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TRANSFER PRICE IN ITALY

Taxing authority and tax law

The transfer price provisions are embedded in the Presidential Decree n. 917 of 22 December 1986, where transfer pricing is ruled by Article 110 (7) and Article 9 (3)-(4).

Relevant regulations and rulings

- The Italian Finance Ministry Guideline n° 32/9/2267 of September 22, 1980;
- The Italian Finance Ministry Guideline n°. 42/12/1587 dated December 12, 1981;
- The Italian Finance Ministry n° 1 dated October 20, 1998, that outlines general methods for tax audits and includes transfer pricing in the framework of regular audits of multinational enterprises;
- Decision of the Italian Supreme Court (Corte di Cassazione) n. 22023 of 13 October 2006 that held the burden of proof is on the tax authority for transfer pricing issues. According to the Supreme Court, and following the 1995 OECD guidelines, in the jurisdictions where the burden of proof is on the tax authority, the taxpayer is not obliged to give evidence that the transfer prices comply with the arm's length principle unless the tax authority has already proved (*prima facie*) that the taxpayer has not complied with the arm's length principle.

OECD guidelines treatment

The Italian transfer pricing rules are mainly provided by the tax law provisions (Article 110 (7) and Article 9 (3)-(4) of the Presidential Decree n. 917 of 22 December 1986), Administration of Finance Circular Letter n. 32/9/2267 of 22 September 1980 and Circular Letter n. 42/12/1587 of 12 December 1981.

The 1980 Circular Letter follows the 1979 OECD Transfer Pricing Guidelines and, although it was issued before the date of enforcement of Article 110 (7) mentioned above, its provisions are still fully applicable. On the other hand, the 1995–1999 OECD guidelines have not been converted yet into specific official Italian guidelines, but only translated by the Italian Ministry of Finance.

The Decision n. 22023 of the Italian Supreme Court makes a clear reference to the OECD guidelines stating that the burden of proof is on the tax authority.

Priorities/pricing methods

Transactional-based methods, such as CUP, Resale Price and Cost Plus, are preferred over profits-based methods, such as Profit Split, Profit Comparison, Economic Sector Gross Margin and Invested Capital Profitability.

According to the Italian transfer pricing rules (particularly the 1980 Circular Letter), the profits-based methods could be used:

- When it is impossible to use the three basic methods
- When
 - Uncertainties arise in verifying the correct use of the three basic methods
 - It is necessary to separate the differential element between two transactions which are susceptible to comparison in order to use one of the three basic methods.

Transfer pricing penalties

General penalties for underpayment apply (Legislative Decree n. 471 of 18 December 1997). In particular, in a case where the tax return has been filed, general administrative penalties apply in the amount equal to a minimum of 100% up to a maximum of 200% of the additional tax or the minor tax credit assessed by Italian tax authorities. This penalty applies when, with reference to the single taxes, (1) the taxable income declared is lower than the one assessed, (2) the taxes declared are lower than those due or (3) the tax credit declared is greater than the one due to the taxpayer. The same penalties apply where undue tax allowances or deductions from the taxable income have been declared in the tax return. Interests on taxes or additional taxes due also apply. The yearly interest rate is presently equal to 2.75% of the taxes due (Article 20 of Presidential Decree n. 602 of 29 September 1973).

Transfer pricing penalties (continued)

Because of the relatively high amount of potential tax revenue in a transfer pricing audit, tax officers often refer assessments to public prosecutors to explore possible criminal tax law ramifications, as permitted under Legislative Decree n. 74 of 10 March 2000. Some mitigation is provided by Art. 7 whereby taxpayers are supposed to disclose their transfer pricing policy into the financial statement (we suggest the involvement of an Italian criminal lawyer).

Penalty relief

There is no provision concerning penalty relief.

Documentation requirements

There are no specific documentation requirements provided. However, the documents should adhere to the OECD Transfer Pricing Guidelines. All income and deduction items should be adequately substantiated. According to Article 32 of Presidential Decree n.

600 of 20 September 1973, Italian tax authorities may require taxpayers to produce or send deeds and documents (in the form of questionnaires) concerning the assessment to which they are subject. Taxpayers are required to comply with the tax authority's requests.

Italian substantive and procedural law does not contain specific rules on the relevance of the documentation. Taxpayers are only obligated to submit the compulsory accounting books and other documents specifically required by the tax authorities (a completely different approach must be followed under the Italian anti-tax-haven provisions where legally, the burden of proof shifts to the taxpayer).

Documentation deadlines

There is no statutory deadline. However, the deadline cannot be less than 15 days from the notification of the tax authority's documentation request, in accordance with Article 32 of Presidential Decree n. 600 of 29 September 1973. The tax authority retains discretion over extension requests.

Statute of limitations on transfer pricing assessments

There is no specific statute of limitations on an assessment for transfer pricing. The general statute of limitations period for tax purposes applies. Therefore, tax assessments must be notified to the taxpayer by 31 December of the fourth year following the year for which the tax return has been filed. If the tax return has been omitted or is treated as null and void, the assessable period for the relevant year is extended by one additional year. Furthermore, for companies that do not benefit from the 2002/2003 Italian Tax Amnesty, the assessable period is extended by two additional years.

Return disclosures/related-party disclosures

Italian companies must officially communicate (in documents, correspondence, register of companies) whether they are managed and controlled by another company and the name of the related company (Article 2497-bis of the Italian Civil Code). Financial statements should include essential data of the managing or controlling company's financial statement and relations with related parties (Articles 2424, 2427, 2428 and 2497-bis of the Italian Civil Code). The tax return should disclose transactions with tax havens concerning costs and expenses.

Audit risk/transfer pricing scrutiny

The risk of transfer pricing scrutiny during a tax audit is very high. In fact, transfer pricing receives the greatest scrutiny. Italian tax authorities usually challenge the price of intercompany transactions that do not comply with the arm's length principle or that result in a mismatch between the characterization of entities and their remuneration. There appears to be a tendency toward challenging transfer pricing in combination with issues related to tax havens and permanent establishments (especially since the Italian Supreme Court's "Philip Morris" case decision in 2002: Ministry of Finance (Tax Office) v. Philip Morris (GmbH), Case 7682/05 of 25 May 2002).

In addition, there is generally greater tax audit activity and particular attention paid to major taxpayers, where the Italian tax authorities are devoting greater resources in intelligence and monitoring activities on multinationals (see also, Italian Tax-Police Command, *Results of the first eleven months of the 2002 and future strategies*, press release of 19 December 2002). According to Article 42 of the Financial Law of 2000 (n. 388 of 23 December 2000), beginning from 2002, taxpayers with a business volume or turnover not lower than about EUR 26 million are expected to be systematically audited at least once every two years, while the taxpayers with a business volume not lower than EUR 5.2 million will be audited at least once every four years. These audits may be complete and extensive or just focus on specific items.

This approach of the Italian tax authorities has also been confirmed by the Circular Letter n. 3/E of 29 January 2004 which stressed a special focus on tax havens, reorganizations, rulings and fiscal units. For these goals, the Italian tax authorities will increase the exchange of information with the foreign tax authorities.

APA Opportunities

The Italian government introduced a unilateral ruling system mainly relating to transfer pricing, dividends and royalties. The law has been enacted with the “*Provvedimento del Direttore dell’Agenzia delle Entrate*,” dated 23 July 2004. This document provides a number of practical guidelines to apply and conduct the ruling program. Previously, APAs were not permitted in Italy. Instead, taxpayers obtained rulings from the Italian tax authority when the interpretation of the tax law was unclear.