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IMPORTANT UPDATES ON TRANSFER PRICING

As a part of the implementation in Italy of OECD Base Erosion and Profit Shifting Project ("**BEPS Project**"), the Ministry of Economy and Finance ("**MEF**") and the Revenue Agency issued, respectively on 14th and on 30th May 2018, two important measures on Transfer Pricing ("**TP**") matters based on the outcome of a public consultation launched on the 21st February 2018.

1. THE CONTEXT

Following the significant changes introduced in the OECD TP Guidelines by the BEPS Project, Italy also amended the domestic TP rules – by approving Article 59 of Law Decree no. 50/2017 (converted into Law no. 96/2017) – with particular reference to Article 110(7) of the Italian Income Tax Code, providing the subsequent issuing (through a ministerial decree) of specific domestic implementing guidelines (*Linee guida*) on TP, based on the best international practices. In this respect, a joint workgroup involving the Tax Policy Department within the MEF, the Italian Revenue Agency (*Agenzia delle Entrate*, "**IRA**") and the Italian Tax Police (*Guardia di Finanza*, "**GdF**") prepared an action plan aimed at (**i**) drafting the guidelines at stake, (**ii**) providing multinational enterprises with further clarifications on the TP legislation and (**iii**) properly training the public officials in charge with the application of the new rules.

2. THE DECREE AND OTHER DOCUMENTS RELEASED FOR PUBLIC CONSULTATION

MEF has decided to open a "public consultation", trying to involve all the potential stakeholders (trade associations, practitioners, etc.) in a proactive, inclusive and advanced dialogue. This represents an innovative and positive approach compared to the past and, above all, confirms the significant improvements made in recent years by the Italian tax administration.

The documents made available by the MEF for public comments were the following (the "**Consultation Documents**"):

(i) a draft of the Decree (the "**Decree**"), containing the domestic implementing guidelines on TP;

(ii) a draft of regulations (*Provvedimento*, the "**Regulations**") of the Commissioner of IRA implementing Article 31-quater of Presidential Decree no. 600/1973 in relation to the so-called "corresponding adjustment procedure";

(iii) a draft of a courtesy translation into Italian of several chapters of the most recent version (July 2017) of the OECD TP Guidelines.

In addition, taking into account the complexity of the matter, MEF invited the interested parties to also send their contributions in relation to other TP issues which might be further clarified in future interpretative documents (e.g. Circular letters of the IRA).

Legance's Tax Department has actively participated to the said public consultation and to the final round-table (in the meeting held in Rome last May 8th), also providing comments on certain wordings of the Decree and the Regulations as well as specific contributions which are useful for the future discussion/adoption of new measures on TP audits such as, for instance, the use/misuse of (**a**) commercial databases and (**b**) data from years following the year of the transactions under examination.

3. MAIN EFFECTS OF THE NEW MEASURES

The domestic guidelines contained in the final version of the Decree, published by MEF only few days after the conclusion of the public consultation, are extremely innovative and should be welcomed insofar as, besides placing Italy among the Countries provided with an advanced (at least under a formal standpoint) TP legislation, they clearly reaffirm a fully OECD-compliant arm's length approach and provide relevant indications, *inter alia*, on:

(i) limitations to the possibility for the tax authorities (*i.e.* the audit teams of IRA and GdF) to disregard the TP methodologies adopted by the MNEs and make alternative analyses based on different criteria/methods;

(ii) proper use of statistic tools and possibility for tax offices to raise TP challenges making reference to an arm's length range value and not necessarily to a specific punctual value, typically corresponding to a central tendency indicator (*e.g.* averages, median, etc.);

(iii) possibility (likewise significant in terms of reduced compliance burdens and higher certainty) to adopt a simplified approach (also at a documental level) in relation to the low value-added intercompany services; from now on, indeed, multinational enterprises will be allowed to determine the appropriate arm's length value of such intragroup services by applying a 5% mark-up on direct and indirect costs.

The above listed clarifications could be very useful in order to limit certain aggressive approaches often adopted by the local tax audit teams. It is hoped, indeed, that such good intentions inspiring the Decree will effectively be put in place and have an actual impact on the day-by-day activities of the provincial and regional offices of IRA and GdF.

As far as the Regulations are concerned, as anticipated above, they provide for implementing rules on the corresponding adjustment procedure (recently introduced in Italy), *i.e.* downward adjustments which can be requested by an Italian-resident taxpayer following a TP primary adjustment made by foreign tax administrations *vis-à-vis* related parties, in order to limit (and/or possibly eliminate) double taxation. In this respect it is worth remembering that MNEs, in order to solve double taxation disputes, besides the "ordinary" activation of a bilateral Mutual Agreement procedure ("**MAP**") based on the relevant tax treaty and/or the EU Arbitration Convention, can now rely on the additional possibility to apply for an Advance Pricing Arrangement ("**APA**") in Italy even only at a unilateral level with the IRA, provided that certain requirements are met.

This reform of the Italian legislation on TP will be further completed and integrated through the expected issuing of interpretative circular letters by IRA, in which a number of critical points still pending (and partly mentioned and discussed during the public consultation process) should be addressed.

At the same time, Italian authorities are now aware of the necessity to grant more certainty and consistency in the implementing phase of such new provisions on TP. In fact, among the next actions that the workgroup coordinated by MEF intends to carry out there is an important joint training plan for the officers in charge for tax inspections (both of IRA and GdF) which will apply the new guidelines on a daily basis. This initiative, indeed, is aimed at making the audit teams' approaches (throughout the Italian territory) not only more consistent, but also more complying with the internationally accepted OECD best practices.

However, there is no doubt that TP is (and will be in the next years) one of the crucial issues of the Italian tax administration's activity as well as one of the high-risk areas that multinational companies will have to carefully monitor.

4. FINAL REMARKS

Although the new domestic guidelines published by MEF are in line with those issued by OECD at international level (and which Italy already substantially complied with), they undoubtedly represent important development and relevant momentum, essentially for the two following reasons: (**i**) on several issues Italian authorities were keeping on proceeding based on very outdated practice indications (*e.g.* the Circular letter no. 32 issued in 1980); (**ii**) due to the recent reform, Italy intended to take a clear stand on certain aspects of TP about which the same OECD was forced to accept compromise solutions (in order to mediate between very distant positions often adopted by the administrations of the member Countries) and provide high-level indications sometimes ambiguous and not decisive.

On a practical level, Legance's Tax Department is already taking into account the methodologic approaches resulting from the new domestic guidelines in the several assistance activities currently on-going, both in the context of the tax audits and litigations before the tax courts, and in a number of negotiations with IRA (during settlement procedures, APA, MAP, etc.).

Legance Tax Team has gained considerable experience in assisting MNEs on TP issues in handling their relationships with the Italian tax authorities, both at the pre-litigation stage and in litigation, including matters concerning the negotiation of APAs. Our team includes professionals with significant experience in this area, in particular Davide Nespolino, a lawyer with an MBA qualification who has worked for about a decade at the IRA and has been involved in the negotiation of important APAs, international procedures (MAP and arbitration cases) and other related activities (tax audits, internal consultancy and lectures to the audit teams, etc.)

Legance's Tax Department is available to support clients in analyzing their situation and to provide advice about the negotiation of APAs, MAPs, arbitrations and other related TP issues (including, among others, the review of the existing documentation, the support in drafting new sets of documents, the evaluation of existing policies and of information available for disclosure, as well as of the potential consequences in case of audits and/or subsequent litigation).

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The Tax Department of Legance is available to provide any clarifications, also in respect of any specific situation which may be of interest to you.

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