



Suitable TP documents could prevent penalties in Italy: But what is “suitable”?

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Multinationals with activities in Italy can get rid of penalties for tax avoidance if they opt to supply the Italian revenue authorities with comprehensive transfer pricing (TP) documents supporting their group’s TP policies. Antonella Della Rovere and Federico Vincenti of Valente Associati GEB Partners explain how this works in practice.

Italian Decree-Law No. 78/May 31 2010 (the “Decree Law”) introduced the option for multinational enterprises to compile all relevant documentation to provide the necessary information on the group’s TP policies. Submission of such documentation has the invaluable potential to relieve taxpayers from penalties in case of a tax audit, on the condition that it is deemed “suitable” by the competent tax authorities. However, practical experience shows that fulfilling this suitability requirement is particularly tricky.

The provision is useful for two reasons. Firstly, it allows multinationals to benefit from an exemption on any penalties that may be due after an audit assessment that adjusts the transfer prices. In particular, the administrative penalty that can be avoided is 90%-180% of the amount of tax considered to have been avoided (Decree-Law no. 471/1997, art. 2 para. 2). Secondly, it allows the tax authority to gain supporting documents during an audit to determine the consistency of prices applied in intercompany transactions by associated enterprises when compared with the ones applied at arm’s length.

Thus, the legislator intends to “reward” taxpayers that adopt a cooperative approach. In addition, Circular No. 21/E/18.5.2011 states that such behaviour “... must be especially taken into consideration within a tutoring context, for the purpose of assessing any evasion/avoidance risk, as a transparency and cooperation index in relation with the tax administration”.

Therefore, any assessment carried out by the auditing bodies that does not apply penalties must take into account the taxpayer’s effort to compile the required TP documentation, as well as their cooperation during the audit in providing the revenue office with any and all documentation/information that might be useful for a thorough understanding of the group’s TP policy.

The suitability of documents

The disapplication of penalties is linked to the revenue office’s assessment on the suitability of the TP documentation provided.

Suitability must be ascertained from a formal standpoint based on:

- The consistency of the documentation compiled by the taxpayer;
- The nature and structure of such documents set forth in explanatory regulation issued by the Italian Revenue Agency issued on September 29 2010 (Provvedimento 137654/2010); and
- A substantial perspective, examining the suitability of the documents compiled by the taxpayer to provide the revenue office with whatever data and findings that will be necessary to carry out a comprehensive and thorough analysis of the transfer prices that were actually applied.

In practice, however, there has always been considerable uncertainty in applying the “suitability” concept during audits.

The purpose of the documentation is to allow auditors to fully ascertain whether the company’s TP policy effectively allowed the taxpayer to determine intercompany transfer prices that are consistent with the arm’s length principle, keeping in mind that the area is characterised by evaluations and estimates that are rather complicated.

Any element that might lead the revenue office to deem, for example, that entities identified by the taxpayer are “not comparable” and/or, to deem that the comparability analysis and the application of TP methods are not accurate, should not be conducive to establishing that the TP documentation compiled by the taxpayer is not suitable. This is because the rationale, outlined in Article No. 26 of the Decree-Law, is to provide the revenue office with any and all elements that are suitable and useful to properly assess the TP policies adopted by the taxpayer.

Substance and content

The suitability of the documents provided by the taxpayer in terms of the substance and content must be determined on its merit. Therefore, the documentation does not have to be perfectly capable of substantiating the criteria adopted by the audited party for the purpose of determining the relevant transfer prices.

In other words, the documentation must allow the auditor to assess the findings of the criteria adopted by the taxpayer, not only for the purpose of upholding the accuracy thereof but also, if the case, for refuting it.

Hence, whenever the documentation analysed allows auditors to gain a thorough understanding of the criteria adopted by a taxpayer in determining transfer prices in all of their theoretical and applicative aspects, it may be rightly stated that the documentation is objectively “suitable” to facilitate the audit.

Compilation of suitable documentation represents, therefore, an element in which the taxpayer’s “good faith” is concretely evidenced in the taxpayer’s relations with the revenue office, even in cases it does not eventually suffice to substantiate the choice of a transfer pricing method over another.

In conclusion, “suitable documentation” and tax recapture may therefore exist simultaneously. The former’s existence avoids the application of penalties, but it does not stop the revenue office from adjusting the transfer prices and recovering the taxes owed.

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