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Italian regional production tax and its impact on taxpayers

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IRAP is a regional production tax (established by Legislative Decree No. 446 of 15 December 1997, the so-called "IRAP Decree") levied on independent and regularly exercised activities of production or exchange of goods and/or provision of services. Piergiorgio Valente, Managing Partner of Valente Associati GEB Partners explains the specifics of the tax and its impact on taxpayers operating in Italy.

The IRAP tax applies to the value of the net production resulting from activities carried out in Italy.

Italian rules on transfer pricing are set forth in article 110, paragraph 7 of the Italian Income Tax Code (TUIR), which requires that the prices charged in transactions between parties belonging to the same multinational group respect the arm's-length principle and, in line with OECD guidelines, allows Italian tax authorities to carry out an adjustment of the transfer prices applied by associated companies (and, as a consequence, of their revenues) to calculate corporate income taxes (IReS).

The application of transfer pricing regulation to IRAP was confirmed by the Ministry of Finance's Circular No 141/E of June 4 1998, which established that, with reference to the computation of the production value, the positive difference between the arm's-length value of the goods supplied and/or services rendered and the accounted revenue contributes to the determination of the IRAP tax base.

The Financial Act 2008 (Law No 244 of December 24 2007) amended the IRAP Decree and, in particular, the rules for determining the IRAP tax base. Specifically, it introduced the so-called "principle of direct derivation", which establishes a criterion whereby the IRAP tax base only depends on the statutory financial statements, while any adjustment made for IReS purposes is irrelevant.

As a consequence, transfer pricing adjustments are relevant to the computation of IRAP only until December 31 2007. As of January 1 2008, the date of entry into force of the Financial Act 2008, the IRAP tax base, is determined on the basis of the statutory financial statements and is no longer subjected to the corporate income regulation set forth in the TUIR; earnings derived from the intragroup exchange of goods and/or services are those reported in the income statement.

However, although there is no such formal rule, the tax authorities may substantiate an effect of transfer pricing adjustments on the computation of IRAP by referring to a recommendation included in Circular No 58 of December 15 2010 on transfer pricing documentation, in which the Italian Revenue Office stated that preparing the appropriate documentation can result in the non-application of the penalty for fraudulent tax returns (as per article 1, paragraph 2 of Legislative Decree No 471 /1997) and, for the sake of consistency, "of similar penalties related to IRAP".

This reference should be understood as referring to the tax periods in which the derivation principle was applicable and for which, on the issue date of Circular No 58/2010, the tax

assessment deadline had not yet passed.

It is indeed worth emphasising that Italian Law introduced the regulation on the preparation of transfer pricing documentation (article 26 of Decree-Law No 78/2010) referring only to article 1 of Legislative Decree No 471/1997 (on income tax returns) and avoiding any reference to article 32 ("Violations regarding income tax returns") of the IRAP Decree.

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