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The Burden of Proof and Transfer Pricing

This article discusses the rule on the burden of proof as laid down in Art. 2697 of the Civil Code. After an analysis, the application of this rule is examined, with an emphasis on case law concerning the burden of proof in controversies relating to transfer pricing.

The rule regarding the burden of proof, contained in Art. 2697 of the Civil Code, reveals two different functions, namely (1) sharing between the parties – with regard to respective claims – the duty to provide evidence of the facts before the courts and (2) establishing a judgement rule on an unproven fact. Should there be uncertainty as to whether significant facts actually exist when the case is examined by the court, this rule allows for the identification of the party that will be subject to the unfavourable consequences of such uncertainty.

The burden of proof within a transfer pricing context is no different from the dialectics the taxpayer and the tax authorities with regard to other taxation cases: tax authorities have to substantiate higher income items, while the taxpayer is required to prove all the factual bases that reduce the tax burden.

From Italian case law it appears that the judges mainly focus on the avoidance aspect, consisting in the transfer of taxable income to countries with a comparatively lower tax burden. In fact, in the majority of controversies dealt with, the tax authorities should have substantiated the fact that taxation in Italy, at the time in which the transactions were carried out, was indeed lower vis-à-vis that of those countries of residence of the associated foreign companies, and subsequently, proceed to the computation of arm's length prices.

1. Burden of Proof under Italian Civil Law

Art. 2697 of the Civil Code provides that:

> [A]ny party wishing to assert a right before the Courts is required to have the facts constituting the basis thereof proven.
>
> Any party raising any objection as to the ineffectiveness of the said facts, or rather, objecting in view of the fact that a right has been modified or extinguished, must prove the facts on which such objection is based.[1]

This provision takes into account the Latin brocard according to which if the plaintiff does not prove its case, the defendant is absolved (*actore non probante, reus absolvitur*). This principle is never modified or deviated from, not even where a judge is automatically granted the power to use whatever means he or she deems necessary for purposes of gathering or assessing evidence.[2]

An analysis of the rule regarding the burden of proof reveals two different functions of such rule, namely (1) sharing between the parties – with regard to respective claims – the duty to provide evidence of the facts before the courts and (2) establishing a judgement rule on an unproven fact. Indeed, in case of uncertainty as to whether significant facts actually exist for the court, this rule allows the identification of which party will be subject to the unfavourable consequences of such uncertainty.

With regard to the general principle stated by Art. 2697 of the Civil Code, the law favours the plaintiff with regard to the inversion of the burden of proof (*onus probandi*): if certain particular legal matters are involved, the burden of proof rests with the defendant, including in the following instances:

- the burden of proof is borne by the defaulting debtor, in the case where such party wishes to be released from the relevant liability, in that such debtor must personally prove that the service giving rise to the liability could not possibly be carried out due to a fact that was not imputable to such debtor;[3]
- the burden of proof imposed upon a lessee who is answerable to the lessor for damages to the rented goods or property, if the lessee cannot prove that the causes of the damages were not imputable to the lessee; and
- certain transactions, such as the promise to pay and the acknowledgement of debt, against which charges may be brought up by the creditor without the latter having to invoke the entitlement relating thereto. In such cases, it is the debtor that may – should it be necessary – substantiate the absence of the fundamental relationship.

2. Burden of Proof in Tax Proceedings

The rule based on the burden of proof under Art. 2697 of the Civil Code is also applicable in tax proceedings, as the burden of proof is applicable in all trials. Eminent scholars have indeed acknowledged that the issue of the (inquisitorial or regulatory) nature of tax proceedings does not in any way affect the (different) issue of the applicability of the rule regarding the burden of proof.

Tax trials are proceedings that challenge an action of the tax authorities. However, it is necessary to understand how the general rule asserted under Art. 2697 is compatible with this distinctive feature.

With regard to the development of the –burden of proof as such, the Supreme Court confirmed, in Decision 2990 of 23 May 1979, that the rule regarding the burden of proof, under which the party seeking to establish its

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1. All translations are the author's.
2. See Supreme Court Decision 536 of 19 January 2000.
3. Art. 1218 Civil Code.

rights, bears the burden of proof (*onus probandi incumbit ei qui dicit*), is also applicable to tax proceedings.

The Supreme Court acknowledged that in tax proceedings, the tax authorities play the role of the "substantive plaintiff",[4] in that although it is the taxpayer who, in the judgement of the Court of First Instance, instigates the litigation proceedings, it is the tax authorities who are first responsible for advancing their own claim, although outside the judicial proceedings, through the issuance of the notice of assessment.

As a consequence and in observance of the general principle endorsed by the Civil Code, the burden of having to prove the constitutive facts of their claim rests with the tax authorities, while it is the taxpayer's duty to provide evidence of obstructive, modifying or extinguishing facts relating thereto. In particular, the taxpayer may provide – during the proceedings – counter-evidence, to be intended as proof concerning the same test case (*thema probandum*) of the tax authorities. Should the taxpayer raise matters other than those asserted in the notice of assessment in the test case, there would be no counter-evidence in technical terms, but the proof of facts different from those asserted by the tax authorities would have the effect of preventing the occurrence of consequences connected to constitutive facts of the initial tax claim, or modifying or extinguishing them. The burden regarding these other facts is borne by the taxpayer, as these refer to facts invoked by the taxpayer on its own behalf during the proceedings.

Case law acknowledges that the burden of proof rests with the tax authorities on the basis of argumentation considered in Decision 2990/1979. Therefore, the burden of proof rests with the tax authorities, as the tax assessment challenged by the taxpayer is issued by the same tax authorities,[5] which are the substantive plaintiff in the tax proceedings, or because Art. 2697 of the Civil Code is also applicable to tax controversies.[6]

3. Burden of Proof Regarding Costs, Relevance, Deductions and Allowances

Case law agrees that it is the taxpayer's duty to prove all those facts (regarding operating expenses in the running of a business enterprise, as well as those costs that confer the right to tax deductions or to deductible costs) giving rise to a reduction of the tax burden.[7] In particular, the burden of proof is identified by case law on the basis of Art. 2697 of the Civil Code, assuming that the cost represents a constitutive fact of the right (to deduction) claimed vis-à-vis the tax authorities.[8]

The rule set out by the Civil Code is moreover cited to justify the fact that the burden of proof rests with the taxpayer with regard to the relevance of a cost connected to an enterprise's business activity carried out,[9] as:

> in order for a cost to be included as reducing income, not only is it necessary that the existence thereof be certain, but it is just as necessary that the relevance thereof be also substantiated, meaning that the cost must refer to activities from which gains or proceeds, contributing to the formation of income, are derived.[10]

The above view is also shared by the great majority of case law, according to which the burden of proof falls on the taxpayer for costs actually borne, to be substantiated by means of documentary support that validates such expenses as well as the relevance thereof.

Finally, Art. 2697 of the Civil Code is also referred to in order to justify that the taxpayer bears the burden of proof for those facts granting the right to deduct tax expenses set forth under Art. 10 of the Italian Consolidated Income Tax Code[11] (*Testo Unico delle Imposte sul Reddito*, TUIR).

4. Among decisions acknowledging the tax authorities' role as "substantive plaintiff", see Supreme Court Decision 10148 of 2 August 2000.
5. See Supreme Court, I Section, Decision 414 of 16 January 1997, in *Giurisprudenza Tributaria* (1997), at 1122; Supreme Court, I Section, Decision 3235 of 21 March 1995, therein included, 1995, at 1075 with a note by Salvaneschi, "Necessaria enunciazione del criterio astratto di determinazione del maggior valore accertato" ["Necessary Statement of Abstract Criterion for the Determination of the Higher Value Assessed"]; Supreme Court, I Section, Decision 8995 of 25 August 1995, therein included, 1996, at 455; Supreme Court, I Section, Decision 8173, therein included, 1996, at 353; Supreme Court, I Section, Decision 4009 of 27 April 1994 in *Il fisco*, 36/1994, at 8603; Supreme Court, I Section, Decision 231 of 11 January 1994, in the *Corriere Tributario,* 1994,at 416; Supreme Court, I Section, Decision 4565, therein included 1993, at 1393: Supreme Court, I Section, Decision 6951 in *Giurisprudenza Tributaria,* 1994, at 159; Supreme Court, United Sections, Decision 8 of 4 January 1993, in *Foro Italiano*, vol. I, at 79; Supreme Court, I Section, Decision 12141 in *Corriere Tributario*, 1991, at 442; Supreme Court, United Sections, Decision 5117 of 30 May 1990, therein included, 1990, at 2532; Supreme Court, United Sections, Decision of 3 June 1987, at 4844 and Supreme Court, United Sections, Decision 4853 of 3 June 1987, both in *Giurisprudenza Italiana*, 1988, vol. I, at 427; Central Tax Court, Section XIII, Decision 3349 of 12 April 1994, in *Giurisprudenza delle Imposte,* 1994, at 298; Appellate Court of Bari, I Section, Decision 394 of 23 May 1989, in *Il fisco*, 14/1990, at 2359; *contra*, but entirely isolated, Tax Court, II Instance of Treviso, Section IV, Decision 1679 of 15 November 1989, in *Rassegna Tributaria*, 1990, vol. l, at 46.
6. E.g. Central Tax Court, Section XI, Decision 1744 of 6 March 1991, in *Il fisco*, 22/1991, at 3765; Central Tax Court, Section XXI, of 5 February 1991, therein included, at 2163; Central Tax Court, Section XI, 6298 of 8 October 1990, in *Corriere Tributario*, 1991, at 1680; Central Tax Court, Section XI, Decision 5611 of 20 June 1986, in *Commissione Tributaria Centrale*, 1986, vol. I, at 464.
7. Recently, see Supreme Court Decision 1181 of 27 January 2001; Supreme Court Decision 4119 of 22 March 2002; Supreme Court, Decision 10802 of 24 July 2002.
8. Central Tax Court, Section XXIV, Decision 3501 of 27 October 1995; Central Tax Court, Section XXIII, Decision 2589 of 28 June 1995; Central Tax Court, Section IV, Decision 2069 of 10 June 1994, in *Corriere Tributario*, 1994, at 2810; Central Tax Court, Section VIII, Decision 6484 of 9 November 1989, in *Il fisco*, 37/1990, at 6008; Central Tax Court, Section XVIII, Decision 1894 of 4 April 1987, therein included 29/1987, at 4742; Central Tax Court, Section II, Decision 265 of 15 January 1985, therein included 25/1985, at 3747; Tax Court, II Instance of Matera, Section I, decision 1360 of 28 March 1992, in *Bollettino Tributario* (1992), at 1870; *contra*, but in minority, Central Tax Court, Section XI, Decision 4082 of 18 June 1992, in *Giurisprudenza delle Imposte,* 1992, at 487.
9. Supreme Court, Section I, Decision 10174 of 26 September 1995, in *Bollettino Tributario* 1996, at 741; Supreme Court, Decision 3419 of 19 March 1992, in *Corriere Tributario*, 1992, at 1387; Central Tax Court, Section V, Decision 3100 of 11 June 1997, in *Tributi*, 1997, at 1536; Central Tax Court, Section XI, Decision 6845 of 24 October 1990, in *Corriere Tributario,* 1991, at 1648; Central Tax Court, Section XXIV, Decision 7799 of 16 November 1991, in *Il fisco*, 35/1991, at 5723; Central Tax Court, Section XIV, Decision 5810 of 27 August 1991, in *Bollettino Tributario*, 1992, at 1380; Central Tax Court, Section XXIV, Decision 3461 of 16 April 1988, in *Giurisprudenza delle Imposte*, 1988, at 820.
10. Supreme Court Decision 6300 of 25 June 1998.
11. Supreme Court, I Section, Decision 3904 of 3 April 1995, in *Il fisco*, at 9003; Supreme Court, Section I, Decision 5240 of 12 May 1995.

4. Burden of Proof on the Subject Matter of Reimbursements, Advantages and Exemptions

Similarly to what occurs regarding the issue of costs and relevance, it is the taxpayer's duty to prove the constitutive fact for the right to benefit from tax advantages or exemptions.[12] Credits and exemptions or advantages are strictly related, as the litigation hinges upon the tacit denial by the tax authorities of the refund request submitted by the taxpayer, following payment of an undue tax, by virtue of a rule that established a tax advantage.[13]

Even if the taxpayer were to challenge the tacit denial of the tax advantage, case law has established that the burden of proof continues to rest with the taxpayer.[14]

5. Burden of Proof in Controversies Relating to Transfer Pricing: Position of the Supreme Court

The discussion below provides an outline of some basic examples of the burden of proof under Italian law. Nevertheless, it is necessary to more closely analyse the application of the general principles to controversies involving the transfer pricing rules. In the last few years, a number of decisions were issued by both the Supreme Court and the Court, which contributed to defining the allocation of the burden of proof in transfer pricing controversies.

5.1. Decision 22023/2006

The Supreme Court dealt for the first time with the issue of the burden of proof relating to transfer pricing in Decision 22023 of 22 June 2006 (filed on 13 October 2006).

The controversy originated from the circumstance that the tax authorities, in agreement with the theory advanced by the tax inspectors, assessed a higher cost with respect to prices at arm's length to be established under the rules set forth by the joint provision of Art. 76, Para. 5 (presently Art. 110, Para. 7) and 9 of the TUIR, on the basis that the associated Italian company of an automotive group, which is a distributor on the national market, assumed without any remuneration the burden for repairs and maintenance of new cars which, by virtue of law, in accordance with Art. 1490 of the Civil Code, rests with foreign manufacturing companies of the group, thus achieving a reduction of the taxable base in Italy "to the advantage of higher profits for associated companies operating in countries with lower taxation".

Upon classification of the transfer pricing rules as an anti-avoidance provision, the Supreme Court established that:

> the burden of proof in the recurrence of avoidance bases rests in any case on the tax authorities that intend to effect the consequent adjustments …. This is further endorsed also in the issue of transfer pricing, given that the OECD Directives … in their 1995 Report expressly highlighted that where the regulations of each national jurisdiction provide for the tax authorities to prove their own claims, the taxpayer is not required to prove the accuracy of transfer prices applied, unless the tax authorities have themselves first provided evidence prima facie, of effective non-compliance with the arm's length principle … Now then, the tax authorities … should have ascertained, first of all, whether taxation in Italy at the time was actually higher with respect to that in force in the source countries from which the sold/purchased cars originated. In the second place, they should have determined on an arm's length basis the prices of vehicles purchased by F. Italia, effectively ensuring whether the remunerations paid by the same to its own associated companies were indeed higher than such value, extending the analysis to ascertain whether the profit margin was sufficiently adequate to cover repair expenses under the guarantee, as well as to an analysis of automotive market conditions, through a comparison of prices applied within the F. group with that applied by other competitors.[15]

In the decision under examination, the Supreme Court concluded that the taxpayer is not required to substantiate the accuracy of transfer prices applied, unless the tax authorities themselves have not provided prima facie evidence that the arm's length principle has not been duly complied with.

In particular, the Supreme Court acknowledged that the tax authorities should bear the burden of having to essentially prove that the absorption rule of the guarantee had not been duly complied with, thus constituting an avoidance method to reduce taxable income in Italy in favour of an increase in taxable income in countries with a comparatively lower tax burden. More specifically, the Supreme Court maintained that the tax authorities should have, first and foremost, ascertained whether taxation in Italy was at the time effectively higher with respect to that in force in source countries from which the purchased/sold vehicles originated (Germany, France and the United Kingdom), and only subsequently adjusted prices of the vehicles purchased by the Italian company, on an arm's length basis, in compliance with the arm's length principle as established by the OECD.

5.2. Decision 11226/2007

In Decision 11226 of 27 March 2007, the Supreme Court re-examined the actual application of the transfer pricing rules, stating, once more, that the burden of proof in transfer pricing controversies rests with the tax authorities when efforts are made to effect consequent adjustments to a taxpayer's income.

Ford Italia S.p.A. belonged to the US Ford Group, and used to operate in Italy as a distributor-seller of vehicles

12. On the taxpayer's burden to prove the constitutive fact on the right to reimbursement, see, in case law, e.g. Supreme Court, I Section, Decision 5989 of 3 July 1997, in *Corriere Tributario*, 1997, at 3393; Supreme Court, I Section, Decision 10698 of 27 October 1993, in *Il fisco*, 48/1993, at 12167; Supreme Court, I Section, Decision 3372, of 23 April 1990, therein included 29/1990, at 4768; Supreme Court, Section I, Decision 5605 of 14 December 1989, in *Giurisprudenza delle imposte*, 1989, at 962; Appellate Court of Milan, I Civil Section, Decision 2170 of 14 July 1995, in *Il fisco*, 10/1996, at 2644; Central Tax Court, Section VIII, Decision 475 of 23 January 1990, therein included 22/1990.
13. See Supreme Court, I Section, Decision 6476 of 18 July 1996, in *Il fisco*, 38/1996, at 9174; Supreme Court, I Section, Decision 6722 of 14 June 1995, therein included 39/1995, at 9652; Supreme Court, I Civil Section, Decision 10697 of 27 October 1993, therein included 48/1993, at 12167.
14. See Supreme Court, I Section, Decision 555 of 21 January 1994, in *Il fisco*, 14/1994, at 3704; Supreme Court, I Section, Decision 5736 of 14 May 1992, in *Corriere Tributario*, 1992, at 2650; Supreme Court, I Section, Decision 5663 of 18 December 1989, therein included 36/1990, at 933; Central Tax Court, Section XVII, Decision 7291 of 15 October 1987, in *Il fisco*, 43/1987, at 6689.
15. See Supreme Court Decision 22023 of 22 June 2006, Para.2.

purchased from its own associated European companies and produced in plants located in Germany, Spain and the United Kingdom.

Subsequent to an audit carried out by the Tax Police Unit of the Financial Guard (*Guardia di Finanza*) relating to the years 1987-1992, the II Office of Direct Taxation of Rome issued an assessment notice regarding the 1991 tax period, by means of which it proceeded to assess taxes related to the alleged over-invoicing of cars purchased by the foreign companies of the group, as well as expenses for the supply of intercompany services.

In particular, the tax authorities assumed a higher cost with regard to the arm's length cost to be established pursuant to Art. 76 of the TUIR, which was in force at the time, as Ford Italia had borne the burden, without receiving any remuneration (by law, resting with the manufacturing company) for repair and maintenance of new cars, thus achieving a reduction of the taxable base in Italy to the advantage of the foreign companies residing in countries with comparatively low taxation.

Further findings by the tax authorities revealed that the Italian company was one of the parties to an agreement with the US parent company, under which certain services that were generally useful to the group had been entrusted to the Ford Europe S.p.A. Group, which in turn recharged them to the European companies by reason of a yearly development project. Some of the services envisaged in the agreement (e.g. advertising, the preparation of motor showrooms, sports programmes and leaflets), further to being invoiced by Ford Europe S.p.A., were also invoiced by the other European companies, including the Italian company, thus determining a duplication of costs.

Subsequent to the decision of the Regional Tax Court, which was favourable to the taxpayer, the tax authorities proposed an appeal to the Supreme Court, maintaining that there was no documentary evidence to support the application of a guarantee provision in the transfer pricing determination. As a matter of fact, according to the tax authorities, as the Italian company did not request a price reduction in view of the costs borne, purchase prices continued to be recorded at their initially disproportionate super value with regard to the actual price of the goods, with consequent reduction of Ford Italia S.p.A.'s proceeds in favour of the foreign companies.

In the assessment notice (issued against Ford Italia S.p.A.), the tax authorities assessed tax related to alleged over-invoicing of cars purchased by foreign group companies. In effect, according to the tax authorities, costs incurred by the Italian company for repairs and maintenance represented a scheme to transfer taxable income to the associated foreign companies. Thus, the proceeds from the transactions were taxed in countries with a lower tax burden vis-à-vis that in Italy, by means of the imputation of costs that were higher than the arm's length costs for intercompany transactions.

In the Supreme Court's opinion, the tax authorities should have proven that transactions carried out by the Italian company were for the specific purpose of transferring taxable income abroad. According to Supreme Court judges, the tax authorities based their counter-deductions exclusively on the absence of a written agreement and on a clause for the recovery of maintenance and repair expenses incurred by Ford Italia S.p.A. in lieu of its associated foreign companies. The tax authorities should have first ascertained whether taxation in Italy was at the time actually higher vis-à-vis the countries of residence of the associated foreign companies. This circumstance was in no way supported by an analysis providing details regarding the different tax rates in the countries of residence of the associated companies, nor did it allow the proof to the courts of the tax savings that were generated by intercompany transactions.

Having quantified the difference between tax burdens, the tax authorities should have assessed the exchange values in order to determine the value of the transactions being examined on an arm's length basis. Such analysis should have been performed by:

> effectively verifying whether remunerations paid by the same to its associated foreign companies were indeed higher than such value, extending the analysis to ascertain whether the profit margin was sufficiently adequate to cover repair expenses under the guarantee….[16]

Such evaluation should have been performed on the basis of the methods indicated in Circular 32/1980. In particular, the judges stated that an analysis of "automotive market conditions through a comparison of prices applied within the Ford group with those applied by other competitors" should have been carried out.

In conclusion, the Supreme Court highlighted how:

> tax assessed on the basis of an unlawful deduction of the taxable base does not appear to have been subjected to these mandatory steps, as the tax authorities, in fact, merely limited themselves to referring to the particular contractual conditions between the parties on the issue of exclusion from the guarantee for the manufacturing defects of the vehicles, therefrom surmising the over-invoicing of vehicles purchased by the Italian companies.[17]

5.3. Decision 1709/2007

In this decision, the Supreme Court, drawing inspiration from a case involving the proof of the existence and relevance of costs, considered the application of transfer pricing rules contained in Art. 110, Para. 7 of the TUIR. In particular, the controversy with the tax authorities was triggered by the Official Records of Findings through which the tax authorities proceeded to recalculate losses for tax year 1992. The basis for assessing tax was the non-deductibility of costs recharged to the Italian company being audited by its foreign parent company for an employee of the same (a sales manager) relating to the period of secondment in Italy.

The Supreme Court, upholding the appeal of the tax authorities, emphasized how the remanding judges, in evaluating the documentation produced by the company for the purpose of verifying the nature and value of the

16. See Supreme Court Decision 11226 of 27 March 2007, Para. 1.
17. See Supreme Court Decision 11226 of 27 March 2007, Para. 1.

services being challenged, as well as the advantages obtained by the Italian company, must adhere to the following legal principle:

> ...the burden of proof and of the relevance of a cost rests with the taxpayer, regarding costs deriving from services provided by a foreign holding company to a controlled Italian company. Such burden includes each and every element that may enable the tax authorities to verify that such services are at arm's length.[18]

The decision in question reconfirmed the general principle under which, with regard to a loss, the burden of proof and relevance thereof rests with the taxpayer.

The reasoning procedure of the Supreme Court in the case in point does not originate, unlike Decision 22023/2006, from the actual application of Art. 110, Para. 7 of the TUIR, but rather from the verification of whether the principle of relevance under Art. 109, Para. 5 of the TUIR has been duly complied with, as the article provides that:

> expenses and other losses different from payable interest, save for tax expenses, social and socially useful contributions, are deductible if and to the extent they refer to assets or goods from which proceeds or other profits that contribute to the formation of income or that do not contribute thereto, since excluded therefrom, are derived….

With regard to the case at hand, it is thus possible to state that it is the taxpayer's duty, under general principles, to prove all the necessary elements to substantiate the deductibility of costs incurred to obtain the services provided by the foreign holding, including the actual usefulness of those services for the controlled company.

5.4. The Court's position

As to the position of the Court, already in 2005[19] the Provincial Tax Court of Milan had dealt with the topic of the burden of proof in transfer pricing.

The controversy relating to the Commission's judgement originated from the findings of the tax authorities that the evidence provided was neither sufficient to prove the advantages received by the associated Italian company with regard to services supplied by a European service centre, nor of the consequent fairness of the consideration paid.

With regard to the burden of proof, the Provincial Tax Court of Milan stated that the tax authorities have to provide evidence of constitutive facts of the tax claim, by providing proof of the circumstances and elements that corroborate the existence of a higher taxable base, while the taxpayer has to provide evidence of losses and costs, regarding both their existence and relevance.

The principles expressed in Supreme Court Decisions 22023/2006, 11226/2007 and 1709/2007 regarding the burden of proof borne by the tax authorities, were also acknowledged by Decision 52 of 26 February 2007 (filed on 9 May 2007) of the Provincial Tax Court of Pisa, which stated that the burden of proof rests with the tax authorities, which have to provide evidence of the fact that the difference between the price applied to intercompany transactions compared to those in the free market is not based on sound business reasons.

The controversy under examination originated from the assessment to tax of proceeds not accounted for, subsequent to the transfer of products by the Italian company to its own French subsidiary at a price deemed to be less than an arm's length consideration.

The Tax Court judges stated that if the rule on transfer pricing is to be interpreted as an anti-avoidance measure, it is essential that the elements pertaining to such intent be identified. In the case in point, the unlawfully pursued advantage has never been determined since the tax authorities have never established the allegedly more favourable treatment pursued through the transfer pricing transaction.

6. Conclusion

With regard to the burden of proof in controversies relating to transfer pricing, it is primarily important to bear in mind that, in case of losses, case law acknowledges that the burden of proof regarding all of the factual bases that reduce the tax burden[20] rests with the taxpayer.

In controversies relating to the assessment of increased income or gains, the judges based their reasoning on an analysis of the rationale contained in Art. 110, Para. 7 of the TUIR, which was introduced "for the purpose of preventing the transfer of taxable income abroad".[21,22]

First, the burden of proof within a transfer pricing context is no different from the dialectics that are established between the taxpayer and the tax authorities with regard to other taxation cases: in effect, it is the burden of the tax authorities to substantiate higher income items, while the taxpayer is required to prove all the factual bases that reduce the tax burden.

From the analysis of the decisions discussed here, what surfaces is that the judges have focused on the avoidance aspect, consisting in the transfer of taxable income to countries with a comparatively lower tax burden. In fact, in the majority of controversies analysed, the tax authorities should have substantiated the fact that taxation in Italy, at the time in which the transactions were carried out, was indeed lower vis-à-vis that of those countries of residence of the associated foreign companies, and subsequently, proceed to the computation of arm's length prices.

The foregoing aspect should not, however, be particularly significant in the evaluation of transfer

18. See Supreme Court Decision 1709, Para. 3.6.
19. Decision 158 of 29 July 2005.
20. See Supreme Court Decision 1709.
21. See Note 9/1989 of 10 March 1982.
22. See Supreme Court Decisions 22023 of 22 June 2006, 11226 of 27 March 2007 and 52 of 26 February 2007.

prices, if one is to consider that intercompany transactions must be *exclusively* subject to compliance with the arm's length principle set forth at Art. 9, Para. 3 of the TUIR.[23]

Art. 110, Para. 7 of the TUIR is a rule on evaluations aimed at the taxpayer that must take this regulation into consideration when filing its tax return. Under this provision, the taxpayer bears the burden to be *first* in providing evidence regarding any variance from losses at arm's length.

Such conclusion may not, however, be regarded as final, as it is important to consider that the arm's length principle is a legal criterion that must be complied with by any party that wishes to assert a claim related thereto (be it the tax authorities or the taxpayer). Such assertion means that the tax authorities must set another price against the price declared by the taxpayer. For adjustment purposes, the tax authorities must, in any event, proceed to the determination of prices at arm's length and the justification thereof.

Of course, there is no reason to identify the arm's length basis if the price has been challenged in its existence or relevance, as in such case the adjustment provides for the application of the ordinary measures under Art. 109 of the TUIR.

The burden of proof which case law refers to is a burden of argumentation, as it entails a proof of values with characteristics that are different from those attributable to proof, generally speaking. As a consequence, it is not proper to refer to "evidence and counter-evidence" in a technical sense, but rather to "arguments and counter-arguments" which may mostly reflect the dialectical nature of an encounter between the tax authorities and the taxpayer in relation to the application of transfer pricing rules.

23. The Provincial Tax Court of Pisa had already remarked that "the most difficult issue to be resolved on the topic of transfer pricing consists in the difficulty of identifying a market price".