilistiche chiare (compresi organi di controllo)
- Profili di responsabilità "gestibili"	- Responsabilità limitata
- Vincoli commerciali	- Commercialmente giustificabile
- Maggiore "flessibilità" finanziaria	- Flessibilità finanziaria?

2. Come investire? *Transaction*

- *Due diligence*
  - *Buyer due diligence*
  - *Vendor due diligence*

2. Come investire? *Acquisition*

- Contrattualistica

Quali sono le *cash repatriation techniques?*

- **Ritenute:** un problema reale o finanziario?

Le ritenute: un problema reale o finanziario? Il percipiente non paga imposte

Descrizione	Società italiana	Società estera
Reddito ante imposte	100	72,5
Reddito imponibile	100	Zero
Imposte (es. 0% nel paese estero; 27,5% in Italia)	27,5	Zero
Utile di bilancio	72,5	72,5
Ritenuta su utile (dividendi) di bilancio (20%)	14,5	
Credito d'imposta		Zero
Imposizione effettiva		42

Le ritenute: un problema reale o finanziario? Il percipiente ha un'aliquota d'imposta inferiore

Descrizione	Società italiana	Società estera
Ricavi	1.000	900
Interessi passivi	900	0
Reddito ante imposte	100	900
Reddito imponibile	100	900
Imposte (es. 5% nel paese estero; 27,5% in Italia)	27,5	45
Ritenuta su interessi (20%)	180	
Credito d'imposta		45
Imposizione effettiva		180

Le ritenute: un problema reale o finanziario? Base imponibile ridotta

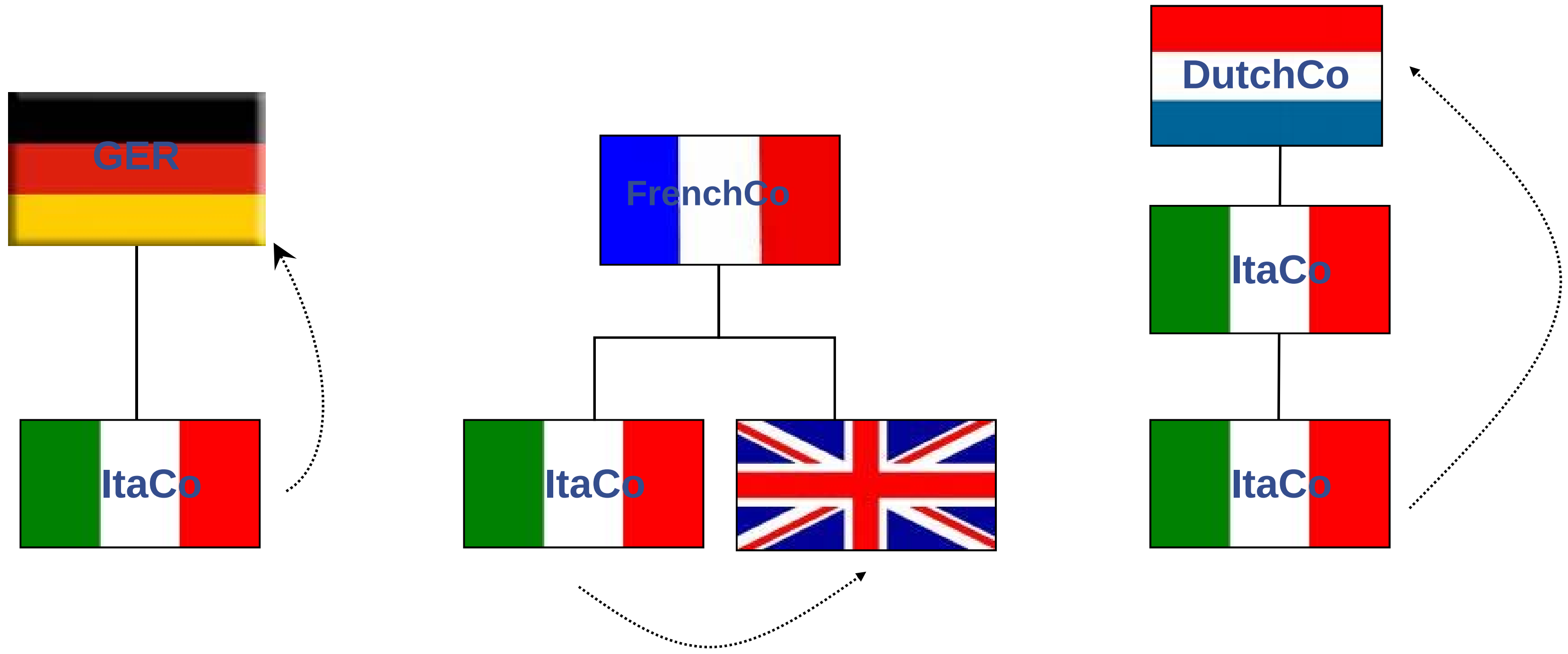
Descrizione	Società italiana	Società estera
Ricavi	1.000	900
Costi diversi dagli interessi passivi	0	800
Interessi passivi	900	0
Reddito ante imposte	100	100
Reddito imponibile	100	100
Imposte (es. 40% nel paese estero; 27,5% in Italia)	27,5	40
Ritenuta su interessi (20%)	180	
Credito d'imposta		40
Imposizione effettiva		180

Quali sono le *cash repatriation techniques?*

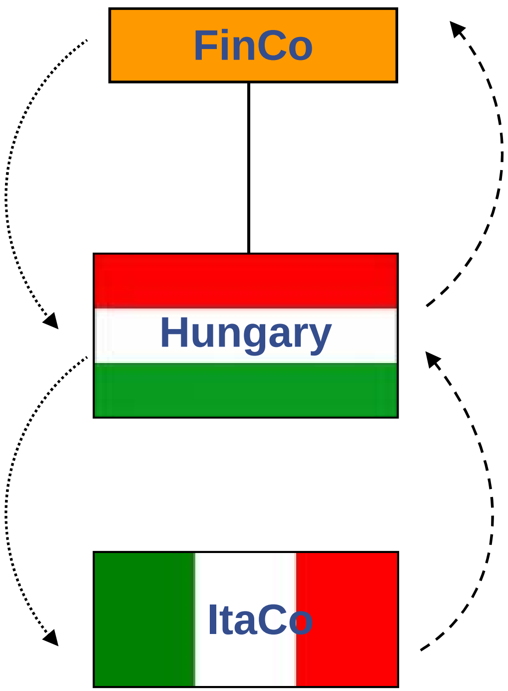
- **Dividendi**
  - *Conduit strategies*

- **Interessi e *Royalty***
  - *Stepping stone*

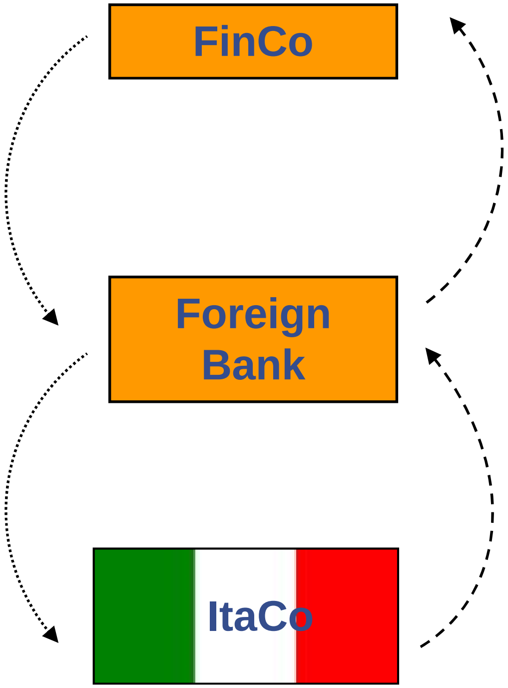
Interest & royalty directive



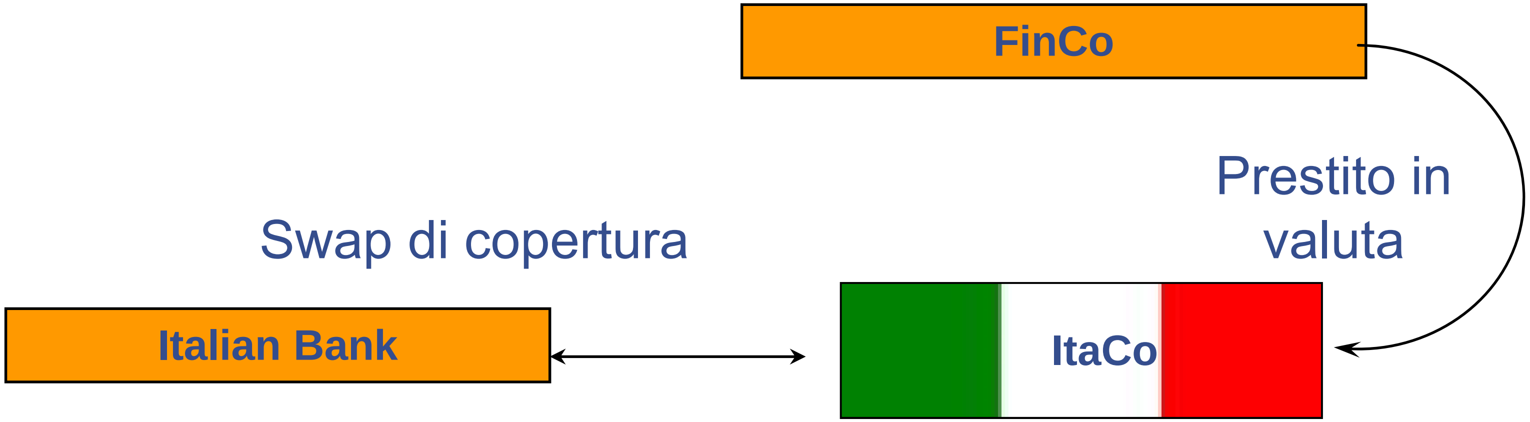
The Hungarian route



Foreign back-to-back



Currency loan



Quali sono le *exit strategy*?

- Cessione di azienda vs. cessione di partecipazioni

Selection of the transfer pricing method

The agenda

1. Criteria for comparability analysis

1. Criteria for comparative analysis

1.1 Meaning of being comparable

- To be comparable means that:
  - None of the differences (if any) between the situations being compared could materially affect the conditions being examined in the methodology (e.g., price or margin), or
  - Reasonably adjustments can be made to eliminate the effect of any such differences

- In order to establish the decree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length transactions

1. Criteria for comparative analysis

1.2 Factors determining comparability

– Attributes or "comparability factors" that may be important when determining comparability include:

1. The characteristics of the property or services transferred
2. The functions performed by the parties (taking into account assets used and risks assumed)
3. The contractual terms
4. The economic circumstances of the parties
5. The business strategies pursued by the parties

1. Criteria for comparative analysis

1.2.1 The characteristics of the property or services transferred

– Characteristics of property or services transferred include:
  - In case of transfer of tangible property: physical features of the property, quality, reliability, availability, volume
  - In case of transfer of services: nature , extent of the services
  - In case of transfer of intangible property: form of the transaction (sale or license), type of property (patent, trade mark, know-how), duration and decree of the protection, anticipated benefits from the use of the property, volume

1. Criteria for comparative analysis

1.2.2 The functional analysis

– In transactions between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed)

- Functions include, e.g., design, manufacturing, assembling, R&D, servicing, purchasing, distribution, marketing, advertising, transportation, financing and management
- Assets include, e.g., plant and equipment, IP, financial assets
- Risks include, e.g., market risks, risks of loss associated with the investment in and use of property, plant and equipment, risks of the success or failure of R&D, financial risks, credit risks

1. Criteria for comparative analysis

1.2.3 The contractual terms

- The contractual terms of a transaction generally define explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the parties. As such, an analysis of contractual terms should be a part of the functional analysis

- Where no written terms exist, the contractual relationships of the parties must be deduced from their conduct and the economic principles that generally govern relationships between independent parties

- Due to the lack of the divergence of interests, it is important to examine whether the conduct of the parties conforms to the terms of the contract

1. Criteria for comparative analysis

1.2.4 The economic circumstances

- Arm's length prices may vary across the markets even for transactions involving the same property or services

- Economic circumstances that may be relevant to determining market comparability include:
  - The geographic location, the size, the extent of competition and the relative position of the buyer and the seller, the availability (risk thereof) of substitute goods and services, the levels of supply and demands as a whole, the consumer purchase power, the nature and the extent of government regulation, the costs of production, including the costs of land, labour and capital, the date and time of the transaction, the existence of a (economic, business or product) cycle

1. Criteria for comparative analysis

1.2.5 Business strategies

- Business strategies would take into account many aspects of an enterprise:
  - Innovation, new product development, decree of diversification, risk aversion, assessment of political changes, input of existing and planned labour laws, duration of arrangements

- Business strategies could also include market penetration schemes

- Scrutiny from the tax administrations and justifications

2. Selection of the transfer pricing method

2. Selection of the transfer pricing method

2.1 The methods

- Traditional transaction methods (TTM):
  - Comparable uncontrolled price (CUP)
  - Resale price method (RPM)
  - Cost plus method (CPM)

- Transactional profit methods (TPM):
  - Transactional net margin method (TNMM)
  - Transactional profit split method (PSM)

- Other methods → Explanation of the reason

2. Selection of the transfer pricing method

2.2 The choice of the method

- The selection of the transfer pricing method is aimed at finding the <u>most appropriate method </u>for a particular case
  - In principle, there is no need to test all methods
  - As a matter of good practice, the selection of the most appropriate method and comparables should be evidenced

- As a rule:
  - The TTM are preferred compared to the TPM
  - The CUP method is preferred compared to the others

3. Selection of the transfer pricing method – the TTM

3. Selection of the transfer pricing method: the TTM

3.1 The CUP method

- The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction <u>in comparable circumstances</u>

- The requirement for comparability of property or services is the strictest for the CUP method

3. Selection of the transfer pricing method: the TTM

3.1 The CUP method - example

- The enterprise sells the same product ("internal comparable") as is sold between two associated enterprise:
  - E.g., an independent enterprise sells unbranded Colombian coffee beans of a similar type, quality, and quantity as those sold between two associated enterprises assuming that the controlled and uncontrolled transactions occur at the same time, at the same stage in the production/distribution chain, under similar conditions

    It would be appropriate to enquire whether the difference in the coffee beans have a material effect on the price (premium or discount)

3. Selection of the transfer pricing method: the TTM

3.1 The CUP method - example

– The enterprise sells the same product (“internal comparable”) as is sold between two associated enterprise:
  - E.g., a taxpayer sells 1,000 tons of a product for $80 per ton to an associated enterprise in its MNE group, and at the same time sells 500 tons of the same product for $100 per ton to an independent enterprise

  This case requires an evaluation of whether the different volumes should result in an adjustment of the transfer price

3. Selection of the transfer pricing method: the TTM

The P/L account

Net Sales

COGS (Cost of goods sold)

Gross Profit

SG&A (Sale, general and administrative expenses)

EBITAD (Earnings before interest, tax, depreciation, amortization

DA (Depreciation and Amortization)

EBIT (Earnings before interest, tax)

Interest

EBT (Earnings before tax)

Tax

Net Profits

3. Selection of the transfer pricing method: the TTM

The P/L account

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

3. Selection of the transfer pricing method: the TTM

3.2 The RPM

– The resale price begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise

– The resale price is than reduced by an appropriate margin on this price (the "resale price margin"). What is left can be regarded as an arm's length price for the original transfer of the property between the associate enterprise

– This method is probably most useful where it is applied to marketing operations

– Internal vis-à-vis external comparables

3. Selection of the transfer pricing method: the TTM

3.2 The RPM – the Resale Prince Margin – example

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

Resale Price Margin = $\frac{\text{Gross Profit}}{\text{Net sales}}$

One side method

3. Selection of the transfer pricing method: the TTM

3.2 The RPM – example

100
(80)
20
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

The resale price margin = 20 %

3. Selection of the transfer pricing method: the TTM

3.2 The RPM

– The comparability analysis put more emphasis on functional similarities than on product similarities

– A distribution company might perform the same functions (taking into account asset used and risks assumed) selling toasters as it would selling blenders, and hence in a market economy there should be a similar level of compensation for the two activities. However, there would be no reason to expect their prices to be the same

3. Selection of the transfer pricing method: the TTM

3.2 The RPM

– The Resale Price Margin is easiest to determine:
  - Where the reseller does not add substantially to the value of the product (e.g., trademark or trade names) and the sale is made in <u>short time frame</u>
  - Before resale the goods are not further processed <u>or</u> are not incorporated in a more complicated product so that their identity is lost or transformed

3. Selection of the transfer pricing method: the TTM

3.2 The RPM – example

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

– Assume there are two distributors selling the same product in the same market under the same brand name:
  - Distributor C offers a warranty but is compensated by the supplier through a lower price
  - Distributor D does not perform the warranty function which is performed by the supplier. However the supplier charges a higher price
  - If Distributor C accounts for the cost of performing the warranty function as a COGS, then the adjustment of the profit margin is automatic otherwise adjustmens should be made

3. Selection of the transfer pricing method: the TTM

3.2 The RPM – example

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

– A company sells a product through independent distributors in five countries in which it has no subsidiaries:
  - The distributors simply market the product and do not perform any additional work
  - In one country, because of its strategic importance, the company has set up a subsidiary. The subsidiary also perform technical applications for the customers
  - Absent a precise comparable, it is necessary to consider whether any adjustments must be made to achieve comparability

3. Selection of the transfer pricing method: the TTM

3.3 The CPM

- The cost plus method begins with the price incurred by the supplier of property (or services) in a controlled transaction for property transferred or services provided to an associated purchaser

- An appropriate cost plus mark up is than added to this cost, to make an appropriate profit in light of the functions performed and the market conditions. <u>What is arrived at after adding the cost plus mark up to the above cost may be regarded as an arm's length price of the original controlled transaction</u>

3. Selection of the transfer pricing method: the TTM

3.3 The CPM

- This method is probably most useful semi finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services (par. 2.39, Chapter 2)

- Internal vis-à-vis external comparables (par. 2.40, Chapter 2)

- Same consideration for the RPM

3. Selection of the transfer pricing method: the TTM

3.3 The CPM – the Cost Plus Mark-up

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

Cost Plus mark-up = $\frac{\text{Gross Profit}}{\text{COGS}}$

One side method

3. Selection of the transfer pricing method: the TTM

3.3 The CPM – example

120
(100)
20
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

The Cost Plus mark up = 20 %

3. Selection of the transfer pricing method: the TTM

3.3 The CPM – example

– In the CPM, one should pay attention to apply a comparable mark up to a comparable cost basis

- If the supplier to which reference is made in applying the cost plus method in carrying on its activities employs leased business assets, the cost basis might not be comparable without adjustment if the supplier in the controlled transaction owns its business assets

3. Selection of the transfer pricing method: the TTM

3.3 The CPM – example

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

– A is a domestic manufacturer of timing mechanisms for massmarket clocks. A sells this product to its foreign subsidiary B:
  - A earns a 5 percent gross profit mark up. A accounts for supervisory, general, and administrative costs as operating expenses, and thus these costs are not reflected in COGS

3. Selection of the transfer pricing method: the TTM

3.3 The CPM – example

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

- X Y, and Z are independent domestic manufacturers of timing mechanisms for mass-market watches. X, Y, and Z sell to independent foreign purchasers. X, Y, and Z earn gross profit mark that range from 3 to 5 percent. The gross profit mark ups of X, Y, and Z, however, reflect supervisory, general, and administrative costs as part of COGS
- Therefore, the gross profit mark ups of X, Y, and Z must be adjusted to provide accounting consistency

4. Selection of the transfer pricing method – the TPM

C'M'S' Law.Tax

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM

– The transactional net margin method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – strengths

- Net profit indicators are less affected by transactional differences than is the case with price, as used in the CUP method

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – example

Distributors	Case 1 No inventory risk	Case 2 Inventory risk
Net sales	1,000	1,000
Purchase pr.	700	640*
Gross Margin	300 (30%)	360 (36%)
Loss on inventories	0	50*
Other expeses	250	250
Net profit margin	50 (5%)	60 (6%)*

* + 50 loss + 10 Net profit

– If a controlled transaction is performed as in case 1 while the third party "comparables" are operating as in case 2, and assuming that the difference in the level of risks is not identified due to insufficiently detailed information on the third party "comparables", then the risk of error when applying a gross margin method could amount to 60 (6% x 1,000) instead of 10 (1% x 1,000) if a net margin method is applied

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – strengths

– Net profit indicators also may be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins. Differences in the functions performed between enterprises are often reflected in variations in operating expenses. Consequently, this may lead to a wide range of gross profit margins but still broadly similar levels of net operating profit indicators

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – example

Distributors	Case 1 Limited MKT function	Case 2 Significant MKT function
Net sales	1,000	1,000
Purchase pr.	600	480*
Gross Margin	400 (40%)	520 (52%)
MKT expenses	50	150*
Other expeses	300	300
Net profit margin	50 (5%)	70 (7%)*

* + 100 MKT expenses + 20 Net profit

– If a taxpayer is operating with an associated manufacturer as in case 2 while the third party "comparables" are operating as in case 1, and assuming that the difference in the marketing function is not identified because, e.g., insufficiently detailed information on the third party "comparables", then the risk of error when applying a gross margin method could amount to 120 (12% x 1,000), while it would amount to 20 (2% x 1,000) if a net margin method was applied

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – strengths

- In some countries the lack of clarity in the public data with respect to the classification of expenses in the gross or operating profits may make it difficult to evaluate the comparability of gross margins, while the use of net profit indicators may avoid the problem

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – the index – examples

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

$$\text{Net profit margin} = \frac{\text{EBITDA}}{\text{Net sales}}$$

One side method

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – the index – examples

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

$$\frac{\text{EBITDA}}{\text{COGS + SG\&A = full costs}}$$

One side method

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – the index – examples

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

$$\text{Return on capital employed (ROCE)} = \frac{\text{EBIT}}{\text{Total assets – current liabilities}}$$

One side method

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – the index – examples

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

$$\text{Return on assets (ROA)} = \frac{\text{Net profits}}{\text{Total assets}}$$

One side method

4. Selection of the transfer pricing method: the TPM

4.1 The TNMM – the index – examples

Net Sales
(COGS)
Gross Profit
(SG&A)
EBITDA
(DA)
EBIT
(Interest)
EBT
Tax
Net Profits

$$\text{Berry ratios} = \frac{\text{Gross margin}}{\text{Operating expenses}}$$

One side method

4. Selection of the transfer pricing method: the TPM

4.2 The PSM

- The transactional profit split method first identifies the profits to be split for the associated enterprises (the “combined profits”). References to “profits” should be taken as applying equally to losses

- It then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm’s length

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – strengths

- The main strength of the transactional profit split method is that it can offer a solution for highly integrated operations for which a one-sided method would not be appropriate

- A transactional profit split method may also be found to be the most appropriate method in cases where both parties to a transaction make unique and valuable contributions (e.g. contribute unique intangibles) to the transaction

- Another strength of the transactional profit split method is that it offers flexibility by taking into account specific, possibly unique, facts and circumstances of the associated enterprises that are not present in independent enterprises

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – strengths

- The two-sided approach may be used to achieve a division of the profits from economies of scale or other joint efficiencies that satisfies both the taxpayer and tax administrations

- The PSM can be used also in case of absence or limited publicly available reliable gross margin information on third parties and absence of internal comparables

- Differences in the characteristics of property or services are also less sensitive in the case of the TPM than in the case of TTM

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – weakness

- Associated enterprises and tax administrations alike may have difficulty accessing information from foreign affiliates

- In addition, it may be difficult to measure combined revenue and costs for all the associated enterprises participating in the controlled transactions, which would require stating books and records on a common basis and making adjustments in accounting practices and currencies

- Further, when the transactional profit split method is applied to operating profit, it may be difficult to identify the appropriate operating expenses associated with the transactions and to allocate costs between the transactions and the associated enterprises' other activities

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – the application

– There are a number of approaches for estimating the division of profits, based on either projected or actual profits, as may be appropriate, to which independent enterprises would have agreed, two of which – contribution analysis and residual analysis – are not necessarily exhaustive or mutually exclusive

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – the contribution analysis

- Under a contribution analysis, the combined profits would be divided between the associated enterprises based upon a reasonable approximation of the division of profits that independent enterprises would have expected to realize from engaging in comparable transactions

- This division can be supported by comparables data where available. In the absence thereof, it is often based on the <u>relative value of the functions performed by each of the associated enterprises participating in the controlled transactions, taking account of their assets used and risks assumed.</u> In cases where the relative value of the contributions can be measured directly, it may not be necessary to estimate the actual market value of each participant's contributions

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – the residual analysis

– A residual analysis divides the combined profits from the controlled transactions under examination in two stages :

- In the first stage, each participant is allocated an arm's length remuneration for its non-unique contributions in relation to the controlled transactions in which it is engaged. Ordinarily this initial remuneration would be determined by applying one of the TTM or TNMM, by reference to the remuneration of comparable transactions between independent enterprises. Thus, it would generally not account for the return that would be generated by any unique and valuable contribution by the participants
- In the second stage, any residual profit (or loss) remaining would be allocated among the parties based on an analysis of the facts and circumstances

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – example

Manuf.	Company A	Company B
Sales	50	100
COGS	Purchases 10 Manu costs 15	Purchases 50 Manu costs 20
Gr. Mar	25	30
R&D	15	10
Other Exp.	10	10
Net profit	0*	10*

Facts

- Company A manufactures and design (IP) a product that is sold to Company B
- Company B designs and manufactures the rest of the product and sell it to a related party (sale price is – by assumption – arm's length)

* + 0 + 10 = 10 = aggregate profits

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4. Selection of the transfer pricing method: the TPM

4.2 The PSM – example

Manuf.	Company A	Company B
Sales	50	100
COGS	Purchases 10 Manu costs 15	Purchases 50 Manu costs 20
Gr. Mar	25	30
R&D	15	10
Other Exp.	10	10
Net profit	0*	10*

Determine the routine profits

- It is established for both countries that comparable manufacturers without innovative IP earn a return on manufacturing cost of 10%
- A's manufacturing costs are 15; the manufacturing profit will be1.5.
- B's equivalent costs are 20; the manufacturing profit will be 2.0
- The residual profit is therefore 6.5, arrived at by deducting from the combined net profit of 10 the combined manufacturing profit of 3.5

* + 0 + 10 = 10 = aggregate profits

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – example

Manuf.	Company A	Company B
Sales	55.4	100
COGS	Purchases 10 Manu costs 15	Purchases 55.4 Manu costs 20
Gr. Mar	30.4	24.6
R&D	15	10
Other Exp.	10	10
Net profit	5.4*	4.6*

Allocate the residual profits

– R&D expenses accurately reflects the relative contributions to the value of the product's

– The residual of 6.5 will be allocated as follows:
  - 6.5 x 15/25 = 3.9
  - 6.5 x 10/25 = 2.6

* + 5.4 + 4.6 = 10 = aggregate profits

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – reliance on data from comparables

- One possible approach is to split the combined profits based on the division of profits that actually results from comparable uncontrolled transactions (par. 2.132, Chapter 2)

- Examples of possible sources of information on uncontrolled transactions that might usefully assist the determination of criteria to split the profits include (par. 2.132, Chapter 2):
  - Joint-venture arrangements between independent parties under which profits are shared, such as development projects in the oil & gas industry
  - Pharmaceutical collaborations
  - Co-marketing or co-promotion agreements
  - Arrangements between independent music record labels and music artists
  - Uncontrolled arrangements in the financial services sector

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – allocation keys

– In practice, the division of the combined profits under a transactional profit split method is generally achieved using one or more allocation keys (par. 2.134, Chapter 2)

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – allocation keys

- In practice, allocation keys based on:
  - Assets/capital (operating assets, fixed assets, intangible assets, capital employed)
    - Asset-based or capital-based allocation keys can be used where there is a strong correlation between tangible or intangible assets or capital employed and creation of value in the context of the controlled transaction (par. 2.136, Chapter 2)

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – allocation keys

– In practice, allocation keys based on:
  - Costs (relative spending and/or investment in key areas such as research and development, engineering, marketing) are often used
    – An allocation key based on expenses may be appropriate where it is possible to identify a strong correlation between relative expenses incurred and relative value added (par. 2.138, Chapter 2)
    – For example, marketing expenses may be an appropriate key for distributors-marketers if advertising generates material marketing intangibles, e.g., in consumer goods where the value of marketing intangibles is affected by advertising (par. 2.138, Chapter 2)
    – For example, research and development expenses may be suitable for manufacturers if they relate to the development of significant trade intangibles such as patents (par. 2.138, Chapter 2)

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – allocation keys

- Other allocation keys based for instance on incremental sales, headcounts (number of individuals involved in the key functions that generate value to the transaction), time spent by a certain group of employees if there is a strong correlation between the time spent and the creation of the combined profits, number of servers, data storage, floor area of retail points, etc. may be appropriate depending on the facts and circumstances of the transactions (par. 2.135, Chapter 2)

4. Selection of the transfer pricing method: the TPM

4.2 The PSM – reliance on internal data

- Where comparable uncontrolled transactions of sufficient reliability are lacking to support the division of the combined profits, consideration should be given to internal data, which may provide a reliable means of establishing or testing the arm's length nature of the division of profits (par. 2.141, Chapter 2)

Law . Tax

International ruling – the Italian experience

Subject of the International ruling

– 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
  - 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. The Rome office is the only competent one in case of bilateral or multilateral APA

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 <u>the International Ruling Office, verifies that the terms of the agreement are complied with</u> 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 lease 15 days before the expiration date the Revenue Agency communicate to accept or not the renewal

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Inputs from statistics

- A bulletin released on 21 March 2013 summarizes, for the second time, for statistical purposes and anonymously, the outcome of the requests for the international ruling procedure made under Italian tax law

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Table 1	
Bilateral APA per State pending as at December 31, 2012	
France	1
Germany	3
Japan	2
The Netherlands	2
UK	1
Spain	1
USA	4
Sweden	2
Switzerland	3
Total APA	19

Table 2					
Pre-filing					
	2009	2010	2011	2012	Total
Pre-filing on a disclosure basis	9	25	27	30	91
Pre-filing on a non-disclosure basis	4	5	3	7	19
Total pre-filing	**13**	**30**	**30**	**37**	**110**
% of pre-filing on a disclosure basis	69%	83%	90%	81%	

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Table 3					
Type of transactions discussed in the pre-filing					
	2009	2010	2011	2012	Total
TP – Production	3	5	8	5	21 (16%)
TP – Distribution	6	10	8	14	38 (28%)
TP – Services	4	8	14	16	42 (31%)
Dividend, interest or royalty	3	3	4	6	16 (12%)
Attribution of profits to the PE	1	3	1	2	7 (5%)
Cost sharing agreements	1	3	1	0	5 (3%)
Business restructuring	0	0	3	2	5 (3%)
Total	**18**	**32**	**39**	**45**	**134**

Table 4

Rulings claimed, under discussion and agreed

	2004 2005	2006	2007	2008	2009	2010	2011	2012	Total
Rulings claimed:	**18**	**10**	**6**	**6**	**12**	**16**	**29**	**38**	**135**
- Unilateral	18	10	6	6	12	13	22	27	114
- Bilateral or multilateral						3	7	11	21
Rulings agreed	**2**	**2**	**4**	**5**	**6**	**7**	**11**	**19**	**56 (41%)**
Rulings under discussion:	**14**	**20**	**16**	**11**	**15**	**21**	**37**	**54**	
- Unilateral	14	20	16	11	15	18	28	35	
- Bilateral						3	10	19	
Rulings rejected	**1**	**2**	**2**	**2**	**2**	**0**	**1**	**2**	**12 (9%)**
Give up by the party	**1**	**0**	**4**	**3**	**1**	**3**	**1**	**0**	**13**

Table 5	
Time spent to get a ruling	
Months	No.
0 – 6	9
7 – 12	19
13 –18	8
19 – 24	11
> 24	9
Total	56
Average time = 16 months	

Table 6	
Transfer pricing methods /No. of agreements	
CUP	4
Cost plus	3
Resale price	2
TNMM	24
Profit split	10 (10 residual analysis)
Total	19

Table 7	
Size of taxpayers (turnover)	
< 25million Euro	15.38%
25 – 100 million Euro	16.92%
> 100 million Euro	67.69%
Total	100%

Table 8					
Type of transactions subject of the ruling					
	2004-9	2010	2011	2012	Total
TP – Production	11	3	2	6	22
TP – Distribution	5	3	4	7	19
TP – Services	3	1	3	4	11
Transfer pricing on royalty	1	0	3	1	5
Dividends, interest and royalty	0	0	0	1	1
Attribution of profits to the PE	2	1	0	1	4
Cost sharing agreements	1	0	1	0	2
Total	**23**	**8**	**13**	**20**	**64**

The Italian transfer pricing documentation 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
  - ✓ 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**

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(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
PREPARED AND COMPLIANT WITH THE ITALIAN TPG	**FILED**	**FULL PENALTY RELIEF**

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 <u>not complete</u> and consistent with the Italian TPG
  - ✓ The information provided for in the documentation is only <u>partially true or completely untrue</u>

Different documentation requirements

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

Small and medium-sized enterprises

- ✓ Same rules BUT
- ✓ Are <u>not required,</u> under certain circumstances, <u>to update</u> 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

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Mutual agreement procedure and EU arbitration convention: are they an effective remedy?

Fabio Aramini, LL.M., partner

MAP and EUAC: are they an effective remedy?

Agenda

Scope of application

Statistics

MAP vs. EUAC

MAP / EUAC and domestic procedures

MAP / EUAC and criminal implications

MAP and EUAC: are they an effective remedy?

Scope of application

- Scope of application
  - MAP
    - Art. 25(1)(2) of OECD model convention
      - Elimination of international double taxation deriving from the taxation not in accordance with the provisions of the tax treaty
  - EUAC (90/436/EEC of 23 July 1990)
    - Art. 1 and Art. 4
      - Elimination of international economic double taxation deriving from transfer pricing adjustments

MAP and EUAC: are they an effective remedy?

Statistics

Inventory of pending MAP cases at end of reporting period (source: OECD)						
OECD Member Countries [1/2]						
	2006	2007	2008	2009	2010	2011
Australia	16	23	22	23	27	21
Austria	144	152	105	120	106	110
Belgium	81	95	152	265	142	241
Canada	134	153	186	206	225	224
Chile	0	0	0	0	0	0
Czech Republic	13	13	4	8	13	14
Denmark	82	82	79	86	67	58
Finland	12	22	20	22	32	37
France	254	233	328	427	490	539
Germany	476	527	519	543	484	702
Greece	4	5	N/A	N/A	N/A	27
Hungary	12	9	10	7	8	4
Iceland	1	1	0	0	0	1
Ireland	4	6	7	13	16	17
Israel	N.A	N.A	N.A	N.A	13	14
Italy	**52**	**63**	**56**	**67**	**80**	**102**
Japan	67	85	82	90	75	61

MAP and EUAC: are they an effective remedy?

Statistics

Inventory of pending MAP cases at end of reporting period (source: OECD)						
OECD Member Countries [2/2]						
	2006	2007	2008	2009	2010	2011
Korea	28	30	30	47	44	59
Luxembourg	31	34	35	38	59	109
Mexico	26	23	14	18	12	11
Netherlands	120	151	127	118	96	99
New Zealand	2	4	1	3	1	1
Norway	25	32	42	51	52	44
Poland	26	25	33	32	26	28
Portugal	43	45	47	47	41	42
Slovak Republic	1	4	5	6	7	9
Slovenia	N.A	N.A	3	1	1	4
Spain	55	109	66	76	84	87
Sweden	94	100	125	103	134	163
Switzerland	33	33	88	143	142	187
Turkey	2	3	2	4	8	4
United Kingdom	84	109	126	120	127	133
USA	430	500	578	724	705	686
total OECD	**2352**	**2671**	**2897**	**3413**	**3317**	**3838**

MAP and EUAC: are they an effective remedy?

Statistics

Total amount of pending MAPs under the EU arbitration Convention in relation to the year when the request was received by the tax administration (source: European Commission)

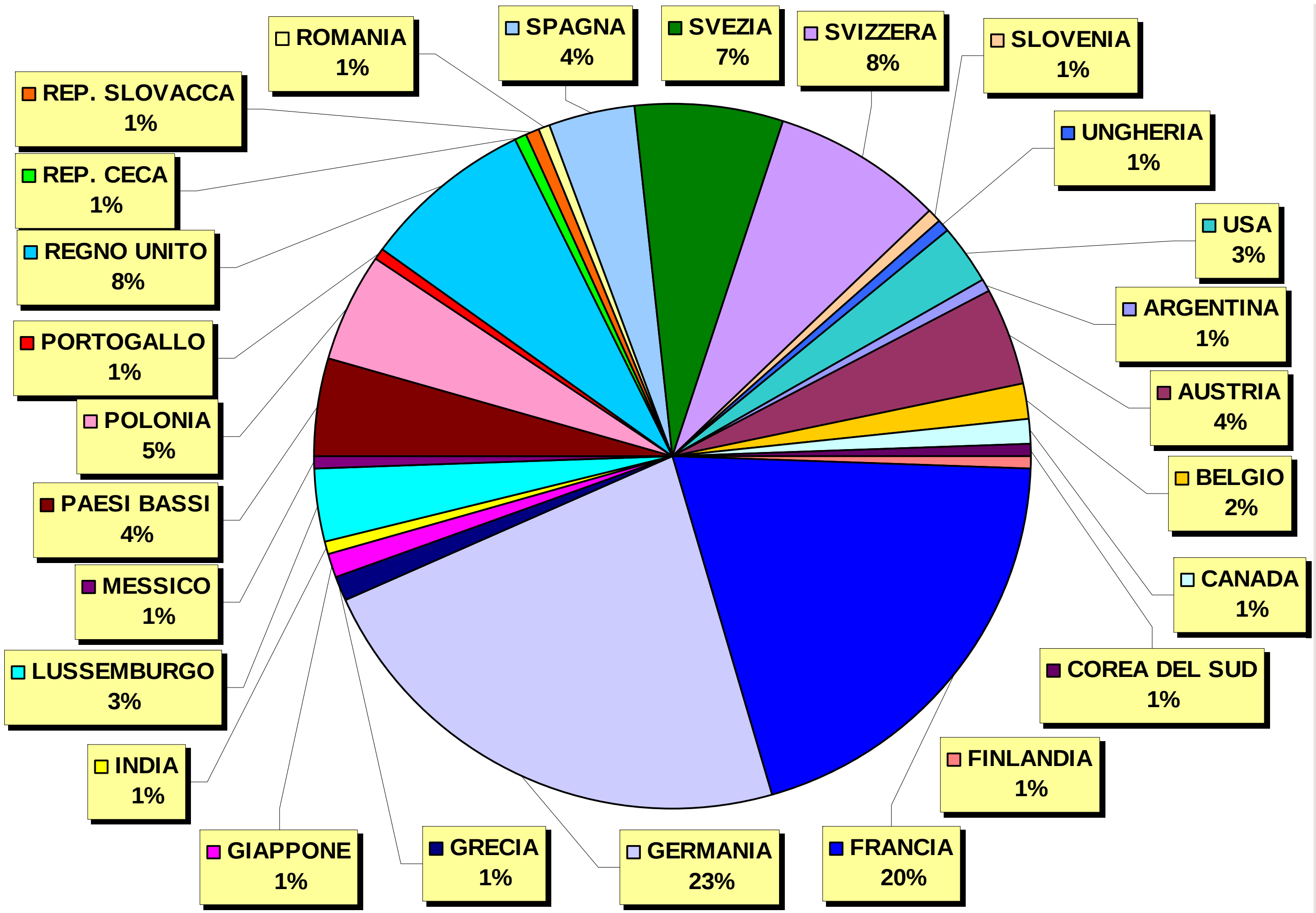
Total amount	Request received prior to 2000	Request received in 2000	Request received in 2001	Request received in 2002	Request received in 2003	Request received in 2004	Request received in 2005	Request received in 2006	Request received in 2007	Request received in 2008	Request received in 2009	Request received in 2010	Request received in 2011	Total pending cases
2011	0	0	0-1	1	1-2	2-3	8-11	13-15	22-25	32-36	72-74	70-76	128-148	355-385
2010	0	0	1	1	1-2	2-4	13-18	14-17	30-39	40-49	82-97	79-93	0	258-330
2009	0 - 1	0 - 0	1 - 2	1 - 1	1 - 2	4 - 4	16 - 19	22 - 27	40 - 51	46 - 55	86 - 108	0	0	217–270
2008	1 - 4	1 - 3	1 - 3	2	2 - 4	4 - 8	21 - 32	36 - 43	54 - 60	54 - 62	0	0	0	174–221
2007	2	1 - 5	1 - 5	4 - 6	3 - 8	6 - 11	29 - 42	45 - 66	55 - 81	0	0	0	0	146–226
2006	2 - 5	3 - 6	0 - 4	4 - 9	10 - 16	8 - 20	39 - 55	46 - 69	0	0	0	0	0	112–184
2005	16 - 24	1 - 13	5 - 10	10 - 18	12 - 23	12 - 25	42 - 68	0	0	0	0	0	0	98–181
2004	24	8	12	24	23	16	0	0	0	0	0	0	0	107

Discrepancies in the number of pending cases reported by Member States may result from cases considered closed by one Member State but not yet formally closed by the other Contracting State

MAP and EUAC: are they an effective remedy?

Statistics

Italian **pending** procedures

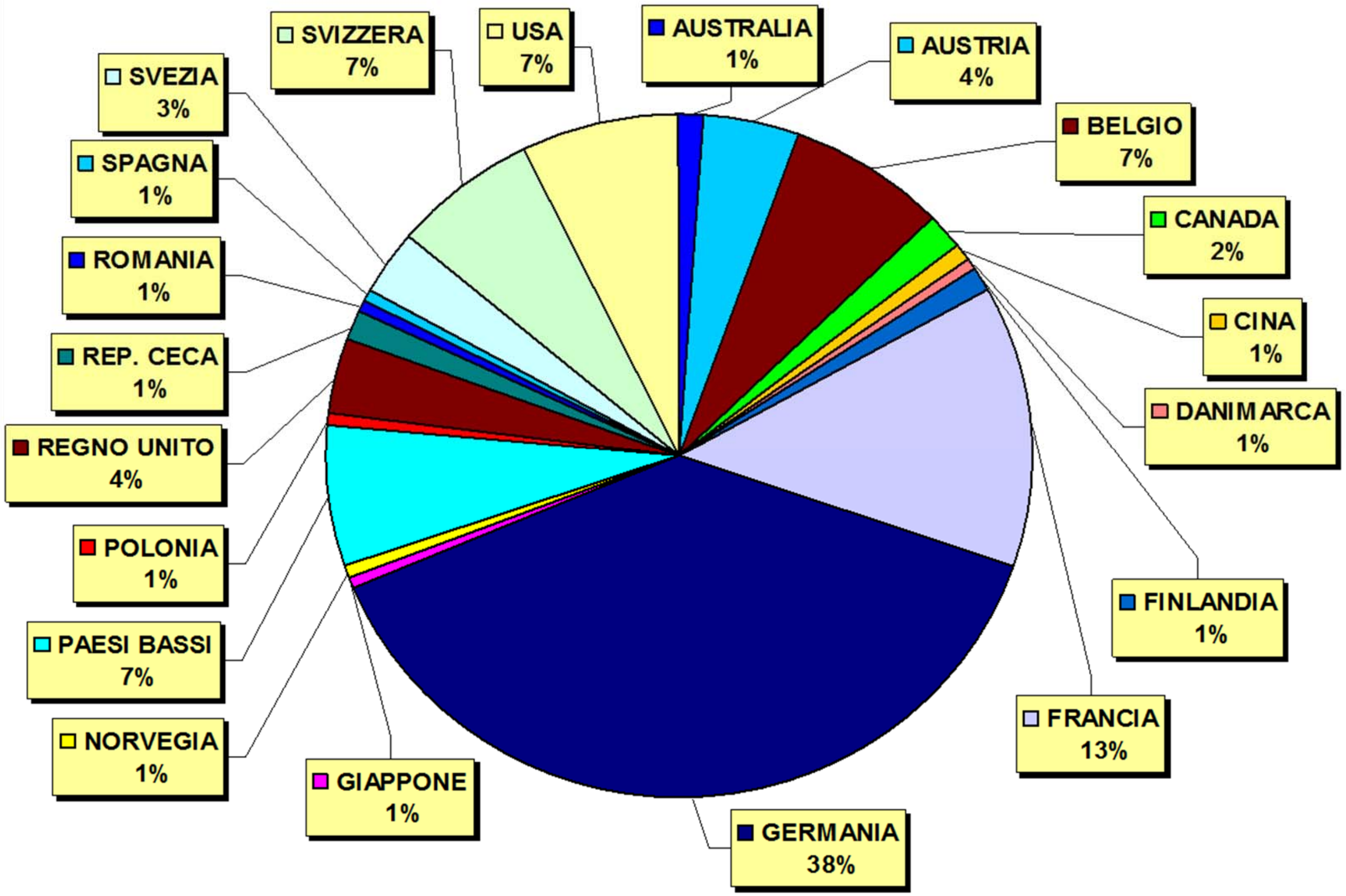


(source: Italian Ministry of Finance)

MAP and EUAC: are they an effective remedy?

Statistics

Italian **closed** procedures

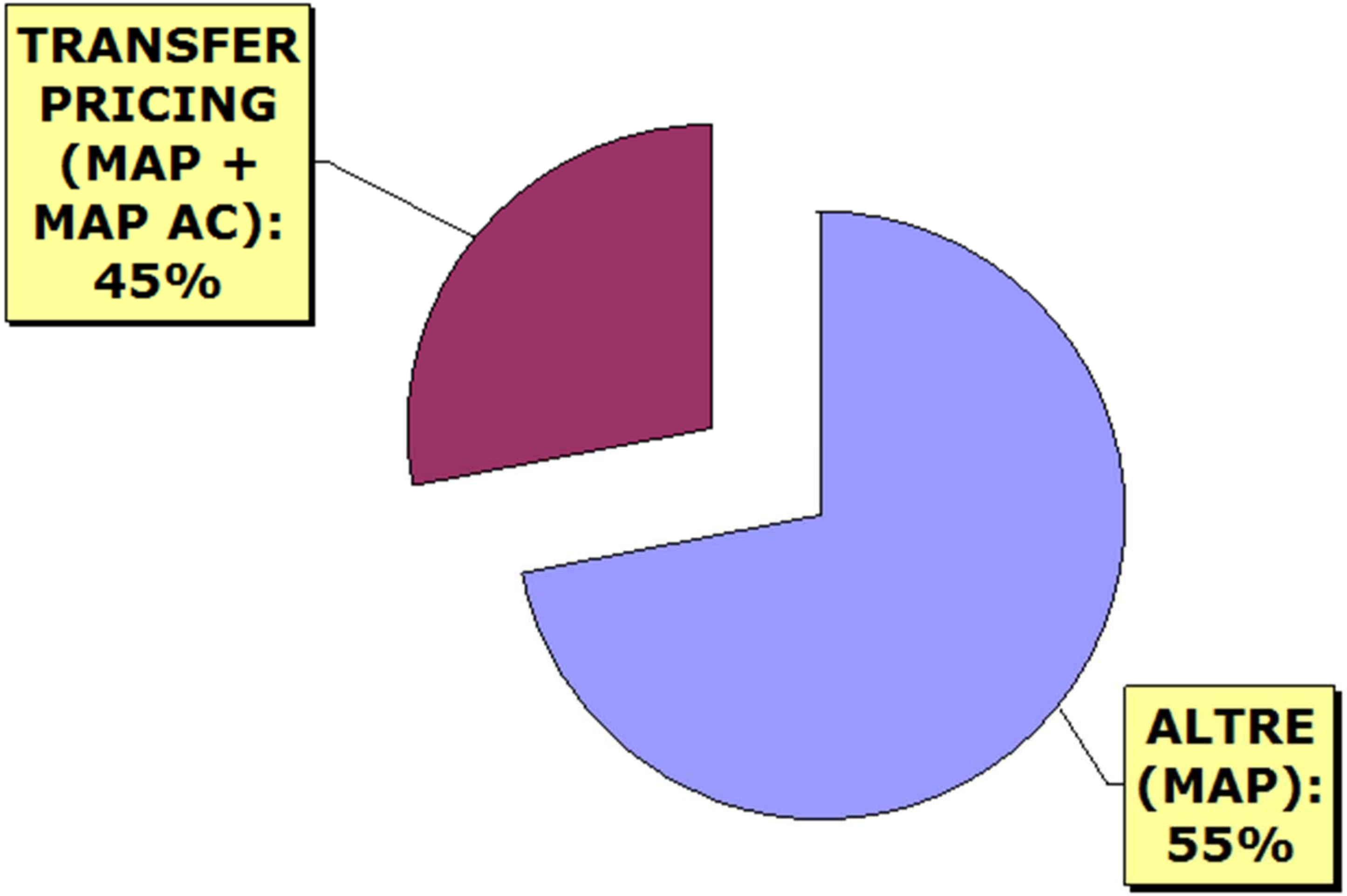


(source: Italian Ministry of Finance)

MAP and EUAC: are they an effective remedy?

Statistics

Italian **pending** procedures

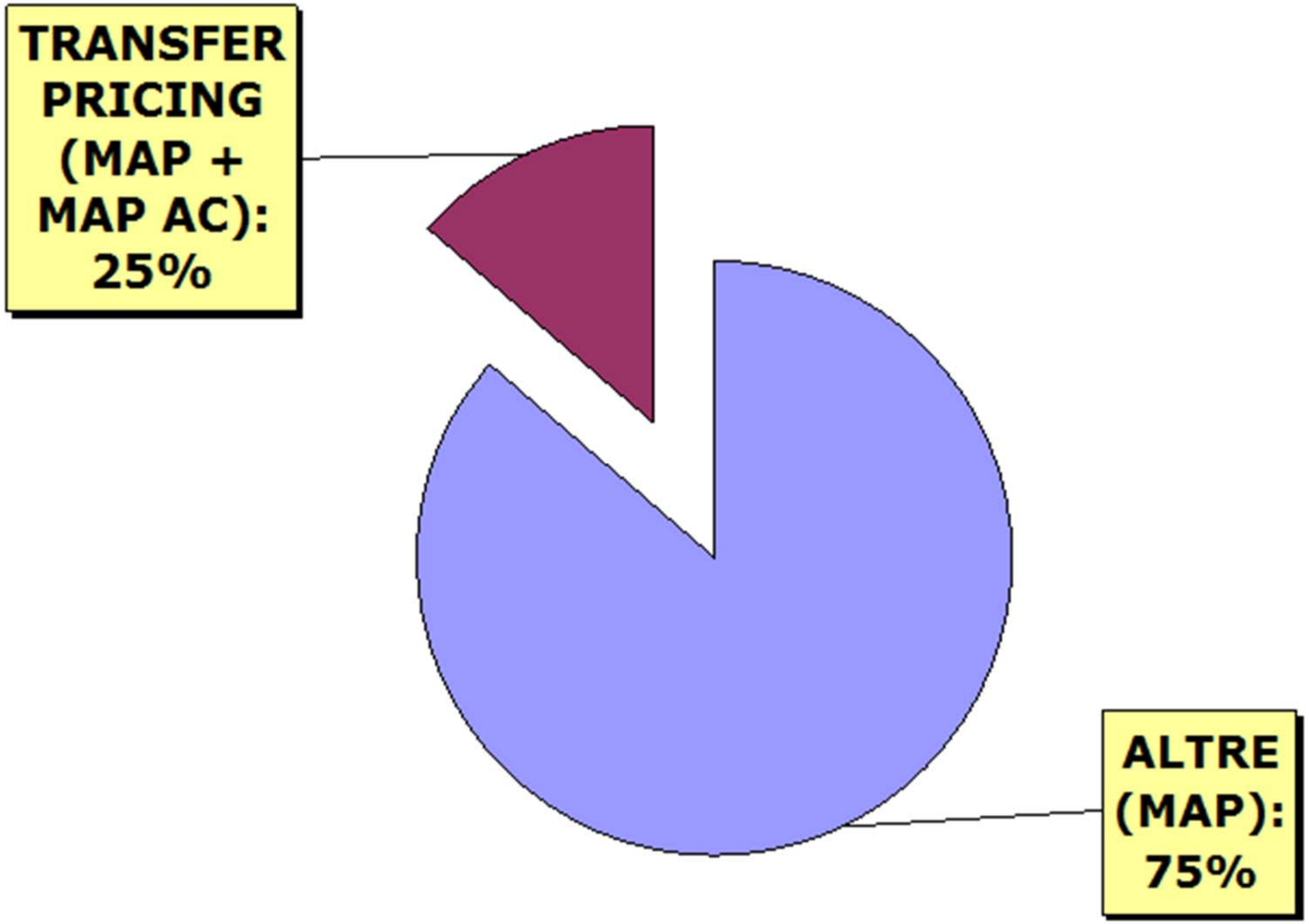


(source: Italian Ministry of Finance)

MAP and EUAC: are they an effective remedy?

Statistics

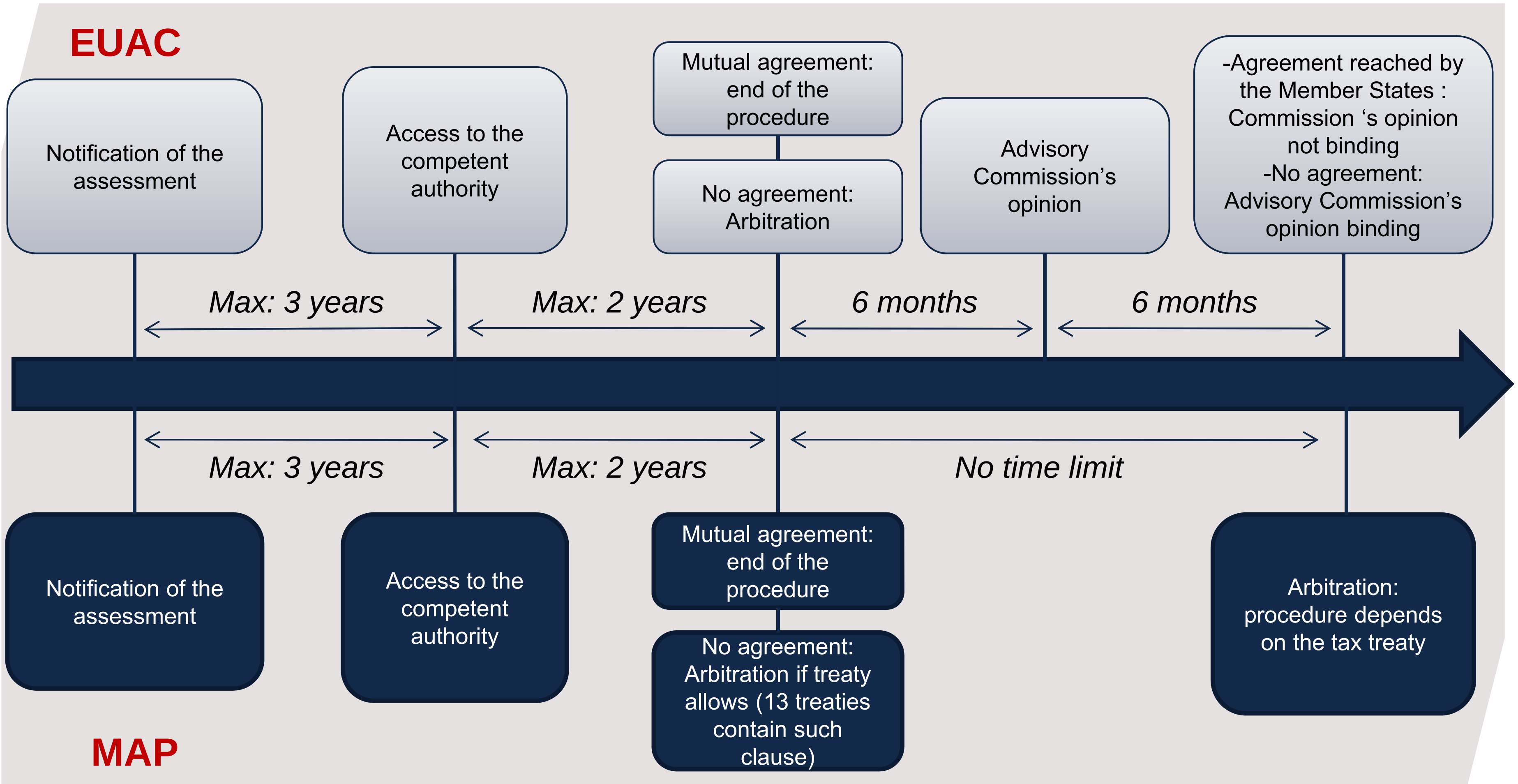
Italian **closed** procedures



(source: Italian Ministry of Finance)

MAP and EUAC: are they an effective remedy?

MAP vs. EUAC



MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

- Art. 25(1) model convention
  - Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident… The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provision of the Convention

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MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Circular letter No. 21/E of June 5, 2012
    - Juridical basis → Tax treaty law and Art. 110 ITC
    - Competent authorities → The Ministry of finance
        – Support from the Revenue Agency
    - Starting date → Wide interpretation (date of denial of refund of excess tax or date in which the notice of assessment has been notified) → Possible even before

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Circular letter No. 21/E of June 5, 2012
  - Subjective scope → "Persons"
  - Meaning of "not in accordance", i.e., objective scope → juridical and economic double taxation

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Circular letter No. 21/E of June 5, 2012
  - Irrespective of the remedies provided by the domestic law of those States → Need to file an appeal before the Court of first instance to avoid that the tax becomes final

    (i) The agreement is reached <u>before</u> the decision of the Court first instance → it is up to the taxpayer to accept it or not

    (ii) Decision of the Court of first instance <u>before</u> the agreement is reached → no possibility to change

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Circular letter No. 21/E of June 5, 2012
    - Suspension of the collection of the taxes → No specific provisions
        - Art. 39(1) DPR No. 602 of September 29, 1973 and 47 of the Legislative Decree No. 546 of December 31, 1992

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Art. 25(2) model convention

  - The competent authority shall endeavour, <u>if</u> the objection appears to it to be justified <u>and</u> if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States

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MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Circular letter No. 21/E of June 5, 2012
    - Starting date of the MAP

      (i) The date in which the procedure has been claimed <u>or</u>

      (ii) The date in which further documentation has been submitted <u>or</u>

      (iii) The date in which the request is received by the foreign tax authority
    - Role of the taxpayer → Cooperation

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

– Art. 6(1)

- Where an enterprise considers that, in any case to which this Convention applies, the principles set out in Article 4 have not been observed, it may, irrespective of the remedies provided by the domestic law of the Contracting States concerned, present its case to the competent authority of the Contracting State of which it is an enterprise or in which its permanent establishment is situated. The case must be presented within <u>three years</u> of the first notification of the action which results or is likely to result in double taxation within the meaning of Article 1

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MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

- Art. 6(2)
  - <u>If</u> the complaint appears to it to be well-founded <u>and</u> if it is not itself able to arrive at a satisfactory solution, the competent authority shall endeavour to resolve the case by mutual agreement with the competent authority of any other Contracting State concerned, with a view to the elimination of double taxation on the basis of the principles set out in Article 4. Any mutual agreement reached shall be implemented irrespective of any time limits prescribed by the domestic laws of the Contracting States concerned

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

– Circular letter No. 21/E of June 5, 2012

- Juridical basis → EU arbitration convention of July 23, 1990 (90/436/EEC), ratified with the Law No. 99 of March, 22, 1993
- Starting date → Wide interpretation (date in which the notice of assessment has been notified) → Possible even before

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

– Circular letter No. 21/E of June 5, 2012

- Subjective scope → Resident companies or Italian permanent establishments of non resident persons
- Objective scope → Transfer pricing and, *inter alia*, allocation of income to the permanent establishments

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

– Circular letter No. 21/E of June 5, 2012

- Starting date of the MAP

  (i) The date in which the procedure has been claimed <u>or</u>

  (ii) The date in which further documentation has been submitted <u>or</u>

  (iii) the date in which the request is received by the foreign tax authority

- Role of the taxpayer → Cooperation

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

– Art. 7(1)

  - If the competent authorities concerned fail to reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6 (1), they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question
  - Enterprises may have recourse to the remedies available to them under the domestic law of the Contracting States concerned; however, where the case has so been submitted to a court or tribunal, the term of two years referred to in the first subparagraph shall be computed from the date on which the judgment of the final court of appeal was given

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

- Art. 7(3)
  - Where the domestic law of a Contracting State does not permit the competent authorities of that State to derogate from the decisions of their judicial bodies, paragraph 1 shall not apply unless the associated enterprise of that State has allowed the time provided for appeal to expire, or has withdrawn any such appeal before a decision has been delivered

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

– Circular letter No. 21/E of June 5, 2012

  - Irrespective of the remedies provided by the domestic law of those States → <u>No possibility to start the arbitration phase unless the appeal is given up or not filed</u> → Impact on the two years period

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MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

EUAC

- Circular letter No. 21/E of June 5, 2012
  - Suspension of the collection of the taxes

  (i) Specific provision → Art. 3(2) of the Law No. 99 of March 22, 1993

  - Possible suspension from the Revenue Agency if all the conditions to claim the EUAC exist
  - The suspension is granted only if no appeal is filed before the Court of first instance

  (ii) Art. 39(1) DPR No. 602 of September 29, 1973 and 47 of the Legislative Decree No. 546 of December 31, 1992

MAP and EUAC: are they an effective remedy?
MAP / EUAC and domestic procedures

1. Proposal from the taxpayer to accept the issues raised in the final report (Art. 5-bis of the Legislative Decree No. 218 of June 19, 1997) – so-called *"Adesione al processo verbale di constatazione"*

- Acceptance of all the issues
- Partial acceptance not permitted
- Communication of acceptance to be submitted within 30 days from the date of delivery of the final report
- Fine reduced to 1/6 of the minimum amount, i.e., 16.67%

2. Observations to the final report (Art. 12(7) of the Law No. 212 of July 27, 2000)

- Communication to be submitted within 60 days from the date of delivery of the final report

MAP and EUAC: are they an effective remedy?
MAP / EUAC and domestic procedures

3a. Proposal from the Revenue Agency to accept part of the issues raised in the final report (Art. 5 of the Legislative decree No. 218 of June 19, 1997) so-called *"Adesione ai contenuti dell'invito al contradditorio"*

- Literally not possible but allowed by par. 2.2 of the Circular letter No. 4/E of February 16, 2009 when the proposal is different from the final report
- Acceptance of <u>all the proposed</u> issues
- Proposal to be submitted within 60 days from the date of delivery of the final report
- Fine reduced to 1/6 of the minimum amount, i.e., 16.67%

3b. Issuance of the notice of assessment

- The issuance of the notice of assessment can be made starting from the 60th day following the one of the final report
- The issuance of the notice of assessment before the 60th day is admitted only in case of urgency (Art. 12(7) of the Law no. 212 of July 27, 2000)

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MAP and EUAC: are they an effective remedy?
MAP / EUAC and domestic procedures

4. Request to open a settlement procedure (Art. 1 and 2 of the Legislative decree No. 218 of June 19, 1997) – so-called *"Accertamento con adesione"*

- The request can be made also before the notice of assessment is issued
- In case the notice of assessment is issued the request for the settlement suspends the term for filing the appeal (60 days) for additional 90 days (150 days in full to reach an agreement)
- If the agreement is reached, sanctions are reduced to 1/3 of the minimum, i.e., 33.33%
- If the agreement is not reached, the notice of assessment can be appealed

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

5. Litigation (Art. 18 of the Legislative decree No. 546 of December 31, 1992)

- Appeal to be filed within 60 days (150 days in case the taxpayer asked to open a settlement procedure) from the notification of the notice of assessment
- Provisional amount due (1/3 – Art. 15 of the Presidential decree No. 602 of September 29, 1973) within 60 days but collection of the 1/3 suspended for 270 days (Art. 29(1)(b) of the Law decree No. 78 of May 31, 2010)
  - Possibility to ask for the suspension beyond the 270 days (Art. 47 of the Legislative decree no. 546 of December 31, 1992 – Art. 39 of the Presidential decree No. 602 of September 29, 1973)
- Possibility to reach an agreement before the first hearing
  - Fines reduced to 40% – so-called "*conciliazione giudiziale*" (Art. 48 of the Legislative decree no. 546 of December 31, 1992)
- 100% fines if the appeal is rejected
  - Possibility to reduce the fines up to 1/3 before filing the appeal (Art. 16(3) of the Legislative decree No. 472 of December 18, 1997)
    - In such a case the fines cannot be claimed back anymore

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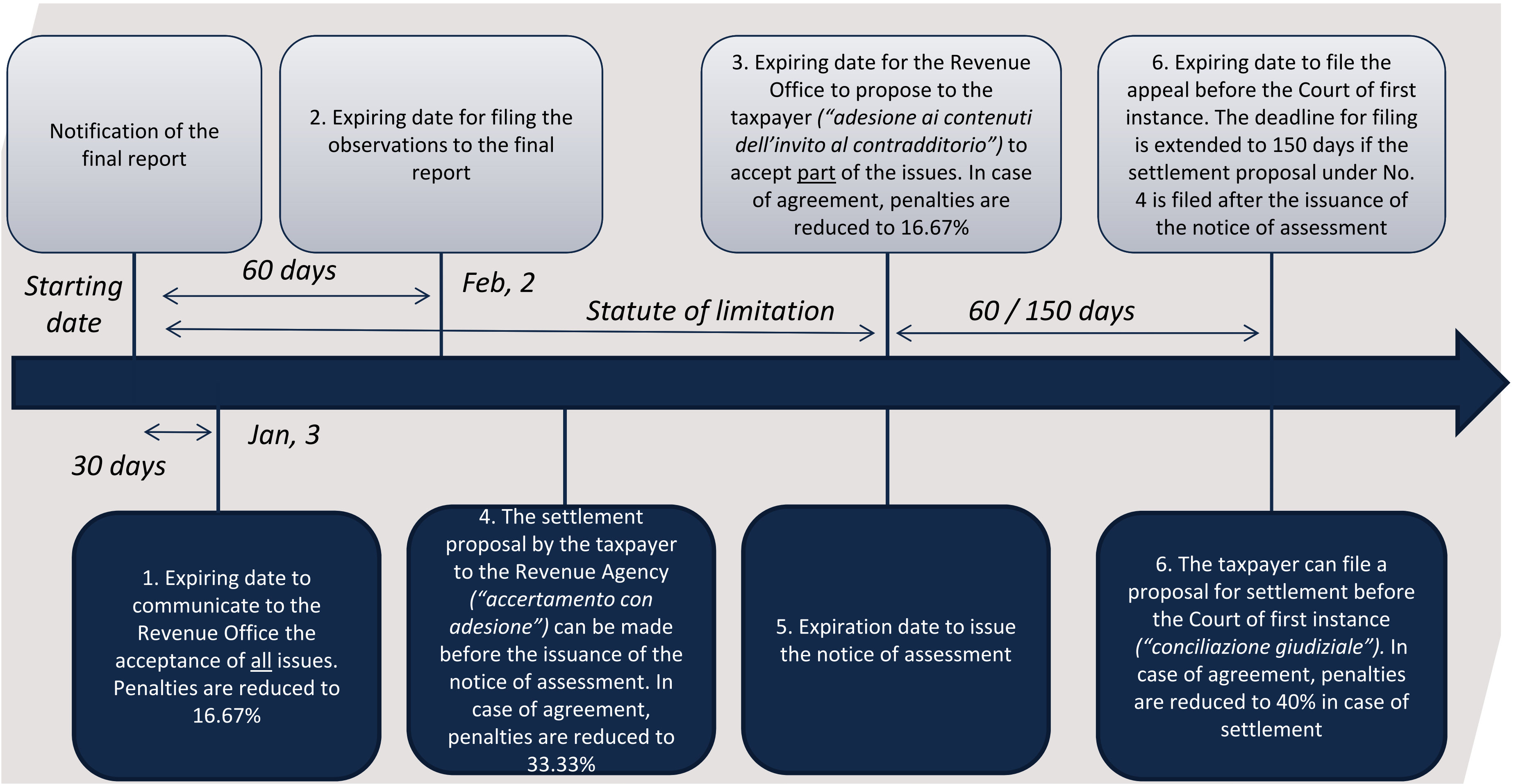
Available options – summary



MAP and EUAC: are they an effective remedy?

MAP / EUAC and criminal implications

- MAP
  - Nothing explicit

MAP and EUAC: are they an effective remedy?

MAP / EUAC and criminal implications

- EUAC
  - Art. 8(1)
    - The competent authority of a Contracting State shall not be obliged to initiate the mutual agreement procedure or to set up the advisory commission referred to in Article 7 where legal or administrative proceedings have resulted in a final ruling that by actions giving rise to an adjustment of transfers of profits under Article 4 one of the enterprises concerned is liable to a serious penalty

MAP and EUAC: are they an effective remedy?

MAP / EUAC and criminal implications

- EUAC
  - Art. 8(2)
    - Where judicial or administrative proceedings, initiated with a view to a ruling that by actions giving rise to an adjustment of profits under Article 4 one of the enterprises concerned was liable to a serious penalty, are being conducted simultaneously with any of the proceedings referred to in Articles 6 and 7, the competent authorities may stay the latter proceedings until the judicial or administrative proceedings have been concluded

MAP and EUAC: are they an effective remedy?

MAP / EUAC and criminal implications

- EUAC
  - Unilateral Declaration of Italy on art. 8
    - The term 'serious penalties' means penalties laid down for illicit acts, within the meaning of the domestic law, constituting a tax offence

MAP and EUAC: are they an effective remedy?

MAP / EUAC and criminal implications

- EUAC
  - Code of Conduct
    - As Article 8(1) provides for flexibility in refusing to give access to the Arbitration Convention due to the imposition of a serious penalty, and considering the practical experience acquired since 1995, Member States are recommended to clarify or revise their unilateral declarations in the Annex to the Arbitration Convention in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud

MAP and EUAC: are they an effective remedy?

MAP / EUAC and domestic procedures

MAP

– Circular letter No. 21/E of June 5, 2012

  - Serious penalty

  (i) Fraud pursuant to Articles 2 or 3 of the Legislative decree No. 74/00 → Very difficult to happen in practice

  (ii) Scope of tax evasion pursuant to Article 4 of the Legislative decree No. 74/00

MAP and EUAC: are they an effective remedy?

MAP / EUAC

EUAC

- Art. 11(1)
  - The advisory commission referred to in Article 7 shall deliver its opinion not more than six months from the date on which the matter was referred to it

MAP and EUAC: are they an effective remedy?

MAP / EUAC

EUAC

– Art. 12(1)
  - The competent authorities party to the procedure referred to in Article 7 shall, acting by common consent on the basis of Article 4, take a decision which will eliminate the double taxation within six months of the date on which the advisory commission delivered its opinion
  - The competent authorities may take a decision which deviates from the advisory commission's opinion. <u>If they fail to reach agreement, they shall be obliged to act in accordance with that opinion</u>

Steps for transitional period

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A practical approach

- ✓ Always need to **comply with the law**
- ✓ However… the effort for compliance must be commensurate with what is needed keeping in mind a cost benefit analysis
  - ✓ Create the documentation since the beginning vis-à-vis utilize the existing files of the MNE
- ✓ Tax audits **quality**
  - ✓ Available options
  - ✓ Courts' attitude

Historical overview of TP in Italy

- ✓ <u>Little focus</u> on TP by Tax Authorities historically

- ✓ Only one (main) administrative practice → 1980 circular letter
  - ✓ Tax inspectors looked at TP as <u>very complex matter</u>

- ✓ General 100% - 200% <u>penalty regime</u> was applicable. However,
  - ✓ Few cases before the Courts
    - ✓ Often reference to the profitability of the sector or internal (non) comparables
    - ✓ 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 (≥100 m Euro) led to an increased focus on TP

- ✓ Criminal law ramifications
  - ✓ Still unclear but two cases law require to pay attention
    - ✓ The D&G and the Raul Bova cases

Two instruments to reduce the risk

- ✓ (Unilateral) advance pricing agreements – APA
  - ✓ Valid only for the **future**
  - ✓ Introduced in 2003
  - ✓ Bulletins released in 2010 and 2013

- ✓ 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

A possible approach

- ✓ One document highlighting what your (local) **TP policy** is
  - ✓ Awareness of the problem
  - ✓ Choice of the policy in compliance with the law (e.g., core vs. non-core services)

A possible approach (cont.)

- ✓ Document(s) aimed at **benchmarking** and **describing** the transactions and the group
  - ✓ Master file
  - ✓ Country specific documentation

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