

Transfer Pricing Audits: Approach by Italian Tax Authorities

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Therefore, the interest of the Italian Tax Authorities in establishing the criteria to determine the value of inter-company transactions is intuitive; it becomes essential for the authorities to avoid that the discretion of the enterprise in the price definition process may – due to the differences in the tax systems of the various States involved – allow an unlawful shift of taxable income in favour of the State with the most favourable tax legislation.

Due to the above, determining transfer prices has become one of the primary concerns of Italian multinationals as they need to establish a price that is not only correct but that will also be acknowledged as such by the Italian tax authorities.

Approach by the Italian tax authorities

Ensuring that tax obligations are duly complied with when multinationals enter into cross-border transactions that involve several jurisdictions, gives rise to some critical issues.

The current tax scenario appears to be especially significant for transfer pricing, due to the fact that the Italian tax authorities, and the Revenue Guard in particular, have been refining and optimising their operating systems and procedural methods in order to:

- effectively respond to the new and ever more complicated evasion and/or avoidance methods which have created increasingly sophisticated operating schemes;
- duly consider any norms and/or recommendations derived from international and EU organisations and based on studies and in-depth investigations within the context of the BEPS Project.

Tax audits by the Italian Revenue Guard are directly affected – also by reason of indications provided by Circular No. 1/2008 and subsequent updates – by the complexity and sophistication of tax avoidance schemes, which also refer to important international corporate groups (i.e. so-called high-tech giants) known for having carried out transactions/operations where substantial intangibility had been well-established some time ago.

Central role of documentation for transfer pricing audits

Within the context of transfer pricing audits, a key aspect relates to the tax inspectors' ability to make an adequate and well-balanced assessment of taxpayer's documentation as submitted by the latter. It is precisely within this context that the Italian tax authorities' relationship with the taxpayer becomes rather challenging.

By acquiring the documentation produced by the company under audit allows tax authorities to avail themselves of a frame of reference with regard to aspects related to both intelligence and documentation (for evidentiary purposes). In particular, the tax authorities have the opportunity to easily acquire the necessary information on any price determination methods that were adopted by the audited company, including selection, evaluation and analysis of the comparables and criteria applied in order to either comply with, or deviate from average values established by the rule for the determination of the arm's-length value.

The tax authorities may count on the benchmark effected by taxpayers as a whole, while limiting any challenges to its accuracy – whether partially or entirely – and may supplement it, where needed, with marginal or partial elements that may be suggested by the self-same analysis effected by the taxpayer. From an evidentiary standpoint, the Italian tax authorities are not held to provide any evidence on either facts or evaluations submitted by the taxpayer himself, unless they intend to challenge such facts and evaluations.

To conclude, the tax authorities do not exclude the possibility of building a database that may be gradually enriched with comparative elements of the various economic sectors and which may ultimately constitute an evidentiary base, to be

simply updated and supplemented and eventually employed for future audits or assessments.

Italian Tax Revenue Agency's Circular No. 16E dated April 28, 2016 – best practices to counteract tax evasion

Circular No. 16E issued on April 28 2016 provides significant insights on the best practices, set forth by the Italian government for Revenue auditors in relation to the 2016 to 2019 period, to counteract tax evasion, and on procedural aspects that should be taken into consideration by the Italian Tax Revenue (ie, *Agenzia delle Entrate*) when dealing with abusive behaviours, for the purpose of counteracting such kinds of practices.

The document endorses a change of behaviour and approach by Italian tax revenue auditors in order to ensure a better relationship between the tax authorities and taxpayers, based on mutual respect, professionalism, proportionality (through the means and actions carried out), and transparency (in line with the cooperative compliance approach championed by the OECD).

The circular intends to emphasise and uphold the concept that audit activities should be clear and straightforward, and should focus on counteracting abusive behaviours, so as to improve tax collection, and act as a deterrent for abusive behaviours, while fostering tax compliance.

The guidelines issued are aimed at:

- Reducing the tax gap;
- Improving the quality of tax assessments and audits;
- Reducing aggressiveness during audit/inspections/assessments; and
- Making an appropriate use of benchmarking.

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