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Moving forward to find solutions

2020 turned out to be a year unlike any other as businesses and governments all over the world faced the most unexpected challenges. Italy responded to the economic distress caused by COVID-19 through the introduction of unifying tax measures to protect the economy and the livelihood of its people.

To ease business dynamics, policy makers notably sought to improve Italy's tax disputes framework by adapting clearer guidelines when handling advance pricing agreements (APAs) and mutual agreement procedures (MAPs). The government were also busy with the interpretation and application of EU law to improve tax compliance and reporting functions.

Looking ahead, ITR has partnered with three leading firms to bring you practical insight from the Italian tax world to consider for 2021.

The article by Chiomenti explains why Italy's implementation of Council Directive 2017/1852 on tax dispute resolution mechanisms, has been largely welcomed by businesses and taxpayers. The measures will broaden the scope of MAPs and provide additional effective tools to taxpayers affected by international double taxation issues.

Lorraine Yardley
Commercial editor
ITR

The 2021 Budget Law modified the APA procedure, introducing new aspects concerning the application of 'roll-backs' and providing the payment of a fee in order to start these procedures. Crowe Valente/Valente Associati GEB Partners discuss the changes and consider how multinational corporations may be affected.

Italy's DAC6 Law is predominantly in line with the scope and requirements of the European original, which seeks to increase the level of transparency surrounding harmful tax practices. LED Taxand explore the peculiarities in the country's DAC6 implementation that must be considered in cross-border arrangements.

We hope you find the third edition of our Italy guide to be an interesting read.

Italy

ITR

A review of advance tax agreements in Italy

Federico Vincenti and **Alessandro Valente** of **Crowe Valente/Valente Associati GEB Partners** discuss advance tax agreements including changes to the roll-back of advance pricing agreements as set out in the 2021 Italian budget law.

Advance tax agreements are binding agreements between taxpayers and the Italian Revenue Agency aimed at enhancing tax compliance and promoting the business of multinational enterprises by providing certainty on international tax issues in advance.

The arrangements are based on mutual cooperation and transparency between taxpayers and the Italian Revenue Agency. An advance tax agreement may be requested by resident companies conducting international activities, meeting a set of requirements.

The 2021 Italian Budget Law modified the advance pricing agreement (APA) procedure, including new aspects about the 'roll-back' and providing the payment of a fee in order to start these procedures.

Advance tax agreements: A tool for increased tax certainty

In previous years, the Italian legislator started targeting reforms of the fiscal policy field with the aim of putting the Italian economy back on track and attract foreign investments.

Indeed, a series of legal tools have been introduced, both in terms of substantive and procedural requirements, in order to ensure a reduction of the tax burden and give the chance to foreign investors to forecast the levy, by promoting the dialogue between taxpayers and the Italian Revenue Agency.

Among the substantive measures, it is worth mentioning the advance ruling in favour of international companies and enterprises.

The advance ruling, as the general 'tax compliance institute', allows taxpayers to adapt their behaviour and reduce litigation with the Italian Revenue Agency.

Resident and non-resident businesses and individuals can submit formal queries to the tax administration to obtain, in advance, clarification on the correct application of a specific tax provision.

With specific reference to transfer pricing (TP) issues, Italian taxpayers increased the use of the APA.

As indicated in paragraph 4.134 of the OECD Transfer Pricing Guidelines issued in July 2018, an APA "is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the TP for those transactions over a fixed period of time."

Therefore, TP issues can be determined before the performance of intercompany transactions in a collaborative manner that engages both the taxpayer and the tax administration.

An APA can be:

- Unilateral: It involves the taxpayer and the tax authority of the country where the taxpayer is resident for tax purposes; or
- Bilateral: It involves both taxpayers (related companies) involved in the intercompany transactions covered by the agreement as well as the tax authorities of the country where the both taxpayers are resident for tax purposes; or
- Multilateral: It involves more than two taxpayers (related companies) involved in the intercompany transactions covered by the agreement, as well as the tax authorities of the country where the taxpayers are resident for tax purposes.

In addition to APAs, another effective and commonly used dispute resolution strategy used is the mutual agreement procedure (MAP), often in conjunction with APAs. The main benefit of opting for a joint use in such strategies is the elimination or reduction of the double taxation for both previous and future tax years.

The MAP is an instrument for the resolution of international tax disputes whenever a person considers that the actions of one or both of the contracting states' tax administration result, or will result, in taxation not in accordance with the provisions of a tax convention or of a tax treaty.

The MAP allows the competent authorities designated from the governments of the contracting states to interact with the intent to resolve the international tax dispute at hand.

The benefits of an APA include:

- Increased tax certainty for taxpayers, avoiding tax audits, assessments, and lengthy tax litigation;
- Optimal tax risk management for taxpayers and the tax administration;
- Improved resource allocation for both taxpayers and the tax administration;
- Promotion of cooperative relationships between taxpayers and the tax administration that enhances tax compliance;
- Effective reduction of double taxation issues; and
- Considerable reputational benefits for taxpayers.

The relevance of the APA as a tool to attract investments in the territory is proved also by the European Commission's investigations of tax rulings issued by member states in the context of state aid.

This is part of a wider set of measures undertaken at European level to fight aggressive tax planning by multinational companies.

The investigations mainly targeted tax rulings concluded by member states, with the aim of verifying whether they provide tax benefits to specific companies and hence may constitute state aid, according to Article 107 of the Treaty on the Functioning of the European Union.

Advance tax rulings in Italy: The procedure

In order to promote the internationalisation of companies and to make the Italian tax system more attractive, the Italian legislation also provides the possibility to apply for 'Advance tax agreements for enterprises with international activities' (which include APAs on TP issues), provided for by Italian legislation (Article 31-ter of Presidential Decree No. 600/1973).

These agreements can be concluded by enterprises with international activities wishing to reach a prior settlement with the Italian tax authorities related to:

- Determination of the arm's-length price of transactions between an Italian company and a non-resident company belonging to the same group, and definition of entry and exit value of assets in case of transfer of residence;
- Attribution of profits and losses to domestic and foreign permanent establishments (PEs);
- Prior assessment on the existence of a PE in the territory of the state;
- Application to a specific set of rules, including international treaty rules, concerning the payment to (or the receipt from) non-resident companies of dividends, interests, royalties or other income; and
- The application to a specific set of rules, including international treaty rules, in order to define the amount of income attributable to a PE in Italy of a non-resident company or to a PE in foreign countries of an Italian resident company.

An advance ruling may only be issued for transactions or activities with an international element. Consequently, only taxpayers with international activities may initiate the APA.

The Italian regulations provide a definition of 'international enterprise' which is an enterprise that resides in Italian territory and:

- Participates in the equity, fund, or capital of non-resident subjects, or which equity, fund, or capital is participated in by non-resident subjects;
- May have been paid to or received, interests, royalties, or other income components from non-residents dividends; or
- Carries out activities through a PE in another state.

The right is also extended to foreign companies that have considered or are considering establishing an Italian PE.

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Federico Vincenti is a partner at Crowe Valente/Valente Associati GEB Partners.

Federico is an experienced tax adviser who advises Italian and global clients, on matters including tax, TP, tax efficient supply chain management (TESCM), APAs and tax litigation. He specialises in strategising, managing, and implementing corporate TP policies that help clients mitigate risk, optimise efficiency, and support business operations.

Federico is a graduate of the University of Parma and Bocconi University. He also serves as a lecturer at several seminars, conferences and master's programmes, and is a regular contributor to specialised publications in the field of TP in Italy and abroad. He is an ANTI representative of the Professional Affairs Committee (PAC) – CFE Tax Advisers Europe.

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Alessandro Valente is a manager of tax and legal matters at Crowe Valente/Valente Associati GEB Partners.

Alessandro advises multinational clients on local and international tax and legal matters. This includes guidance on streamlining projects and the reorganisation of European groups, international tax treaties and double taxation aspects, and matters regarding permanent establishments. He also advises on TP matters such as group planning, defence, documentation, benchmarking analysis, unilateral APA, bilateral APA, as well as on legal tech matters.

Alessandro holds degrees from the University of East Anglia, the University of Miami and the University of Campania Luigi Vanvitelli. He is a member of the tax technology committee – CFE Tax Advisers Europe, and serves as the co-chair of the ethics and sustainable development group and is a member of the digitalised economy group of the International CFOs Association. He is also regular contributor to specialised publications in the field of tax and TP in Italy and abroad.

These advance rulings bind the taxpayer and the tax authorities for the tax period during which they are stipulated and for the four subsequent tax periods, unless there are changes in the factual or legal circumstances relevant to the agreements signed and resulting from them.

As of January 1 2021, the effects of unilateral prior agreements may be extended to all prior tax periods for which the assessment periods have not yet expired, if:

- The same factual and legal circumstances underlying the agreement apply;
- Audits or other assessment activities of which the taxpayer has formal knowledge have not been initiated.

With reference to unilateral advance rulings, the previous regulations provided for the right to also retroactively extend the effects of the agreement to tax periods prior to the one in which it was signed, but not beyond the tax period in which the application to open the procedure was submitted.

From January 1 2021, roll-back is also possible in the case of bilateral and multilateral advance rulings.

In such cases, in order to be able to apply the roll-back to previous tax periods:

- The taxpayer must have made an explicit request in the application to open the procedure;
- The other foreign tax authorities involved agree to extend the agreement to previous years;
- The same factual and legal circumstances underlying the agreement apply; and
- No audits or other assessment activities have been initiated of which the taxpayer has formal knowledge.

The application of roll-back is an option granted to the taxpayer which can be exercised:

- By means of voluntary repayment;
- Through a possible supplementary declaration; and
- Without the application of administrative sanctions.

Starting from January 2021, a multilateral advance ruling procedure is subject to the payment of a fee (as already provided for in other countries) that varies according to the total turnover of the group:

- €10,000 (approximately $11,863) if the total group turnover is less than €100 million;
- €30,000 if the total group turnover is between €100 million and €750 million; and
- €50,000 if the total group turnover exceeds €750 million.

The fees above are reduced by half if the agreement is renewed.

The procedure for obtaining an APA begins with an entitled taxpayer filing an application with the competent tax authority. Before initiating the application, the taxpayer can apply for a pre-filing meeting to discuss the formal issues of the procedure.

With specific reference to the APA, the application must indicate:

- A description of the intercompany transactions covered by the APA;
- The foreign companies involved in intercompany transactions covered by the APA; and
- The TP methods selected and the reasons why such methods are considered compliant with the arm's-length principle.

Once the application is filed, the Italian tax authority will communicate to the taxpayer within 30 days the admission to the procedure.

Generally, the Italian tax authority may access the companies' business premises to:

- Ask for further documentation related to the intercompany transactions covered by the APA;
- Interview key people; and
- Perform a functional analysis of the taxpayer aiming at better understanding the functional profiles of the companies involved in the intercompany transactions.

The procedure will be concluded within 180 days from the notification of the application. However, this time limit is non-mandatory and in practice can take up to two years in complex cases or even longer in bilateral rulings.

The procedure is concluded with the signing of the agreement by the tax authorities' executive in charge and by the enterprise's legal representative or any other party with the necessary representative powers.

Once the agreement is reached, compliance with the terms and conditions of the APA may be verified during the period of the agreement.

Upon request, the taxpayer must prepare and give evidence of his compliance to the agreement.

If the facts and circumstances underlying the agreement change, it will be renegotiated to align with the new situation.

Discussions may be initiated either by the competent authority or by the company. In the latter case, the taxpayer files an application showing:

- The reasons why the change was not foreseeable at the time the APA was concluded;
- The amendment proposed; and
- The factual and legal circumstances on which the amended advance tax agreement is based.

An APA may be renewed for a five-year period upon agreement of the parties. Negotiation of the renewal is conditional on the company submitting an application for renewal at least 90 days before the expiration of the existing APA.

Changes in the critical assumptions underlying and APA have been discussed by the OECD in the Report 'Guidance on the transfer pricing implications of the COVID-19 pandemic' issued on December 18 2020.

Considering that COVID-19 has led to material changes in economic conditions that were not anticipated when many APAs covering fiscal year 2020 and potentially future financial years affected by COVID-19 were agreed, OECD analysed the impact of the pandemic on such agreements.

The OECD encouraged taxpayers to adopt a collaborative and transparent approach by raising these issues with the relevant tax administration in a timely manner.

Italian tax authorities have not yet issued specific guidelines on the impact of COVID-19 on the APA. However, considering the OECD suggestions, it is advisable to discuss in a pro-active manner how to consider the impact of COVID-19 on existing/future APAs.

As provided by the new Italian regulations on TP documentation (issued on November 23 2020 to better align the Italian rules to the OECD Standards), the list and brief description of the Group's existing APAs and other tax rulings relating to the allocation of income among countries need to be indicated in the local file prepared by Italian taxpayers.