



Italy: Transfer Pricing

The Italian Revenue Agency has issued new Transfer Pricing documentation guidelines that fully replace the 2010 version

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On 23 November 2020 the Italian Revenue Agency issued new guidelines (the 'Guidelines') that fully replace the 2010 guidelines for the preparation of so-called 'Italian Transfer Pricing Documentation'. The new Guidelines complete the Ministerial Decree dated 14 May 2018, which sets the rules for the practical application of the arm's length principle.

A group company, or a branch of a foreign entity or an Italian company that owns a foreign branch must prepare, in order to apply for penalty protection, both a Masterfile and a Country File.

The previous distinction between group holding companies, sub-holdings of groups and subsidiaries, which used to determine the different levels of documentation required, has been replaced and the same set of documents is now required for all taxpayers, regardless of the position of the Italian entity within the group.

Although the overall structure of the Masterfile and the Country File appears to be in line with the BEPS Action 13 (OECD Guidelines CHP V) format, there are several differences which require special attention.

The Masterfile must include the following elements:

1. Overview of the group and group structure.
2. Activities performed by the group, including a description of the following:
 - 2.1 Main drivers of profit.
 - 2.2 Flows of the five main group products representing at least five percent of group revenues.
 - 2.3 Main service agreements.
 - 2.4 Main markets of reference.
 - 2.5 Value chain of the group and FAR of its entities.
 - 2.6 Business restructurings that have taken place in the financial year.

3. Intangible assets of the group
 - 3.1. Description of the group's R&D and IP management strategy.
 - 3.2. List of IP relevant to intercompany transactions, including its legal ownership.
 - 3.3 Summary of the main IP agreements, including CCA.
 - 3.4 TP policies in relation to IP.
 - 3.5 Significant intercompany transactions taking place within the financial year that involve the IP.
4. Intragroup financial activities
 - 4.1 Description of the source of group financing.
 - 4.2 Description of the group treasury functions, including a description of their effective place of management.
 - 4.3 Description of the main TP policies for intercompany financial transactions.
5. Group financial information
 - 5.1. Consolidated financial statements.
 - 5.2 Description of 'APAs' or other 'Advance Cross-Border Rulings' issued by or entered into with the tax authorities in the countries where the group operates, grouped by country of reference.

With respect to the Country File, the Guidelines indicate that the following elements must be included:

1. Company description
 - 1.1 Operating structure, including organization chart, details of local management and country of residence of the management structure to which local management reports.
 - 1.2 Business strategies pursued and changes compared with the previous tax year, including business restructurings and transfers of IP.
2. Intercompany transactions grouped as recommended in the OECD Guidelines. For each group of transactions, the following details must be included.
 - 2.1 Description of the intercompany transaction:
 - Amounts (including payments).
 - Counterparts.
 - Potential comparables (internal and external).
 - 2.2 Comparability analysis based on the five comparability criteria set in the OECD Guidelines for internal/external uncontrolled transactions. This must include the details needed to 'accurately delineate the transaction' and highlight any changes compared with the previous year.
 - 2.3 Method(s) adopted to determine the transfer prices, including the procedure used to select the method, and the resulting comparability analyses demonstrating the arm's-length nature of the transfer prices applied.

- 2.4 Result of the application of the method(s).
- 2.5 Critical assumptions adopted in the application of the method(s).

3. Financial information
 - 3.1 Financial statements of the local entities.
 - 3.2 Sheets reconciling the financial statements and the Profit Level Indicators (PLIs) used in the analysis.
 - 3.3 Financial data of comparable entities.

The company must attach:

- All the intercompany agreements pertaining to the documented transaction.
- APAs of the Italian entity itself as well as 'APAs' or 'Advance Cross-Border Rulings' to which the Italian entity is not a party but which are, however, linked to the documented intercompany transactions of the Italian entity.

Extremely careful attention must be paid to the following details:

- If a transactional profit method is applied, explanations must be given for the rejection of a traditional transaction method (where potentially applicable). If a traditional transaction method is applied, explanations must be given for the rejection of a CUP method (where potentially applicable).
- A description must be given of the 'critical assumptions' underpinning the application of the method and, should these assumptions change, the potential effects.

The Guidelines also state that, even where the documentation is available, it is left to the sole discretion of the tax inspectors to decide during a tax audit whether the documentation is complete and compliant with the Guidelines. If it is not, the inspectors may refuse to recognize penalty protection for Transfer Pricing related adjustments.

In terms of the formalities:

- The documentation must be in Italian (however, the Masterfile may be in English).
- The entire documentation set (both the Masterfile and the Country File) must be digitally signed by the taxpayer's legal representative by the filing date for the relevant income tax return.
- The existence of the documentation must be declared in the annual income tax return.
- Any additional documentation requested during the audit must be submitted within seven days.

Penalty protection is denied if the documentation is not complete and/or compliant with the Guidelines, if there is no 'contemporaneous' digital signature by the legal representative of the entity (which also certifies that the documentation on that date is complete and no longer modifiable), or if the information in the documentation is not true.

KPMG's observations

Certain elements of the Guidelines should assist the taxpayer in preparing the documentation, while others will require more care. The first include the recognition that certain omissions, where not material, should not affect the overall validity of the documentation.

Instead, the factors that require more care and discussion from a local operational perspective include the following.

- The requirement to report 'APAs' and 'Advance Cross-border Rulings' to which the Italian entity is not a party but which, having been entered into by entities with which the Italian entity engages in intercompany transactions, affect the intercompany transactions reported in the local documentation.
- The need for the local taxpayer's legal representative to sign a Masterfile that includes information not directly under the legal representative's control, which might create friction within multinational groups.
- The full reconciliation of the financial information used to determine the tested PLIs with the financial statements.
- The 'critical assumption approach', which is typical of a ruling rather than of documentation.
- The confirmed fact that only SMEs are exempted from the annual renewal of the economic analysis (and only if this information can be gathered from public sources).

The new rules apply to the documentation of fiscal years starting from that in progress on 24 November 2020.

As the new rules impose a considerable amount of restructuring and addition of new information not included in previous documentation, it would be strongly advisable for groups and local taxpayers to tightly schedule this work so that the documents can be digitally signed on time (under the current rules, for a taxpayer whose fiscal year ends on 31 December 2020, the deadline is 30 November 2021).

KPMG's team of Transfer Pricing specialists is available to provide additional information or answer your questions.

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