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by Piergiorgio Valente and Federico Vincenti

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FEATURED PERSPECTIVES

Statistics From Italy's APA Program

by Piergiorgio Valente and Federico Vincenti

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On March 19, the Italian Revenue Office published the second edition of the international tax ruling bulletin, nearly three years after its first edition. The bulletin provides an update on the activities carried out by the International Tax Ruling Office from 2010 to 2012.

The increase in auditing activities by Italian tax authorities (especially in transfer pricing matters) has prompted taxpayers to try to define in advance those cases that are characterized by the highest degree of uncertainty.

The international tax ruling procedure can be applied to businesses that carry out international activities and are defined by the law as:

- any company resident within the state territory (in accordance with current provisions on income taxes) that, alternatively or simultaneously:
  - — is subject to one or more of the provisions indicated in article 110(7) of the Presidential Decree of December 22, 1986, No. 917 (Italian income tax code, or TUIR);
  - — holds stakes in the assets, funds, or capital of nonresident persons or whose assets, funds, or capital are held by nonresident persons; or
  - — has paid out to or received from nonresident persons dividends, interest, or royalties; or
- any nonresident company that carries out its activities in Italy through a permanent establishment (qualified as such under the relevant provisions of the TUIR).

The international tax ruling procedure allows Italian businesses that carry out international activities to agree in advance with the Italian tax authorities on:

- the methods for calculating the arm's-length value of intercompany transactions in accordance with article 110(7) of the TUIR (transfer pricing transactions can include cost-sharing agreements and business restructuring operations);
- the application, in specific cases, of rules concerning the tax treatment of dividends, interest, royalties, and other income paid to or collected from a nonresident person, also based on applicable treaties; and
- the application, in specific cases, of rules concerning the allocation of profits or losses to the PE in Italy of a nonresident company or the PE in another member state of a company resident in Italy, also based on applicable treaties.

International tax ruling agreements are binding for the contracting parties and are valid for three years from the beginning of the tax period during which they are stipulated.

In order to provide clarifications on how to submit an international tax ruling application or on other more general issues, the International Tax Ruling Office grants preliminary meetings with prospective applicants (so-called prefiling meetings). During these meetings, the taxpayers can remain anonymous.

The international tax ruling bulletin of March 19 highlights the increase in prefiling meetings over the last three years; in fact, Italian tax authorities held as many as 97 prefiling meetings from 2010 to 2012 (30 in 2010, 30 in 2011, and 37 in 2012), whereas in 2009, prefiling meetings were held only 13 times.

Most prefiling meetings dealt with transfer pricing issues (101 out of a total of 134 cases).

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Regarding transfer pricing, the international tax ruling bulletin defines an advance pricing agreement as:

> an agreement between the taxpayer and the tax authorities in the taxpayer's country of residence, which makes it possible, in advance and for a set period of time, to determine the method for calculating the arm's length value of the transactions covered by the agreement.

APAs represent a chance for tax authorities and taxpayers to have constructive discussions and avoid or prevent litigation that would have uncertain results and could turn out to be costly, in terms of resources used, for both parties.

Depending on the number of contracting parties involved, APAs can be unilateral, bilateral, or multilateral agreements.

A unilateral APA is an agreement between one tax authority and the taxpayer. It follows that unilateral APAs do not solve double taxation issues, since the competent tax authority in a state may choose not to recognize the terms of the agreement that were stipulated in a different state and may therefore reassess transfer prices independently.

On the contrary, as pointed out in the international tax ruling bulletin, a bilateral or multilateral APA:

> ensures that related companies profits derived from transactions covered by the agreement are not subject to double or multiple taxation, since the APA is an agreement by and between the competent authorities of all foreign jurisdictions involved.

The international tax ruling bulletin also highlights that since the end of 2010, Italian tax authorities have provided the opportunity to request bilateral or multilateral APAs.

The first edition of the bulletin highlighted how 19 out of 52 ruling applications submitted through December 31, 2009, had been approved (and resulted in an agreement), 17 were still being reviewed, seven had been denied as nonqualifying, and nine had been withdrawn.

In the last few years, the use of international tax rulings has increased significantly, as shown by data compiled starting in 2004 in Table 1.

An analysis of the data in Table 1 shows the following:

- An increase in ruling applications submitted in the 2010-2012 period compared with the previous years; specifically, 83 applications were submitted in the last three years, whereas only 52 were submitted during the 2004-2009 period (as many as 38 applications were turned in 2012).
- About 19 percent of the applications submitted did not result in an agreement either because they did not qualify or because the tax authority or the taxpayer interrupted the procedure. The main reasons why taxpayers withdrew their applications include changes to company restructuring requirements, objective or subjective, resulting from the preliminary investigation. Reasons for interruption by the tax authorities include the taxpayer's lack of responsiveness to requests made by the International Tax Ruling Office during the investigation.

The second edition of the international tax ruling bulletin reports the average time it took to sign an

Table 1. International Ruling Applications Submitted, Procedures Underway, and Agreements Reached

	2004/2005	2006	2007	2008	2009	2010	2011	2012	Total
International ruling applications submitted	18	10	6	6	12	16	29	38	**135**
Unilateral	18	10	6	6	12	13	22	27	**114**
Bilateral or multilateral	-	-	-	-	-	3	7	11	**21**
International tax rulings granted	2	2	4	5	6	7	11	19	**56**
Procedures underway	14	20	16	11	15	21	37	54	
Unilateral	14	20	16	11	15	18	27	35	
Bilateral or multilateral	-	-	-	-	-	3	10	19	
Nonqualifying applications	1	2	2	2	2	0	1	2	**12**
Procedures withdrawn or interrupted by one or both parties	1	0	4	3	1	3	1	0	**13**

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agreement. Regarding the total number of agreements reached as of December 31, 2012, the average time taken to sign off is slightly over 16 months, calculated as the simple average of the months taken to execute each agreement. In particular, note that:

- from 2004 to 2012, 83 percent of the international ruling agreements were executed in less than 24 months;
- the average time it took to execute a ruling agreement from 2004 to 2009 was nearly 20 months, while it was close to 15 months from 2010 to 2012;
- half of the agreements (28 out of 56) were executed in less than 12 months; and
- about 6 percent of the agreements took longer than 24 months to execute.

Regarding transfer pricing, the international tax ruling bulletin shows the methods for determining transfer prices adopted when an agreement was executed. In particular, agreements stipulated from 2004 to 2012 provided for the application of the transfer pricing methods shown in Table 2.

Table 2. Methods for Determining the Arm's-Length Value of Transfer Prices

Transfer Pricing Method	Number of Agreements
Comparable uncontrolled price	4
Cost-plus method	3
Resale price method	2
Transactional net margin method	24
Profit-split method	10

An analysis of Table 2 shows that 79 percent of the agreements on transfer pricing involved income-based methods, whereas 21 percent of them focused on traditional methods.

Specifically, the most used transfer pricing method is the transactional net margin method (TNMM), which applied in 56 percent of the cases.

Such data are in line with the first edition of the international tax ruling bulletin regarding transfer pricing methods used from 2004 to 2009; in fact, 79 percent of the agreements on transfer pricing involved income-based methods, whereas 21 percent of them focused on traditional methods. More specifically, the TNMM was applied in 53 percent of the agreements subscribed, while the resale price method was never applied (only in the 2010-2012 period did the resale price method begin to be included in ruling agreements).

The international tax ruling bulletin of March 19 pinpoints how, in some cases, the tax authorities — to eliminate any differences (in terms of functions performed, risks assumed, and assets held) between the profile of the comparables identified during the investigation and the taxpayer's profile — carried out appropriate adjustments of the financial statements data of the comparable companies.

Regarding the types of transactions covered by the agreements, note that:

- 22 agreements focus on transactions related to the functional profile of a manufacturer (half of them were executed from 2010 to 2012);
- 19 agreements focus on transactions related to the functional profile of a distributor (14 of them were executed from 2010 to 2012);
- 11 agreements focus on the intercompany supply of services (eight of them were executed from 2010 to 2012);
- five agreements focus on the determination of the value of royalties paid or received (four of them were executed from 2010 to 2012); and
- 89 percent of the agreements executed dealt with a transfer pricing matter, while of the remaining 11 percent:
  - two agreements focus on cost-sharing agreements (one of them was executed from 2010 to 2012);
  - four agreements deal with the allocation of profits or losses to a PE (two of them were executed from 2010 to 2012); and
  - in 2012, the first agreement concerning the application, in specific cases and based on applicable treaties, of rules concerning the tax treatment of dividends, interest, royalties, and other income paid to or collected from nonresident persons was executed.

The second edition of the bulletin also grouped the type of taxpayers who requested an international tax ruling according to their size (based on 2010 turnover) and their business sector.

In particular, regarding the agreements executed as of December 31, 2012, and those whose application was pending on that date, note that:

- 15.38 percent of the applicants reported revenues below €25 million;
- 16.92 percent of the applicants reported revenues between €25 million and €100 million; and
- 67.69 percent of the applicants reported revenues greater than €100 million.

There is therefore a clear predominance of medium-size and large applicants (84 percent) and, in particular, of so-called large taxpayers (68 percent).

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By contrast, the first edition of the international tax ruling bulletin pointed out that in the 2004-2009 period, 48.15 percent of the applicants reported revenues below €100 million.

Regarding the business sectors in which the applicants operate, the second edition of the bulletin highlights that taxpayers requesting an international tax ruling belong to a varied group: Roughly half of them carry out production activities (52 percent), while the other half belong to the service industry (48 percent).

The analysis of data provided also shows that a large number of applicants operate in highly specialized and technological sectors, such as information technologies and the electronics industry. ◆

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