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Transfer pricing audit: Italian approach

Piergiorgio Valente of Valente Associati GEB Partners and Federico Vincenti of Centro Studi Internazionali GEB Partners explain how to cope with an Italian transfer pricing audit.

In recent years the complexity and importance of transfer pricing risks have increased as a result of growing globalisation, cross-border mergers and the sophistication of the financial sector.

Transfer pricing cases pose numerous challenges to tax administrations, particularly in terms of the resources needed to manage them effectively.

The key aspects of transfer pricing audits are:

- effective risk assessment;
- dialogue between tax administration and the taxpayer;
- introduction of a governance system for transfer pricing audits;
- avoiding or limiting delays in transfer pricing audits; and
- use of specialised personnel.

With respect to large taxpayers, the Italian tax authorities have long adopted an approach inspired by the strategy of enhanced cooperation, which aims to prevent tax violations through preliminary discussions on issues of particular impact, such as transfer pricing or structured finance operations.

The so-called tutoring of large taxpayers includes monitoring some occurrences associated with important risk factors, which are also the object of analysis by the OECD, such as:

- international tax planning schemes;

- policies for the instrumental use of tax losses;
- arbitrage based on the exploitation of complex financial tools;
- transfer pricing policies not in line with the arm's-length principle.

Specific characteristics of transfer pricing audits carried out by Italian tax authorities are:

- Analysis of transfer pricing documentation: official guidelines dated September 29 2010 establish the non-application of penalties when a taxpayer, subject to an inspection, provides proper documentation supporting consistency with the arm's-length principle (even though submitting such documentation is not required by law).
- Selection of transfer pricing method: the above mentioned guidelines require that the reasons for the selection or exclusion of a method be explained in the transfer pricing documentation. In particular, when "a transactional profit method [...] is selected instead of a traditional transactional method that could have been applied in an equally reliable manner, the reasons for the exclusion of the latter must be provided. The same explanation is required when a method other than the CUP method is selected, if the latter could have been chosen instead".
- Selection of the right set of comparables: the selection of comparables should be based on a specific functional analysis of the parties involved in the transactions. Well-documented search procedures and comparability criteria make the comparability standard transparent and ensure that results are less susceptible to cherry picking since the reasons for the rejection of each potential comparable are provided.
- Possible criminal relevance: the redetermination of transfer prices by the tax authorities could have criminal consequences. In fact, Italian criminal law (see Art. 4 of Legislative Decree No. 74/2000) establishes a penalty, subject to a minimum quantitative threshold that is easily met by large corporations, for tax returns that are

merely discrepant, devoid of any fraudulent connotations. However, some specific offences, for example, the issuance of invoices for fictitious transactions and/or their use in a tax return, described by Italian criminal law (see Arts. 2 and 8 of Legislative Decree No. 74/2000) do not apply to transfer pricing matters. In those cases, the spirit of the law is to not penalise estimates regarding transactions that differ from estimates that are deemed to be correct, but rather the material fact that the transactions did not occur.

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