



Italy issues draft of new measures on implementation of domestic transfer pricing provisions for public consultation

Global Transfer Pricing Alert 2018-010

Italy's Ministry of Economy and Finance on February 23 launched a public consultation on several transfer pricing issues. Specifically, the ministry requested comments and suggestions from all potentially interested parties on the following documents:

1. A draft decree providing the relevant guidelines to address arm's length issues in accordance with the OECD transfer pricing guidelines;
2. A draft of the regulations implementing the newly introduced unilateral corresponding adjustment procedure (new Art. 31 quarter of Decree 600/1973); and
3. An Italian courtesy translation of the OECD transfer pricing guidelines.

The above documents have been released for public consultations to be concluded by March 21. The results of the consultations will be made available to the public.

Draft decree on implementation of the arm's length principle

The draft decree contains measures aimed at implementing the OECD transfer pricing guidelines within the Italian tax system. Preliminarily, the decree addresses the following issues:

- A definition of "associated enterprises," both related to legal and *de facto* control;

- An illustration of the concept of comparability under the five comparability factors in compliance with Chapter III of the OECD transfer pricing guidelines; and
- A description of the relevant transfer pricing methods and the criteria for selecting the most appropriate one, according to the OECD transfer pricing guidelines.

Furthermore, a precise definition of the concept of “arm's length range,” which has been missing from Italian regulations, has been provided, defined as the “range of values resulting from the indicator financial resources selected in accordance with the most appropriate method rule, where they refer to a number of uncontrolled transactions that are equally comparable to the transaction under analysis.”

The draft clarifies that if the value of the tested transaction (or the margin of the tested party) falls outside the arm's length range, the tax authorities will make an adjustment to bring that value within the range. The new provision represents a step forward in providing taxpayers with more precise guidance; however, it does not clarify to which point in the range (for example, first quartile, median, etc.) the adjustment should bring the tested party's profitability to make it arm's length.

Finally, the decree contains a clause that allows the Revenue Agency to issue further instructions/regulations, based on future amendments to the OECD transfer pricing guidelines.

Draft regulations on unilateral corresponding adjustments

The set of draft documents released for public consultation includes a draft regulation to implement the provisions of Article 31-quater of Decree 600/1973 (recently introduced by Law Decree 50/2017), which will provide Italian taxpayers with a new tool to avoid double taxation in case of transfer pricing adjustments made by foreign tax authorities under the arm's length principle.

Under the draft regulations, if a decrease in the Italian taxable income was necessary to avoid double taxation deriving from a transfer pricing assessment, a downward adjustment would be possible in the future, not only by means of the mutual agreement procedure provided under the EU Arbitration Convention (Convention 90/436/EC of 23 July 1990), or the applicable income tax treaties, but also through a specific request for a “correlative adjustment” to be filed by the Italian taxpayer with the domestic competent authority.

Such a unilateral adjustment, which would allow the taxpayer to recover the excess taxes paid in Italy, could be claimed only in the case of transfer pricing adjustments that meet the following conditions:

- The primary adjustment must comply with the arm's length principle;

- The state that made the primary adjustment must have entered into an income tax treaty with Italy that includes an effective exchange of information provision; and
- The primary adjustment must be final in the other country.

To demonstrate that the primary adjustment is final, the taxpayer must provide the Revenue Agency with a certificate issued by the foreign state confirming that that is the case.

The draft regulations indicate how to file the application, and the Revenue Agency has 180 days to respond. However, should the Revenue Agency decide to request information from the other jurisdiction under a legitimate exchange of information procedure, that term will be suspended.

The Revenue Agency must issue a decision accepting or rejecting the claim within the 180-day period. If the request is accepted, the Revenue Agency will determine the taxpayer's right to receive a refund (currently, the possibility of allowing the use of the relevant tax credit to offset an equivalent amount of taxes due in the corporate income tax return is not contemplated) based on the amount of the corresponding adjustment.

If the relevant conditions are met, the taxpayer would retain the right to request the activation of a MAP, either under the relevant tax treaty or the Arbitration Convention.

Draft translation of OECD transfer pricing guidelines

As mentioned above, the Ministry of Finance has published a draft translation of Chapters IV and V of the OECD transfer pricing guidelines.

The ministry describes the translation as a "courtesy translation" that has been issued with the goal of simplifying implementation of the OECD transfer pricing guidelines. In cases of discrepancies between the translation and the original, it is reasonable to assume that the OECD guidelines' original language will prevail.

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