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ARTICLE

An In-Depth Analysis of New Transfer Pricing Documentation Rules

Piergiorgio Valente*

The purpose of this work is to provide an in-depth analysis of the topic of transfer pricing documentation within the context of inter-company transactions entered into with non-resident enterprises, in view of amendments recently introduced by Decree-Law No. 78 of 31 May 2010. To such end, it would be useful to focus on the development of the debate that has been taking place in the last few years within an international scenario relating to the need to provide documentary requirements to justify – in case of tax audits by the tax authorities – the application of certain inter-company prices.

1. Introduction

Notwithstanding the unquestionable usefulness of the so-called Transfer Pricing Policy, in Italy, contrary to what happens in other countries, there is no downright 'obligation' to provide documentation on transfer prices. Certain recent amendments to existing provisions have, in effect, introduced in Italy, in lieu of the above obligation, a documentary 'duty' for the taxpayer who enters into international inter-company transactions and intends to prevent any possible penalties that might ensue from any tax authorities' investigations.

Particular reference here is made to Article 26 of Decree-Law No. 78/2010,[1] which ratified the amendment to the regime of administrative penalties by adding Article 1 of Legislative Decree No. 471 of 18 December 1997, paragraph 2-*ter*, pursuant to which the penalty for the filing of a discrepant income tax return is not applicable in the case where, during access, investigations, audits, or other preliminary activity, the enterprise submits the necessary documentary support to justify the determination criteria for transfer prices applied towards other non-resident group companies.

The above documentation has the purpose of facilitating the need to identify evidence of a value corresponding to the arm's length principle of inter-company payments applied in accordance with provisions under Article 110, paragraph 7, of the *Testo Unico delle Imposte sul Reddito* (TUIR, or the Consolidated Italian Income Tax Code), which regulates transfer pricing from a tax perspective.

2. New Elements Introduced by Article 26 of Decree-Law No. 78/2010

By means of Article 26 of Decree-Law No. 78/2010, legislators intended to introduce some special measures with the aim to increase the effectiveness as well as the efficiency of tax authorities' inspections on inter-company transactions ex Article 110, paragraph 7, of the TUIR. The aim of the new rule is, in particular, to provide for standard documentation so as to allow verification of compliance to the arm's length value of transfer prices applied by enterprises within the context of international inter-company transactions.

The above verification, which is particularly complex from a technical standpoint, turns out to be even more awkward in the absence of the taxpayer's full cooperation.

The new provision has thus a twofold advantage since it allows, on the one hand, multinational enterprises to benefit from a regime that does not apply penalties for administrative violations pursuant to Article 1, paragraph 2, of Legislative Decree No. 471/1997 (so-called discrepant tax return) deriving from any possible adjustment of transfer prices applied; on the other, it enables the tax authorities to avail themselves, during inspections, of an effective documentary support for the purposes of verifying the consistency of prices applied to inter-company transactions by associated enterprises with prices applied within the scope of free competition regulations.

The new paragraph 2-*ter* of Article 1 of Legislative Decree No. 471/1997 appears to be meeting the need for certainty and transparency by taxpayers and by foreign enterprises

Notes

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1 Decree-Law No. 78 of 31 May 2010 was published in Ordinary Supplement No. 114 to the Official Gazette No. 125 of 31 May 2010 and became effective on the same date. It was subsequently converted into Law No. 122 of 30 Jul. 2010 of the Ordinary Supplement No. 174 to the Official Gazette No. 176 of 30 Jul. 2010 and became effective as of 31 Jul. 2010.

that invest on the Italian territory. Thus, the enterprises would be guaranteed the possibility of having all of the essential information for the implementation of their own transfer pricing policies, in compliance with legal provisions.

The non-application of administrative penalties therefore constitutes a definite incentive for resident enterprises belonging to multinational groups to comply with the new '*documentary duty*' introduced by the rule under examination in order to prevent any possible penalties that might derive from tax authorities' inspections.

Said rule appears, moreover, to be rather consistent with those fundamental principles that govern the relationship between taxpayers and the tax authorities and, in particular, with the cooperation and good faith principles ratified by Article 10 of Law No. 212 of 27 July 2000 (so-called Statute of Taxpayers' Rights).

2.1. Introduction of a 'Documentary Duty' in *Lieu* of an Obligation

In Italy, the adoption of a measure relating to transfer pricing had been eagerly expected; thus, the introduction of the provision set forth under Law No. 122/2010 allows Italy to be aligned to the great majority of other industrialized states, even if differently; as a matter of fact, after the measures introduced by Spain[2] and France,[3] the Italian economy was the only large economy that did not have a specific regime, although relevant indications could be drawn from recent case law.

It is quite interesting to note how the Italian lawmaker has not imposed a specific obligation but has preferred the introduction of a substantial incentive to document intercompany transfer prices, eliminating – also in observance of the recommendations expressed by the 2006 EU Code of Conduct on documentary requirements on the matter of transfer pricing – administrative penalties for those enterprises, which, notwithstanding the assessment of a higher taxable income, show the willingness to cooperate with the tax authorities by means of the submission of suitable documentation on the foregoing prices. Nevertheless, in order for such documentation to be taken into consideration, its ownership must be previously communicated to the tax authorities according to procedures and terms indicated in the official guidelines to be issued by the director of the Italian tax authorities within sixty days from the decree's conversion into law. Said official guidelines will have to contain instructions regarding the contents of the documentation in order for the same to be considered sufficiently suitable according to legal terms, although the explicit reference to Article 26 of Decree-Law No. 78/2010 to the Organization for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in the version issued on 22 July 2010 (hereinafter 'OECD Guidelines') on the subject matter of transfer pricing is conducive to believe that these may already provide reliable indications to that effect.

According to the implementation procedure set forth by the lawmaker, the ninety-day term provided for the ownership of the documentation should fall due, at the latest, on 28 December 2010, which is a rather imminent date, in view of the complexities that enterprises will have to face; it is quite obvious indeed that as long as requirements exacted by the tax authorities will not be disclosed, it will clearly not be possible for those enterprises that are involved to verify the suitability of their own documentation.

Other critical aspects might derive from the possibility that once the ninety-day term for the above communication has run out, the Revenue Service might turn its attention especially to enterprises belonging to multinational groups that shall not have complied with forwarding requirements.

In any event, although a specific penalizing regime is lacking for the omission of the aforementioned communication, the importance of submitting the above documentation is rather patent since the exclusion from the application of tax and administrative penalties, in case of the ownership of same, assumes a strategic value for the group of enterprises as a whole.

3. Documentary Requirements and Risk Profiles for the Taxpayer: Effects on Assessment

When pondering the subject matter of transfer pricing, it is the burden of proof that assumes the greatest significance. In this case, what needs to be established is whose burden it is (between the tax authorities and the taxpayer) to provide substantiating elements to prove compliance (or non-compliance) of transfer prices in accordance with legal provisions.

Also with respect to such topic, the new aspect introduced by Article 26 of Decree-Law No. 78/2010 seems to be perfectly aligned with the need of clarity and transparency in the relationship between the tax authorities and the taxpayer; as a matter of fact, when speaking of burden of proof within this context, reference is made to the documentary duty set forth by the new regime, which, although not established as an outright obligation, is clearly expected to involve a great number of entities carrying out international inter-company trading exchanges.

As to the burden of proof in transfer pricing controversies, what ought to be remembered first is that, in the last few years, a number of judgments have been succeeding

Notes

[2] Ley 29 Nov. 2006, No. 36.

[3] Loi 30 Dec. 2009, No. 2009-1674.

each other in the jurisprudence of legitimacy and in the jurisprudence of merit, which have contributed to define the sharing of the *onus probandi* in transfer pricing controversies.

Ex multis, reference should be made to Decision No. 22023 of 13 October 2006 by means of which the Court of Cassation (so-called 'Ford case') established that:

> the burden of proof, in the case of recurrence of the avoidance bases, falls in any case on the Tax Authorities which intend to effect the consequent adjustments. . .The foregoing is further confirmed in the transfer pricing area, in view of the fact that the OECD directives. . . contained in the 1995 Guidelines expressly underlined that, where the regime of each national jurisdiction prescribes that the burden of proof of the claims advanced by the Tax Authorities fall on same, the taxpayer is not required to provide evidence as to the accuracy of transfer prices applied, if the Tax Authorities have not *prima facie* demonstrated that the arm's length principle has not been duly complied with. . .Now then – according to the Judges (Ed.) – the Tax Authorities. . .should have, above all, ascertained if taxation in Italy was at the time more advanced with respect to that of other countries from which the bought/sold vehicles originated. In the second place, the arm's length value of vehicles purchased by F. Italia should be determined by actually verifying if the sums paid by same to its associated foreign companies were indeed higher than such value by proceeding to an investigation that is extended to the profit margin obtained in order to cover repair expenses as a guarantee and an analysis of automotive market conditions through a comparison of prices applied within the F. group against those applied by other competitive enterprises.

In other terms, in the decision under examination, the Court of Cassation established that the taxpayer is not obliged to provide evidence of the accuracy of transfer prices applied, unless the tax authorities have been able to prove actual non-compliance with the arm's length value.

With regard to documentary duties introduced by Article 26 of Decree-Law No. 78/2010 on the subject matter of transfer pricing, while waiting for the regime of the director of the tax authorities (*Direttore dell'Agenzia delle Entrate*), who shall outline the specific features thereof, it might be useful to refer to provisions of the EU Code of Conduct (essentially consistent with OECD Guidelines). According to the suggestions that are derived from the said Code, the national documentation must be drawn up in the language laid down by the relevant Member State. Data/Information relating to a controlled transaction that involves one or more Member States must be contained in the national documentation of all Member States involved or in the 'Masterfile'.

It should be noted that the adoption of the EU Transfer Pricing Documentation (TPD) is optional also after the entry into force of Article 26 of Decree-Law No. 78/2010. A multinational group that opts for the EU TPD has, in any event, the obligation to apply said approach to all associated enterprises that carry out controlled transactions with EU enterprises. If a multinational group opts for the EU TPD with reference to a particular tax year, each group company shall have to inform its respective tax authorities.

The groups commit themselves to the drawing up of the Masterfile in due time to satisfy any possible requests by any of the relevant tax authorities. The taxpayer of a given Member State must make its respective EU TPD available upon request of some particular tax authorities within a reasonable term by reason of the complexity of the transactions.

The decision of a multinational group to adopt EU TPD entails – therefore – a commitment by all associated EU enterprises to make the Masterfile as well as the national documentation relating thereto available to the relevant national tax authorities.

The aggregation of transactions must prove to be 'transparent' for the tax authorities and must comply with provisions of the OECD Guidelines, which must be applied while keeping into account, in particular, the number and the complexity of the transactions referred to.

In view of the fact that the EU TPD provides only basic information for the purposes of evaluating transfer prices, each Member State has the right, within the framework of internal regulations, to demand, upon special request or during tax audit, supplementary information or documentation with respect to that required by the EU TPD. Said additional information must be provided within a reasonable term to be determined on a case-by-case basis, in view of the volume and the complexity of the requested information.

As stated before, according to OECD and EU recommendations, taxpayers are not subject to penalties if they agree to the adoption of the EU TPD and provide the supplementary information that was specifically requested. It seems rather clear that said provision was essentially reproduced in Article 26 of Decree-Law No. 78/2010.

Always on the basis of suggestions provided by the foregoing organizations, taxpayers should be required to submit to the tax authorities the Masterfile as well as the national documentation only at the very beginning of a tax audit or upon special request. If a Member State requests a taxpayer to provide information on transfer prices within a tax return filing context, it should be possible to comply with said request, quite likely through the submission of a brief questionnaire or a special risk evaluation form.

Member States should not impose upon taxpayers the obligation to keep documentation beyond a term that is reasonable and compatible with national provisions of law that are applicable to each group enterprise.

Member States ought to valuate comparable national or foreign entities with a view to facts and circumstances relevant to the case in point. Comparable entities identified in pan-European data banks should not be automatically deemed unreliable.

If the documentation relating to a given period remains valid for subsequent periods thus confirming compliance of price determination with principles of free competition, the

documentation relating to subsequent periods might be simply limited to referring back to the previous one. The documentation must not necessarily reproduce documents relating to transactions among enterprises operating under conditions of free competition, provided that it contains information adequate enough to evaluate whether the price was fixed in accordance with the arm's length principle.

As far as the tax authorities are concerned, the place where a taxpayer draws up and keeps the national documentation should be irrelevant, provided that, upon request, it be promptly submitted to the particular tax authorities involved. Taxpayers should nevertheless have the possibility to keep their documentation in a centralized or non-centralized manner. The filing system of the documentation – whether on paper, electronically, or by means of any other system – ought to be left at the taxpayer's discretion, provided it be easily made available to the tax authorities.

As to the effects on the assessment of the new provision introduced by Article 26 of Decree-Law No. 78/2010 with regard to the documentation on transfer pricing, it should be noted that, in case of tax audit by the tax authorities, a number of situations may occur:

(1) The taxpayer has the documentation and has communicated the possession thereof; in such case, the tax authorities might deem the documentation valid and, upon examination of same:
   (a) identify compliance of transfer prices determined by the taxpayer at arm's length value (formal and substantial compliance); or
   (b) identify substantial compliance of transfer prices determined by taxpayer at arm's length but also identify some formal discrepancies; therefore, adjustments are applied for the purpose of removing formal or logical discrepancies that might have been identified in the computation process adopted by the taxpayer (substantial but not formal compliance); or
   (c) identify a difference between prices adopted by the taxpayer and the arm's length value (formal and substantial compliance).

(2) The taxpayer has the documentation but has not communicated his being in possession thereof; in such case, in view of the fact that the tax authorities might not deem the documentation to be valid for penalty exemption purposes, the same might proceed to investigate relations entered into with associated companies through the examination of the T-accounts bearing the latter's names, the identification of the method deemed most suitable for the determination of the arm's length value of transactions, and finally, its application to the case in point:
   (a) identifying compliance of transfer prices determined by the taxpayer at arm's length value (formal and substantial compliance); or
   (b) identifying substantial compliance to transfer prices determined by taxpayer at arm's length but also some substantial discrepancies; therefore, adjustments are applied for the purpose of removing formal or logical discrepancies that might have been identified in the computation process adopted by the taxpayer (substantial but not formal compliance); or
   (c) identifying a difference between prices adopted by the taxpayer and arm's length value (formal and substantial discrepancy).

(3) The taxpayer is not in possession of the documentation; in such a case, the tax authorities, after having investigated relations entered into with associated companies through the examination of the T-accounts bearing the latter's names, the identification of the method deemed most suitable for the determination of the arm's length value of transactions, and finally, its application to the case in point:
   (a) identify compliance of transfer prices determined by taxpayer at arm's length (formal and substantial compliance); or
   (b) identify substantial compliance of transfer prices determined by the taxpayer at arm's length but also some formal discrepancies; therefore, some adjustments are applied for the purpose of removing formal or logical discrepancies that might have been identified in the computation process adopted by the taxpayer (substantial but not formal compliance); or
   (c) identify a difference between prices adopted by the taxpayer and the arm's length value (formal and substantial discrepancy).

With regard to cases 1.a and 1.b, no particular issues arise since in both cases, substantial compliance of transfer prices to the arm's length value is identified. On the other hand, with reference to case 1.c, we may observe that in the light of amendments introduced by Article 26 of Decree-Law No. 78/2010, the tax administration penalties shall no longer be applied in case of discrepant tax return pursuant to Article 1, paragraph 2, of Legislative Decree No. 471/1997, since the new paragraph 2-*ter* supplementing the aforementioned provision establishes that:

> (i)n case of adjustment of the arm's length value of transfer prices applied within the scope of transactions under Article 110, paragraph 7, of Presidential Decree No. 917 of 22 December 1986, from which a higher tax or a credit difference may derive, the penalty under paragraph 2 shall not be applicable in the case where, during the phase of access, inspection or any other preliminary activity, the taxpayer shall deliver to the Tax Authorities the documentation set forth in the relevant provision issued by the of the Tax Authorities Director, suitable enough to allow identification of compliance to the arm's length value of transfer prices adopted. The taxpayer who is in possession of the appropriate documentation set forth under the foregoing paragraph, must submit due communication to the Tax Authorities according

to the terms and procedures therein established. In the absence of said communication, paragraph 2 shall apply.

Moreover, as to cases under points 2 and 3, there are no new aspects with regard to the past since in cases 2.a, 2.b., 3.a, and 3.b, compliance of transfer prices to the arm's length value is identified, while for cases 2.c and 3.c, tax administration penalties shall continue to be applied in the case of discrepant tax return pursuant to Article 2, paragraph 2, of Legislative Decree No. 471/1997.

In case of tax audit, hence, bodies in charge of tax investigations regarding transfer pricing matters are justified, on the basis of OECD and EU recommendations and general principles of the Italian tax regime (as well as the new provision set forth by Article 26 of Decree-Law No. 78/2010), to request the taxpayer who is subject to inspection to provide the due documentation attesting to the compliance of transfer prices to the arm's length principle.

In order to properly evaluate the transfer pricing policy adopted by an enterprise and give the latter the possibility to submit the documentation that is 'effectively' tax-relevant for the purposes of Article 26 of Decree-Law No. 78/2010, it is essential that inspectors' requests be as precise and as relevant as possible. In fact, it is important to highlight that general requests or those strictly limited to an invitation to submit all of the documentation supporting transfer pricing, further to being rather ineffective from a practical viewpoint, cause the abovementioned penalty to become inapplicable and unsuitable for future documentation submissions. It is therefore necessary, in order to avoid any and all misunderstandings, that the taxpayer should organize the documentation by scrupulously following instructions that shall be provided by the tax authorities director and that shall adopt recent regulatory amendments.

3.1. Documentation Requirements for Years Preceding the Introduction of the Regulation

Pursuant to provisions set forth under the second sentence of paragraph 2 of Article 26 of Decree-Law No. 78/2010, the communication relating to the availability of the documentation may also be provided with reference to previous years, provided it be submitted to the tax authorities within the established term.

As a consequence, for tax periods preceding the period in progress as of 31 May 2010 (date on which Decree-Law No. 78/2010 became effective), taxpayers are required to give communication supporting the arm's length value of transfer prices within ninety days from the publication of the above regime issued by the tax authorities director.

The above would allow multinational enterprises to avoid the application of tax administration penalties also for years prior to the introduction of the regime.

Ultimately, what should be observed is that, in view of the reference made to Article 110, paragraph 7, of the Italian Tax Code, the documentation at issue is strictly suitable to provide evidence of the arm's length value of 'transfer pricing' proper, meaning the one referring to non-resident group enterprises, while on the other hand, it has no legal value with regard to relationships with resident group enterprises (so-called internal transfer pricing).

4. The Tax Authorities Director's Regime

On 29 September 2010, the Regime of the tax authorities director was issued (Protocol No. 2010/137654) as contemplated by Article 26 of Decree-Law No. 78/2010 (hereinafter 'Regime').

The Regime specifically refers to provisions contained in the Code of Conduct on transfer pricing documentation for associated enterprises in the EU adopted by the EU Council on 27 June 2006[4] and in the OECD Guidelines.

The following paragraphs provide evidence of the main contents set forth in the above Regime.

5. Entities Subject to the Documentary Duty

Differently from what most sets of rules of other countries provide, the Regime clearly identifies those entities required to gather and keep evidentiary documentation to support their transfer pricing policy:

– 'holding company belonging to a multinational group' shall mean a company that resides in the state territory for tax purposes that is not controlled by other company or business enterprise or by any other entity endowed with legal status and carrying out a business activity, residing anywhere, and controls, also by means of a sub-holding, one or more companies residing in the state territory for tax purposes;

– 'sub-holding company belonging to a multinational group' shall mean a company residing in the state territory for tax purposes that is controlled by other company or business enterprise or by any other entity endowed with legal status and carrying out a business activity, residing anywhere, and controls in turn one or more non-resident companies on the state territory for tax purposes;

– 'controlled enterprise belonging to a multinational group' shall mean a company or an enterprise residing in the state territory for tax purposes that is controlled by

Note

[4] Published in the Official Journal C176 of 28 Jul. 2006.

other company or business enterprise or by any other entity endowed with legal status and carrying out a business activity, residing anywhere, and does not control any other company or enterprise/s that is/are not resident in the state territory for tax purposes.

6. Small-Medium-Sized Enterprises (SMEs)

The Regime contains certain ad hoc provisions for entities that may be qualified as SMEs.

It should be noted that within an EU context, the definition of SMEs was provided by means of recommendation no. 96/280/EC of 1 January 2005, subsequently amended by recommendation no. 2003/361/EC of 6 May 2003.

EU regulations (and, as a consequence, also Italian regulations) allow determining the qualification for SME by means of the following three criteria:

– number of employees (structural requirements);
– turnover and the value of total net assets (economic and financial requirements); and
– economic independence requirements (capital requirements).

It is worth emphasizing that in order to define a dimensional threshold, the three requirements must be 'cumulatively' valued in the sense that at least two must fall under the established thresholds.

As far as internal regulations, the definition of SME may be drawn from the contents of Article 2435-*bis* of the Italian Civil Code, which establishes the drawing up of financial statements in an abridged format. Said option is indeed exclusively granted to companies that have not issued negotiated instruments and that do not fall under certain dimensional thresholds:

– total assets in the Statement of Assets and Liabilities: EUR 4,400,000;
– proceeds from sales and services: EUR 8,800,00;
– average employees during the fiscal year: 50 HR.

The Regime differs from the definition provided under Civil Law as it identifies SMEs by referring uniquely to the proceeds criterion derived from sales/turnover, which must not exceed EUR 50 millions.

For companies that may qualify as such, these have been exempted from the requirement to update the documentation for the next two tax periods following the relevant tax period which such documentation refers to:

– in the case where the comparability analysis has been performed on the basis of publicly available information; and
– in the case where no changes occurred with respect to the characteristics of goods and services, functions performed or assets utilized, nor to contractual and economic conditions.

The Regime did, however, clarify that holdings and subholdings may not qualify as SMEs in the case where they control directly or indirectly at least one entity that does not qualify as an SME.

7. Typology and Contents of the Documentation

Consistently with the information contained in the Code of Conduct on transfer pricing documentation for associated enterprises in the EU, the Regime identifies the following documentation 'types':

– a set denominated Masterfile;
– a set denominated National Documentation (which substantially corresponds to the set denominated Country-Specific Documentation in the EU Code of Conduct). The Masterfile and the National Documentation represent the appropriate documentation that would allow a taxpayer to benefit from the non-application regime pursuant to Article 1, paragraph 2-*ter*, of Legislative Decree No. 471 of 18 December 1997. The administrative penalties referred to are applicable to the extent of 100% to 200% of the higher tax or credit difference assessed (as well as in the case of undue tax deductions or undue deductions from the taxable income).

The Regime establishes that the Masterfile gathers information relating to the group in accordance with provisions of the Code of Conduct. The submission of various

Table 1. Qualification Criteria for SMEs

Definition of an SME				
	Thresholds			
Type of company	**Human Resources**	**Turnover**	**O**	**Assets**
Medium sized	<250	≤EUR 50 millions		≤EUR 43 millions
Small sized	<50	≤EUR 10 millions		≤EUR 10 millions
Micro	<10	≤EUR 2 millions		≤EUR 2 millions

Masterfiles is allowed in the case where the group operates in a diversified manner, in various sectors of activity (or business lines) regulated by specific transfer pricing policies.

The information to be included in the Masterfile is the following:

(1) general description of the multinational group (history, recent developments, activity sectors, and general profiles of reference markets);

(2) group structure:
   (a) organizational structure (organization chart, list, and corporate designation of group members and relevant shareholdings); and
   (b) operative structure (with evidence of a summary description of the role carried out by each of the associated enterprises within the framework of the group's activity);

(3) general strategies pursued by the group (with special reference to development and consolidation strategies) and any possible strategy changes regarding the prior tax period;

(4) flow of operations (including invoicing procedures and relevant amounts, underlying economic/legal motivations for which the business activity has been structured according to the above flow dynamics). Transactions must be described in a flow chart that covers also those transactions relating to operations not included under the area of ordinary management. This also involves the evidence of information relating to the structure of flows deriving – for example – from business restructurings defined by the new Chapter IX of the Guidelines as 'the cross-border redeployment by a multinational enterprise of functions, assets and/or risks';[5]

(5) inter-company transactions:
   (a) transfer of tangibles or intangibles, supply of services, supply of financial services [the following details must be provided for each type of transaction: (i) nature of inter-company transactions, with the option to exclude those transactions relating to goods or services carried out between associated enterprises where each enterprise resides in a non-EU Member State; (ii) entities belonging to the group, between those listed under the foregoing Chapter 2, among which transactions relating to the described goods and services have been carried out. Homogeneous categories of goods and services may be uniformly treated in compliance with provisions set forth under the OECD Guidelines];
   (b) services that are functional to the carrying out of the inter-company business activity (the Regime requires that a 'sufficiently accurate' indication of the characteristics be provided of those services that are functional to the carrying out of group activities provided by one ore more associated companies for the benefit of one or more associated companies);
   (c) cost allocation agreements (list of cost allocation agreements, with indication for each cost, of the relevant purpose, duration, participating parties, scope of activities, and projects covered);

(6) functions performed, *assets* utilized, and risks assumed (general description of performed functions, assets, and risks assumed by each of the enterprises involved in the transactions and of changes that may have occurred in functions, goods, and risks with respect to prior tax period, with special reference to business restructuring operations as above defined);

(7) intangibles (held by each of the enterprises involved in the transactions, with separate indication of any royalties, separated by the receiving or issuing entity, paid for the exploitation of the same);

(8) policy for the determination of the group's transfer prices (description of the policy for the determination of the group's transfer prices and the reasons whereby said policy is deemed to be in compliance with the arm's length principle. To support such kind of information, it shall be necessary to provide even a brief account of the existence and of the essential contents underlying the adoption of the relevant transfer pricing policy adopted);

(9) relationships with the tax authorities of EU Member Countries with reference to 'Advance Pricing Arrangements' (APAs) as well as rulings on transfer pricing matters (summary description of APAs and rulings, respectively signed with or issued by the tax authorities of the countries in which the group operates, with a description of the subject matter, contents, and validity terms).

The National Documentation contains the following information relating to the company:

(1) general description of the company (history, recent development, and general profile of reference markets);

(2) sectors in which the company operates;

(3) operative structure of the company (brief description of the role carried out by each department and business unit of the enterprise within its business activity);

(4) general strategies pursued by the enterprise as well as any strategy changes with respect to the prior tax period (relevant information also connected to specific strategies linked to special sectors or markets);

(5) inter-company operations such as transfer of tangibles or intangibles, supply of services, supply of financial services (information to be included must relate to

Note

[5] Compare OECD, *Report on the Transfer Pricing Aspects of Business Restructurings* (2010).

all transactions carried with group entities. A rather accurate definition of the nature of the goods/services transactions being negotiated is required, including services that are functional to the carrying out of group activities, provided or received by one or more associated companies, as well as the relevant amounts and the economic/legal motivations underlying the structure of flows).

For each transaction, the following information must be submitted:

- description of group entities with which transactions have been entered into (the same indication must be provided even where such transactions have been carried out with independent entities);
- comparability analysis (consistent with the five comparability factors contemplated by the OECD Guidelines);
- evidence of the method applied for the determination of transfer pricing (in compliance with the new selection and application standard for methods set forth by the OECD; the selected method must be the most appropriate method to the circumstances of the case);
- application criteria of the method;
- results deriving from application of the selected method;

(6) Inter-company transactions (so-called Cost Contribution Arrangements (CCAs)) the enterprise participated in):

(a) entities, subject matter, and duration of the CCA;

(b) scope of activities and projects covered;

(c) determination method of expected benefits at the level of each of the associated enterprises participating in the arrangement and relevant forecasts in figures, partial results, or variances;

(d) form and value of contributions provided by each of the participating enterprises as well as determination methods and criteria of the same;

(e) formalities, procedures, and consequences of entering into and exiting from an agreement of enterprises participating thereto, as well as the termination thereof;

(f) contractual provisions relating to offsetting payments or amendments to agreement terms depending upon changed circumstances;

(g) changes occurred in the meantime to the agreement.

The Regime further specifies that the National Documentation must include the following documents:

- flow charts relating to inter-company transactions, as well as non-ordinary transactions (i.e., transactions entered into as a consequence of business restructuring operations); and
- copy of agreements regulating transactions entered into.

Table 2. Comparison between Contents of EU Code of Conduct and Regime of Tax Authorities Director – Masterfile

	EU Code of Conduct 27 June 2006	**Regime of Tax Authorities Director 29 September 2010**
Information relating to the group (*Masterfile*)	A general description of the group and its strategy, including strategy changes with respect to previous financial year	General description of the group
		General strategies pursued by the group and any strategy changes with respect to previous tax period
	A general description of organizational, legal, and operative structure of the multinational group (including an organization chart, a list of the group companies, and a description of shareholding percentages)	Organizational and operational structures
	General identification data of associated enterprises performing controlled transactions, which involve EU-resident enterprises; a general description of controlled transactions entered into by EU-resident enterprises	Flow of transactions
		Inter-company transactions (transfer of tangibles and intangible, supply of services, supply of financial services)
		Services that are functional to the carrying out of inter-company activities
	A general description of functions exercised and risks assumed, including changes that may have occurred to functions and risks with respect to previous financial year (i.e., the company changed from a full-fledged distributing company to a commissionaire)	Functions carried out, risks assumed, and assets utilized by the entities involved in the transactions, providing evidence of changes with respect to previous tax period and those deriving from business restructuring operations

Table 2. (Continued)

	EU Code of Conduct 27 June 2006	Regime of Tax Authorities Director 29 September 2010
	A description of intangibles held (patents, trademarks, know-how, etc.) as well as of paid or collected royalties	Itemization of intangibles held by each company participating in the transactions, with separate indication of any royalties separated by the payable/receivable entity
	A description of the multinational group's policy on the subject matter of transfer pricing among companies or rather of the system for the fixing of transfer prices including an explanation of transfer prices compliance with the principle of free competition	Description of the transfer pricing policy adopted within the group and reasons for compliance with the arm's length principle
	List of CCAs, APAs, as well as rulings and decisions concerning transfer pricing related aspects as far as they involve EU-resident group companies	Information relating to CAAs
	The commitment of each national taxpayer to provide additional information upon request and within a reasonable term pursuant to national regulations	

Table 3. Comparison between Contents of the EU Code of Conduct and the Regime of Tax Authorities Director – National Documentation

	EU Code of Conduct 27 June 2006	Regime of Tax Authorities Director 29 September 2010
Information relating to the company (Country-Specific Documentation or National Documentation)		General description of the company
		Operative structure of the company
	A detailed description of the enterprise and its strategy, including strategy changes with respect to the previous financial year	Sectors in which the company operates and general strategies pursued by the enterprise as well as any possible strategy changes with respect to previous tax period
	Information such as description and explanation relating to national controlled transactions with particular reference to: – transactions flows (tangibles and intangibles, services, financial assets), – qualitative aspects, – invoicing flows, – volume of transactions flows- quantitative aspects	Description of inter-company transactions (transfer of tangibles and intangibles, supply of services, supply of financial services)
	A comparability analysis: – characteristics of goods/assets and services, – functional analysis (functions performed, activities carried out, risks assumed), – contractual terms, – economic conditions, – corporate strategies	Comparability analysis
	Indications on the selection and application of the method/methods for the fixing of transfer prices, namely of the reasons on the basis of which a particular method was selected and relevant application method	Statement of selected method and reasons for its compliance with the arm's length principle
		Application criteria of selected method

Table Continued

Table 3. (Continued)

	EU Code of Conduct 27 June 2006	Regime of Tax Authorities Director 29 September 2010
	Information on comparable internal and/or external elements, where possible	
	A description of the implementation and application of group policy on the subject matter of transfer prices	Results deriving from the application of selected method
		Agreements on allocation of costs in which the enterprise participates

8. Appropriate Documentation for Relevant Entities

For each of the legal entities addressed by the provision, the Regime establishes the documentation deemed appropriate for the purpose of guaranteeing the application of Article 1, paragraph 2-*ter*, of Legislative Decree No. 471/1997:

- appropriate documentation for holding companies consisting of:
  - a set denominated Masterfile;
  - a set denominated National Documentation;
- appropriate documentation for sub-holding companies consisting of:
  - a set denominated Masterfile (which may be structured with information relating solely to the sub-group at which top the sub-holding is positioned);
  - a set denominated National Documentation.

The Regime establishes that, instead of the Masterfile (solely relating to the sub-group), the Masterfile relating to the entire group may be submitted, even if compiled by an entity residing in another EU Member State in compliance with the Code of Conduct. In the case where the Masterfile relating to the entire group were to contain less information with respect to the sub-group, the same must be supplemented by the sub-holding;

- for controlled companies belonging to a multinational group, appropriate documentation consists exclusively of the National Documentation;
- for permanent establishments in Italy of non-resident entities, appropriate documentation is determined by considering the 'typology' of the entity to which it belongs (holding company, sub-holding company, and controlled company).

9. Language

The Regime establishes that both the Masterfile and the National Documentation must be submitted in the Italian language.

In case of submission of the Masterfile relating to the entire group that has been compiled by a sub-holding company, the same may be submitted in the English language.

10. Initialling of Appropriate Documentation

The appropriate documentation (both the Masterfile and the National Documentation) must be initialled on each page by the legal representative of the taxpayer (or by one of his proxies) and signed at the foot of the last page by the same or authenticated by means of an electronic signature.

In the case where the Masterfile has been compiled by a company belonging to a multinational group with parent company residing in the EU that has adopted the Code of Conduct, the signature of the legal representative of the taxpayer attests to the compliance of the copy, submitted to the national authorities involved, with the original document.

11. Documentation Format

The documentation must be submitted to the inspecting authorities in an electronic format.

Submission of documentation in hard copy does not cause prejudice to the application of the provision contained under Article 1, paragraph 2-*ter*, of Legislative Decree No. 471/1997, on condition that the taxpayer provides – within a suitable term (of which no indication is set forth) – to deliver the relevant information on electronic support.

12. Due Date of Documentary Submission in Case of Audit, Access, Inspection, Assessments

The documentation must be submitted to the tax authorities within ten days from request.

In the case where, during inspection or other preliminary activity, the need for further information with respect to

that contained in the document were to arise, such information must be provided within seven days from request. Having regard for the complexity of the requested information, the tax authorities may grant an extension of the term, where the same is compatible with the audit and the inspection.

The above terms having elapsed, the inspecting authorities are not obliged to apply Article 1, paragraph 2-*ter*, of Legislative Decree No. 471/1997 (with the consequence of the possible application of administrative penalties).

13. Compilation of the Documentation

The documentation must be compiled on a yearly basis and must be available for each tax period for which assessment terms are still open pursuant to ordinary regulations.

14. Obstructive Circumstances to the Application of Article 1, Paragraph 2-*ter*, of Legislative Decree No. 471/1997

The tax authorities are not compelled to apply Article 1, paragraph 2-*ter*, of Legislative Decree 471/1997 (and thus the taxpayer continues being subject to administrative penalties) should the following circumstances occur:

– the contents of the documentation do not contain complete information and are not in compliance to provisions set forth by the Regime although they do comply with its formal structure;
– information contained in the documentation is partially or entirely discrepant.

The following causes may not be considered obstructive to the relevance of the non-application regime of administrative penalties:

– any partial omissions or discrepancies that do not cause prejudice to the audit and the accuracy of results thereof;
– omission of exhibits to be enclosed to the National Documentation (i.e., flow charts of transactions and copy of agreements regulating such transactions).

15. Communication of Documentation Ownership

With reference to the communication procedure relating to ownership of the documentation, the following cases ought to be distinguished:

– generally, the taxpayer shall submit the relevant communication while filing his yearly income tax return;
– for tax periods preceding those still open at the date of the entry into force of Decree-Law No. 78/2010 (i.e., before 31 May 2010, which is the date of the entry into force of Article 26 of Decree-Law 78/2010), the communication must be electronically submitted via Entratel services (also by means of authorized intermediaries) within a ninety-day term from publication of tax authorities director's Regime. Communications received beyond the above term shall, in any case, be accepted, provided that these are prior to any access, inspection, audit, or any other assessment activity of which the entity had been formally acquainted with.

16. Critical Considerations

In Italy, the adoption of a regime regulating transfer pricing documentation had been eagerly expected for the longest time; therefore, the introduction of the provision under Law No. 122 of 30 July 2010 allows Italy to be aligned with the great majority of the other industrialized countries, even if by different means; as a matter of fact, after the rules introduced by Spain and France, the Italian regime was the only one left without a specific regulation, although some indications relating thereto could be drawn from recent case law.

16.1. Reference to OECD Guidelines

Provisions relating to the contents of the Masterfile and of the National Documentation reflect some of the main changes introduced in the new version of the OECD Guidelines issued on 22 July 2010. Special reference should be made to the adoption of the new standard for the application of transfer pricing determination methods aimed at the identification of the method deemed most appropriate on the basis of the specific case and transactions being analysed. To such effect, it should be noted that the 1995 Guidelines set forth that the determination of the prices within the context of free competition for tangibles transactions might be carried out through the application of one of the following methods:

– comparable uncontrolled price method within a free market (i.e., Comparable Uncontrolled Price Method) is based on a comparison of the price applied to tangibles pertaining to inter-company transactions with the price applied to tangibles transferred during the course of a comparable transaction on the free market carried out under similar circumstances;
– resale price method (Resale Minus Method) refers to the price of a product – bought by an associated enterprise – and resold to an independent enterprise. Said price, also known as 'resale price', is subsequently reduced by an adequate gross margin ('gross margin of resale price'), which allows a reseller to cover sales costs and other management expenses and to realize an adequate profit as well. The sum obtained by subtracting the above gross

margin may be considered as the free competition price for the original transfer of the good between associated enterprises. The said method is considered particularly useful for enterprises mainly dealing in distribution;

– marked-up cost method (i.e., Cost Plus Method) considers (direct and indirect) costs borne by the supplier of tangibles in the course of a controlled inter-company transaction. To the cost of production, an appropriate mark-up margin is subsequently added (i.e., Cost Plus Mark Up) calculated on the basis of functions performed as well as market conditions, in order to determine the free competition price. According to the OECD, such method proves to be the most reliable one for transactions relating to the long-term supply of semi-finished goods towards associated parties.

In the case where the application of traditional methods, which are transaction-based, should not have provided reliable results, the OECD set forth alternative methods based on proceeds deriving from transactions carried out between associated enterprises.

In particular, income methods (i.e., Transactional Profit Methods) were deemed by the 1995 OECD Guidelines as the 'last resort methods';[6] their application was limited to exceptional situations, where it might not have been possible to obtain sufficient information regarding independent transactions, or rather, in the case where such information was not deemed reliable, or still, in the case where the particular business circumstances did not allow the application of traditional methods: 'in such cases of last resort, practical considerations may suggest application of a transactional profit method either in conjunction with traditional transaction methods or on its own'.[7]

Especially noteworthy is the provision requiring to provide adequate documentation of the functional analysis (for those entities involved in business restructuring operations) and of inter-company flows connected to corporate restructuring.

As specified in Chapter IX of the Guidelines,[8] corporate restructuring operations involve the transferring of functions, assets, and risks among the group entities involved. The said operations may determine early termination of agreements in force or the substantial renegotiation thereof.

In order to verify compliance with the arm's length principle under such circumstances, it would be opportune to proceed to a comparability analysis. In the case where it is possible to identify independent comparable transactions, the comparability analysis has the purpose of verifying the reliability of the foregoing comparison and, should it be necessary or feasible, to make adjustments for the purpose of removing the effects deriving from the differences that may subsist among those circumstances that are subject to the comparison.

The unavailability of comparable third-party transactions does not mean that the restructuring operations carried out within the group are not at arm's length. Should such circumstances occur, the behaviour of independent entities (i.e., not belonging to a group) that might have been adopted in comparable circumstances ought to be verified with regard to:

– restructuring operations and functions, assets, and risks before and after the restructuring;

– business purposes and expected benefits, including the role of synergies;

– alternatives that are actually available to entities involved in the relevant operation.

Considering that restructuring operations may entail early termination or substantial renegotiation of agreements in force, it is necessary to verify whether, under free market conditions in comparable circumstances, an agreement envisaging a form of indemnification in favour of the entity vested by the restructuring might be stipulated by third parties; should such circumstance occur, it would be opportune to proceed to a valuation of the *quantum* of such indemnification.

As specified by the OECD, what must be understood by 'indemnification' is:

> any type of compensation that may be paid for detriments suffered by the restructured entity, whether in the form of an up-front payment, of a sharing in restructuring costs, of lower (or higher) purchase (or sale) prices in the context of the post restructuring operations, or of any other form.[9]

The Guidelines specify that early termination of agreements or the substantial renegotiation thereof does not entail the presumption of recognizing an arm's length indemnification: in order to establish whether the indemnification is actually due, it is necessary to evaluate all circumstances existing at the time the restructuring operation occurred, including (should these be significant) options actually available to the parties. Therefore, the following conditions should be examined:

– if the concluded agreement, neither renewed nor renegotiated, has been drawn up in writing and includes indemnification clauses;

– if the agreement terms and the existence of an indemnification clause, or any other kind of guarantee, are consistent with a free market rationale;

Notes

6 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (1995), para. 3.50.

7 *Ibid.*, para. 3.50.

8 *Transfer Pricing Aspects of Business Restructurings*.

9 Compare OECD, 2010, para. 9, 102.

– if indemnification rights are provided by business regulations of the relevant regime or if they have been evaluated in case law;
– if within a free market, under comparable circumstances, an independent entity would have indemnified the opposing party penalized by the termination or the renegotiation of the agreement.

16.2. Documentation Format

The documentation must be compiled in an electronic format; the said requirement is in compliance with provision set forth under Article 2220 of the Civil Code, according to which entries and other accounting documents may be kept under recorded form on disk image support, provided the recordings perfectly correspond to the relevant documents and may, at any time, be legible through the means made available by the entity using such electronic supports. Further clarifications would be appreciated with reference to supports to be used for the purpose of keeping documentation records (Compact Disks (CDs), Digital Video Disk (DVDs), etc.) whereas *nulla quaestio* on the issue that the documentation may be provided in the usual formats (Word, Excel, PowerPoint, Portable Document Format (PDF), extensible Business Reporting Language (XBRL)).

16.3. The Non-Application Regime of Administrative Tax Penalties and the Burden of Proof

The underlying rationale of the new provisions relating to the documentation supporting transfer prices is to allow multinational enterprises to benefit from a regime that does not apply the penalties set forth under Article 1, paragraph 2, of Legislative Decree No. 471/1997.

It should nevertheless be noted that, in the great majority of regimes, the purpose of a documentary compilation is to provide the tax authorities involved with the necessary evidence that the arm's length principle has been duly complied with in inter-company transactions. The documentation, therefore, plays a precise role in the dialectical articulation between the taxpayer and the tax authorities on the issue of the burden of proof connected to transfer pricing.

In general terms, it should be noted that in tax matters, the taxpayer is subjected to specific restrictions that are, at times, even substantial. Within such context, the obligation must be set not only to prepare certain books, registers, etc. but also to exhibit them at each request by the inspecting authority, according to the terms and procedures provided by the single tax legislations.

Within the tax area, accounting (in a broad sense) is among legal evidence elements, without a doubt the most important tool that the tax authorities may wield for the exertion of their power and/or for the taxpayer to demonstrate the groundlessness of the Revenue's claim.

Therefore, accounting entries:

– represent, on the one hand, the fulfilment of a legal obligation by the entrepreneur. The accounting entries thus constitute an ordinary tool that may be used to assess the actual taxpaying capacity of the entity obliged to keep such entries;
– they allow the exercise of a right. A challenge of their formal and substantial compliance by the tax authorities is rather unlikely, unless the same have recourse to other equally important and legally effective substantiating elements.

On the other hand, accounting entries (as well as any other documentation/information that may be deemed tax-relevant) allow the dialectical articulation, in terms of the burden of proof, with the tax authorities.

Article 110, paragraph 7 of the TUIR (i.e., the Italian Income Tax Code) is a rule on valuations addressed to the taxpayer, who has to keep such rule into account when filing the tax return. According to this approach, the burden of proof would fall on the latter, who would have to be first in providing evidence of the absence of any deviation from the arm's length value of negative components.

Said conclusion nevertheless may not be deemed as final, since it is necessary to consider that the arm's length value is a legal criterion that must be duly respected by whoever lays a claim thereto (whether it be the tax authorities or the taxpayer). The foregoing statement entails the tax authorities setting a different price against the taxpayer's stated price. For adjustment purposes, the tax authorities are nevertheless required to proceed with the determination of the arm's length value and the justification thereto.

It goes without saying that there is no reason to identify an arm's length value if the cost is challenged in its subsistence or in its inherence since, on the basis of the above hypotheses, the adjustment requires the application of the ordinary provisions under Article 109 of the TUIR.

The burden of proof which Court decisions – which kept on succeeding each other – referred to in the last few years (in both relevant Court decisions and case law of the Supreme Court) is in effect a burden of argumentation since we are in the presence of a proof of value, with characteristics that are different from those attributable to proof in general. As a consequence, it is not proper to refer to 'evidence and counter-evidence' in a technical sense but rather to 'arguments and counter-arguments', which may, by and large, reflect the dialectical nature of an encounter between the tax authorities and the taxpayer with respect to the application of the transfer pricing regime.

16.4. Differences with Other Regimes

Along with elements of substantial compliance with the regime on the issue of OECD and EU documentation, the Regime indubitably discloses certain particular aspects.

In the first place, none of the OECD Member Countries are required to have the documentation initialled by the legal representative of the company. Said provision raises questions on two elements:

– on responsibility profiles that might derive and fall on the legal representative (or one of his proxies); and
– on the nature of such responsibility.

With reference thereto, a clarification would be most welcome by the tax authorities, in view of the fact that legal representatives – with reference to physical persons as well as legal entities – are required to comply with the burdens connected to formal obligations of disclosing and declaring their incomes as foreseen by legislators at the level of those entities that such legal representatives represent.

As far as the reference to the nature of the legal representative's responsibility, the general reference is to the regime set forth on the topic of administrative tax penalties, under Article 11 of Legislative Decree No. 472 of 18 December 1997. Pursuant to the above-said regime, the offence is attributable to the physical person who perpetrated such offence or has contributed to perpetrate such violation, in observance of the principle of the penalty being directly imputable to the person, irrespective of the fact that the said person might coincide with the taxpayer.

The documentation must be delivered to the tax authorities within ten days from the relevant request, but such term is notably shorter with respect to the term set forth by some of the main OECD Member Countries.

The ten-day term appears to be indeed rather tight, in the case where, during preliminary activities, additional information to that contained in the Masterfile should be required.

To such effect, it would be helpful to recall that the OECD does acknowledge that the tax authorities must not, in any case, oblige taxpayer to produce documents that are not in his possession or that may not be reasonably obtained. Furthermore, the tax authorities may not demand more documentation than what is 'deemed strictly necessary to facilitate controls'.

Also on the issue of transfer pricing, rules therefore the principles pursuant to which the taxpayer must be facilitated, without incurring excessive administrative burdens that might derive from the difficulty of:

– tracking down of the documentation of foreign associated companies within a short term;
– having the burden to search for situations, i.e., comparable transactions.

Table 4. Terms for the Submission of the Documentation in Some OECD Member Countries

Country	Due Date for Submission of Documentation
Belgium	Within thirty days from tax authorities' request
Canada	Within three months from tax authorities' request
Korea	Within sixty days from request. The term is set at thirty days for the submission of contemporaneous documentation
Denmark	Within sixty days from request
Finland	Within sixty days from request. The term may be further extended to ninety days
France	Within thirty days from tax authorities' request
Germany	Within sixty days from request. The term is set at thirty days for documentation relating to so-called extraordinary transactions
Japan	Not applicable
Norway	Within forty-five days from request
The Netherlands	Upon request. In the case where the documentation is not submitted upon request, the same may be produced within a reasonable term (from one to three months)
Portugal	Upon request
Slovakia	Within sixty days from request
Spain	No term has been set for submission of documentation, but the tax authorities may request the said documentation the day following the filing of the annual income tax return
Sweden	Generally within thirty days from request
UK	Within thirty days from tax authorities' request
Hungary	The documentation may be immediately submitted upon request by the tax authorities
USA	Within thirty days from request

16.5. Documentary Burden and Risk Assessment[10]

A further distinguishing element with respect to the practice adopted by the greater majority of other regimes is the provision regulating the transmission of the communication pertaining to ownership of the documentation for tax periods prior to those in effect as at the date of the entry into force of Decree-Law No. 78/2010.

According to the Report to the Bill of Law converting Law-Decree No. 78/2010, the purpose of the said communication is to 'proceed with a more efficient preliminary analysis of the specific tax risk, especially with reference to those entities that are devoid of such analysis'. In that respect, the approach adopted appears to be rather similar to the one in force in the Australian regime, where the compiled documentation and the level of information details represent the fulcrum to perform a sound risk assessment analysis.

The tax risk assessment must in any case be reconciled with the inspection activity drivers; as a matter of fact, it would be useful to keep in mind that:

> with regard to selection criteria to be used for the identification of positions to be subjected to inspection by means of external preliminary activities, priority should be given to the inspection of entities which, during the process of drawing up risk index charts, have been assigned a high-intensity risk. For other large taxpaying companies, indications already provided in 2009. . .are confirmed.
>
> Special attention ought to be paid to the phenomenon of international arbitrage (achieved also through the use of hybrid tools/entities or of complex financial instruments), to transnational corporate restructurings that exhibit abnormal elements as well as to those involving the topic of transfer pricing.

Operative instructions for preliminary activities regarding large taxpaying companies are those expressed under paragraph 2.1.2 of Circular No. 13 of 9 April 2009. It should be further considered that also medium-sized enterprises are subject to inspection with reference to inter-company transactions and on the subject matter of transfer pricing.

The selection of the said entities occurs on the basis of the criteria of dangerousness expressed in the cited Circular No. 13/2009 or rather:

- for enterprises that are most complex, thereby meaning, for example, those characterized by high or fragmented business volumes, by particular management and accounting procedures – as in the case of financial brokers – or by the presence of considerable foreign transactions volumes, in business as well as in financial activities, on the basis of criteria that are substantially the same as those adopted for the large taxpaying companies;
- for other enterprises, on the basis of the usual evasion/avoidance risk indicators, the following deserve special attention (which may, in any case, be relevant for more complex enterprises):
  - considerable extraordinary burdens;
  - considerable financial burdens;
  - high service costs;
  - irregular variations and fluctuations within short and medium terms;
  - significant VAT credits used for offsetting purposes or brought forward to the next tax period that seem particularly significant and somehow discrepant in relation to the information declared and with legal regimes that are applicable with respect to the activity carried out;
  - entities that submit income tax returns with a turnover that is not consistent with the amount of purchases and the cost of labour employed.

Paragraph 9.2 of the Regime establishes that said communication must be effected via Entratel, which is an electronic service (and also through authorized intermediaries) by 28 December 2010; nevertheless, the same paragraph contains a provision that is in contrast with the previous one, since late communications are considered acceptable (i.e., received beyond the ninety-day term) provided such communications be previous to the onset of any accesses, inspections, audits, or other administrative activities of which the taxpayer had been formally acquainted with.

The provision for the above communication imparts perhaps greater emphasis on the asymmetry in the relationship between the taxpayer (who independently used to decide to produce the documentation in accordance with the principles expressed by the OECD Guidelines and the EU Code of Conduct) and the tax authorities before the promulgation of Article 26 of Law-Decree No. 78/2010.

As a matter of fact, in general terms, by virtue of the provision set forth under Article 32, paragraph 3 of the Presidential Decree No. 600/1973, the tax authorities may request the taxpayer to exhibit and/or transmit deeds and documents pertaining to the assessment in progress.

Said provision used to be construed (in line with rules set forth by OECD Guidelines) within a pre-promulgation context of the rule contained under Article 26 of Decree-Law No. 78/2010 as the request for documents that could reasonably contain useful information on determination procedures for transfer pricing.

According to the OECD Transfer Pricing Guidelines:

> The taxpayer's process of considering whether transfer pricing is appropriate for tax purposes should be determined in accordance with the same prudent business management principles that would govern the process of evaluating a business decision of a similar level of

Note

[10] Compare Ch. 5 of OECD, 1995.

complexity and importance. It would be expected that the application of these principles will require the taxpayer to prepare or refer to written materials that could serve as documentation of the efforts undertaken to comply with the arm's length principle, including the information on which the transfer pricing was based, the factors taken into account, and the method selected. It would be reasonable for tax administrations to expect taxpayers when establishing their transfer pricing for a particular business activity to prepare or to obtain such materials regarding the nature of the activity and the transfer pricing, and to retain such material for production if necessary in the course of a tax examination. Such actions should assist taxpayers in filing correct tax returns. Note, however, that there should be no contemporaneous obligation at the time the pricing is determined or the tax return is filed to produce these types of documents or to prepare them for review by a tax administration.[11]

In the application of principles of diligent corporate management, it is necessary for taxpayers to draw up or refer to written material, which would not otherwise be taken into consideration outside the taxation context, as well as documentation deriving from group enterprises residing abroad.

The importance of the compliance with the principle of diligent corporate management, also with reference to the documentation relating to transfer pricing, is evident where the tax authorities inspection activities aim at the need to identify and trace:

(1) 'Accounting Documentation': the general accounting ledger, VAT registers on purchases and sales, auxiliary entries containing assets and income elements ('sales and purchase ledgers' as well as 'T-accounts for revenue and expenses'), and auxiliary warehouse stock entries; inventory and financial statements; the register of depreciable assets; corporate books, purchases and/or sales invoices; transport documents, procedures, and payment means, etc.

(2) 'Supplementary Documentation': agreements entered into, price lists, notes, correspondence, any analyses, opinions (including any drafts) by anyone provided on the price policy adopted by the company; if there is one, a document of concrete logical-systematic determination procedures of prices applied in relationships with non-resident associated companies, generally, with the indication of cases that are comparable to that of the company under examination (the so-called Policy, usually the result of studies by external expert professionals).

(3) To such effect, it was highlighted that according to the OECD, information relating to each associated enterprise involved in the controlled transactions under examination might be useful, that is, a description of the business activity, structure of the organization, shareholding percentages within the multinational group, the sales volume and operative results in the last few years preceding the transaction, the level of transactions carried out by taxpayer with the associated enterprise, for example, the volume of sales of warehouse stock, the supply of services, the renting of tangibles, the use and transfer of intangibles and interest on loans. Scholars and expert opinions deem that such elements, contained in special documentation, would be able – in summary – to provide information relating to:
   - business policies and strategies (board of directors' resolutions, or reports of the department head, etc.);
   - application of adopted method (internal reports, consultants' opinions, etc.);
   - any offsetting transactions (resolutions and/or correspondence bearing a given date so as to reduce the risk of any possible interpretative issues);
   - situations pertaining to the enterprise's industrial aspects (environmental situations, foreseen and foreseeable changes, technological progress, etc.);
   - functions performed by the enterprise (industrial accounting, inventory accounting, and stock management, etc.); and
   - financial evaluations that may justify the implementation of the method adopted by the group.

(4) 'Documentation on Electronic support': found in the premises subject to access. Within the context of a tax audit relating to transfer pricing, supplementary electronic documentation, just as paper documentation, may provide significant information for the purpose of identifying any possible pathological behaviours adopted by the entity under inspection within the context of international inter-company transactions.

17. Preliminary Conclusions

The provision contained in Article 26 of Decree-Law No. 78/2010, which was implemented by the tax authorities director's Regime of 29 September 2010, has the merit of aligning transfer pricing regulations actually in force in Italy with the regulations in force in the major EU and non-EU economies, while it also provides greater assurance in the articulation of the relationship between taxpayers and the tax authorities.

A clarification by the tax authorities would, nevertheless, be most welcome when considering the 'venerable age' of administrative procedures relating to the regime provided under Article 110, paragraph 7, of the TUIR.

Note

[11] OECD, 1995, para. 5.4.