

# Tax Risk Management — The Italian Approach

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# PRACTITIONERS' CORNER

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In this article, the author provides an overview of Italy's new cooperative compliance regime from a business perspective, focusing on the obligations of corporate taxpayers wishing to exploit cooperative compliance, engagement requirements, and benefits to be gained.

**T**ax risk management has been at the center of a growing number of heated debates worldwide not only in the boardrooms of multinationals, but also among government officials, tax authorities, international organizations, taxpayers, and society in general. These deliberations are not surprising, considering the pressing need for fairer taxation, improved compliance, better evidence of compliance, increased transparency, and more accurate disclosures.

Since 2008 tax risk management has been assigned an important role in this environment. The concept was born in the 2008 “Study into the Role of Tax Intermediaries” by the OECD Forum on Tax Administration and was revised and further developed by the OECD in subsequent reports released in 2013<sup>1</sup> and

<sup>1</sup>OECD, “Co-Operative Compliance: A Framework. From Enhanced Relationship to Co-Operative Compliance” (2013).

2016.<sup>2</sup> It is the system businesses use to detect, evaluate, manage, and control potential fiscal risks<sup>3</sup> arising from their activities. Tax risk management plays a key role in developing “enhanced relationships” between tax authorities and corporate taxpayers.

Tax risk management is envisioned as a key tool for achieving maximum transparency and appropriate disclosures in relations between businesses and tax authorities. The OECD uses the phrase “cooperative compliance” to underline the importance of solid cooperation based on mutual trust between tax authorities and taxpayers, cooperation that is expected to improve compliance and lead to prompt payment of the proper tax. In a cooperative compliance framework, transparency and disclosure may be rewarded through legal certainty and faster task completion.

Italy initiated its own concrete cooperative compliance program in 2014.<sup>4</sup> Italy recently took a new step in this direction with the issuance of a regulation by the Italian Revenue Agency.<sup>5</sup> The regulation details the path to cooperative compliance and the obligations it entails for both businesses and tax authorities. Italian legislation follows OECD proposals, and tax risk management plays an important role in the effort to achieve effective cooperation. This article provides an overview of the key new provisions from a business perspective, focusing on the obligations of corporate

<sup>2</sup>OECD, “Co-Operative Tax Compliance. Building Better Tax Control Frameworks” (2016).

<sup>3</sup>Definition in accordance with the provisions of Italian Law No. 23 of Mar. 11, 2014.

<sup>4</sup>Law No. 23 of Mar. 11, 2014.

<sup>5</sup>Regulation No. 54237 of Apr. 14, 2016, issued in accordance with the provisions of Legislative Decree, No. 128 of Aug. 5, 2015, which in turn was issued following authorization by the aforementioned Law No. 23 of Mar. 11, 2014.

taxpayers who wish to implement cooperative compliance, fulfill engagement requirements, and take advantage of all available benefits.

## I. Obligations of Corporate Taxpayers

### A. Tax Risk Management System

The primary obligation of any corporate taxpayer under the Italian cooperative compliance regime is the implementation of a tax risk management system.<sup>6</sup> The system is designed by each individual business with an eye toward its unique needs and the nature of its activities. The risk management system must be part of the company's internal control system and must be capable of ensuring that tax risks, including possible violations of tax provisions arising out of corporate actions (such as decisions, activities, operations, and transactions), be duly identified, evaluated, managed, and controlled.

In any case, a tax risk management system must:

- clearly allocate responsibilities for controlling tax risks at the division level — this implies that the role must be assigned to specific persons for each department of the business and that those persons are provided with the resources necessary to perform this function;
- provide for the development of policies to identify, evaluate, manage, and control tax risks that will be respected throughout the entire life of the business — in particular, all employee actions and behaviors should align with the policies designed (primarily) by the directors;
- effectively react to any deficiencies of the tax risk management system itself and provide procedures for the ongoing optimization of this process;
- provide for a regular, at least annual, review and evaluation of the system by management — this review should focus on how the company determined its tax obligations, steps taken to address any system deficiencies, and activities planned for the future; and
- lead to regular and prompt fulfillment of tax obligations.

### B. Other Obligations

In addition to the foregoing, regarding risk management systems, the corporate taxpayer wishing to enjoy the benefits of cooperative compliance should:

- introduce into its tax risk management system any amendments deemed necessary by the tax authorities evaluating the system;
- promptly provide the tax authorities with any and all information regarding potential tax risks, especially concerning schemes that may involve ag-

gressive tax planning, taking into consideration any guidelines issued by the competent authorities;

- respond as soon as possible to any requests from the authorities; and
- implement a corporate governance system favoring transparency, fairness, and compliance with tax laws.<sup>7</sup>

## II. Applying for the Compliance System

The cooperative compliance regime is optional. Large corporations meeting threshold requirements may be eligible, if they have in place a compliant tax risk management system as detailed above.

More specifically, corporate taxpayers may apply for access to cooperative compliance under any of the following three conditions: (i) their turnover or revenue exceeds €10 billion; (ii) their turnover or revenue exceeds €1 billion and they had applied for participation in the pilot project for the regime; or (iii) they are proceeding with new investments approved by the competent tax authorities under article 2 of Legislative Decree No. 147 of September 14, 2015.<sup>8</sup> The foregoing applies to all corporate taxpayers, regardless of tax residence.

Upon application, the competent tax authority examines:

- the budget of the applicant, as well as its operating performance;
- the applicant's corporate assets;
- whether the applicant has in place a proper and effective segregation of duties; and
- the applicant's IT systems.<sup>9</sup>

This examination is effected transparently, on the basis of objective criteria, and according to principles of rationality and proportionality.<sup>10</sup> Successful applicants are included in a list published on the tax authority's website.<sup>11</sup> Similar reevaluations will take place regularly after acceptance and may lead to exclusion from cooperative compliance if the company is found to fall short of the necessary requirements.<sup>12</sup>

## III. Benefits of Cooperative Compliance

In addition to the advantages inherent in tax risk management systems — for example, facilitation of

<sup>7</sup>Article 5, para. 2, Legislative Decree No. 128 of Aug. 5, 2015.

<sup>8</sup>Article 2, para. 1, Regulation No. 54237 of Apr. 14, 2016.

<sup>9</sup>Article 5, para. 1, Regulation No. 54237 of Apr. 14, 2016.

<sup>10</sup>Article 5, para. 1(a), Legislative Decree No. 128 of Aug. 5, 2015.

<sup>11</sup>Article 5, para. 7, Regulation No. 54237 of Apr. 14, 2016.

<sup>12</sup>Article 5, para. 8, Regulation No. 54237 of Apr. 14, 2016.

<sup>6</sup>Article 4, Legislative Decree No. 128 of Aug. 5, 2015.

audit controls and certification of financial statements — participation in cooperative compliance represents a reward in itself. Corporations can likely expect to enjoy several advantages in exchange for their transparency. These advantages correspond to obligations falling on the Italian tax authorities and are largely intended to provide greater legal certainty and more effective procedures.<sup>13</sup>

Among the expected benefits, the following are worth noting:

- Companies may be able to receive a prior evaluation of arguable transactions or operations that might involve tax risks. Thus, taxpayers can resolve doubts before the filing of the tax declaration.
- Participants may have the opportunity to check their tax declaration before filing.
- Companies may have access to an abbreviated procedure under which they can obtain clarification on the application of tax legislation to specific facts. The procedure would lead to a final answer within 45 days of the submission of the request or other required documents.
- If the company promptly and exhaustively notified the competent tax authorities of an actual tax risk, applicable penalties may be reduced by half.

<sup>13</sup>Article 6, Legislative Decree No. 128 of Aug. 5, 2015.

- In case of a prosecution for tax offenses, the tax authorities may notify the public prosecutor that the corporate taxpayer has engaged in cooperative compliance.
- Companies may be released from the obligation to provide guarantees for tax refunds.

Further, it may be assumed that an effective cooperative relationship implies for all interested parties fewer disputes, smoother resolution of disputes that do emerge, and, hopefully, also a decreased need for tax controls.

#### IV. Conclusion

The importance of tax risk management is unquestionably growing. Apart from safeguarding businesses against tax risks, which is its intrinsic purpose, it has turned into a tool for communication and transparency. Under the Italian framework, tax risk management is the key to a cooperative relationship with the tax authorities. This provides several benefits for taxpayers, in particular proactive dispute resolution and efficient request procedures.

In its 2016 report, the OECD concludes that “the value to both a taxpayer and the tax administration of a fully developed and monitored internal control system that includes a robust tax control framework is well demonstrated.” While it remains to be seen how tax authorities will evaluate tax risk management systems, businesses with activities in Italy should be strongly encouraged to take advantage of the new regime. ◆