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Italy Issues New Guidance on Transfer Pricing Documentation: New Requirements to Avoid Penalties and (some) Simplification.

Stefano Versino (AndPartners Tax and Law Firm) · Friday, March 12th, 2021

1. ***Introduction***

On November 23, 2020 Italian Tax Authorities ("**ITA**") issued the Provision no. 360494/2020 ("**Provision**") by which it introduced new measures[1] as for the content and validity of the transfer pricing documentation ("**TPD**") – to be prepared by Italian resident enterprises and Italian permanent establishments of foreign entities – in order to benefit from the so called "*administrative penalty protection*"[2] in the case of transfer pricing adjustments made by tax authorities.

The new measures – **applicable from the fiscal period 2020[3]** – replace the previous provision of the ITA dated September 29, 2010 and align Italian tax law to the guidance provided by OECD BEPS Action 13[4] ("**Action 13**") and Transfer Pricing Guidelines 2017 version ("**TP Guidelines**") [5].

2. ***Executive summary***

The Provision introduces **significant changes** to the mandatory contents of the TPD to be granted the relief from administrative penalties.

As for the set of TPD, **the Masterfile will become a mandatory document** also for subsidiaries of non-resident entities, where shall be included new relevant information on the multinational group and its operations.

Moreover, both Masterfile and Local country file shall be signed by the legal representative (or by a delegate representing the taxpayer) **by means of an electronic signature and a timestamp** ("*marca temporale*"), by the date of submission of the tax return for the relevant fiscal year.

The Provision introduced also the possibility to adopt a **simplified approach** for the so called "*low value-adding intra-group services*" ("**LVAIGS**") – that seems to be a dedicated set of documentation – for which, nevertheless, taxpayers shall provide a **considerably amount of information**.

Finally, it is provided the possibility to set the TPD with regard to **selected intercompany transactions** and to **amend the TPD for earlier financial years**, upon certain conditions.

In this regard, the ITA should publish a circular letter in the coming weeks in order to clarify certain operational aspects of uncertain application.

3. ***Detailed Analysis***

3.1. "Brand new" TPD set

Under the Provision, the appropriate TPD consists of a Masterfile and a Local country file[6], which structure is fully aligned with the OECD standards[7].

This means that also resident controlled companies **shall include the Masterfile**[8] **on the TPD**, in order to benefit from *administrative penalty protection*.

In this regard, the Masterfile shall include information relating mainly to the multinational group as a whole and its operation.

Compared to previous guidance (2010), more detailed information shall be provided, such as:

- description of the activity(es) performed and of the **main drivers of business profit**;
- description of **the supply chain for the group**'s five largest products and/or service offerings by turnover plus any other products and/or services amounting to more than 5% of group turnover;
- description of the group's **overall strategy for the development, ownership and exploitation of intangibles**, including a description of the agreements in force and of the transfer pricing policy applied;
- description of how the group is **financed, including important financing arrangements** with unrelated lenders, and the identification of the central financing function for the group.

As for the Local country file, the information to be provided concerns the transactions taking place between the Italian local entity and associated enterprises in different countries[9].

Unlike the previous guidance, the Provision now requires the inclusion of the following attachments *(i)* copies of the **contractual documentation** for each covered transaction, including any cost sharing and CCAs and *(ii)* copies of advance pricing agreements ("**APA**") and **any other cross-border tax rulings of the Italian entity**, as well as APAs or rulings not concluded by the Italian entity but linked to the transactions covered.

The non-inclusion of such documents within the TPD could now **compromise the granting of the relief from administrative penalties**.

3.2. Drafting and validity requirements

The TPD shall be set in Italian, except for the Masterfile that **could be provided in English**, considering that in certain Countries this document is already mandatory and must be prepared according OECD standards[10].

Both the Masterfile and the Local country file shall be signed by the Italian entity's legal

representative (or a delegated person) by means of **an electronic signature and a timestamp** ("*marca temporale*") no later than the date of filling of the relevant tax return[11].

In addition, the TPD must be electronically submitted to ITA by an increased term of 20 days (rather that 10 days provided under 2020 guidance) from the request.

This means that, in any case, once the TPD is electronically signed before the above-mentioned deadline (*i.e.*, of filling the tax return), **the documentation can no longer be amended**.

In this regard, the Provision does not clarify whether the delayed fulfilment of such formal obligation (i.e., the signature of the TPD after the date of filling of the relevant tax return) **could jeopardize the validity of the TPD**, namely the *penalty protection**[12]***.

Moreover, it is not clear whether the *ad hoc* set of documents for **LVAIGS**, under the "*simplified approach*", should bear the electronic signature with the timestamp for the purposes of its validity.

Anyway, this new measure will undoubtedly have an **impact on the management of the timing relating to the flow of documents and information** – both at local and group level – needed to complete the TPD.

As regards the validity requirements, the TPD covers only **one fiscal year** and must be kept until the statute of limitations has expired.

In this respect, it is worth noting that the Provision introduces the possibility of **selecting the transactions covered by the documentation to be prepared**, in order to benefit from administrative penalty protection in case of assessment.

It goes without saying that the relief will be granted exclusively with regard to the **transactions included in the TPD**, for which relevant information must be provided.

3.3. Specific LVAIGS documentation

As mentioned, the Provision introduces the possibility of adopting a **simplified approach for the so called "*low value-adding intra-group services*"** (LVAIGS)[13], i.e., those services that are, *inter alia*, of a supportive nature and therefore are not part of the core business of the group[14].

In this regard, in determining the arm's length charge for LVAIGS, it is possible to apply a **profit mark-up equal to 5% of the relevant cost**. The mark-up under the simplified approach does not need to be justified by a benchmarking study.

On the other hand, detailed information shall be provided, such as:

- a description of the categories of **qualifying services** provided, including a description of the expected **benefits** of each category of services and support for the selected allocation keys;
- written **contracts or agreements** for the provision of services;
- calculations showing the **determination of the cost pool**, including a detailed listing of all categories of services and amounts of relevant costs; and
- calculations showing the application of the specified **allocation keys**.

As said, it is not clear whether such documental set – that seems to be autonomous compared to the TPD – should bear the electronic signature with the timestamp for the purposes of its validity.

3.4. Election for penalty protection regime

The Provision[15] confirms that the TPD election must be made **in the tax return related to the relevant fiscal year** (e.g., in case of a taxpayer adopting the calendar year as its fiscal year, the election for 2020 can be made with the tax return filled in 2021).

In addition, the Provision introduces the option to amend the tax returns of **open fiscal years as of November 23, 2020**, without the application of penalties and interest, upon certain condition[16].

In details, in case the taxpayer performed, in a given year, a transaction non-compliant with the arm's length principles – which determine an unfavourable transfer pricing adjustment, i.e., higher taxable income – he is allowed to amend the related tax return **without the application of penalties and interest** on such adjustment.

Anyway, the wording of the Provision on this point, as well the possible practical implication of such rule, are not still clear and need of additional clarification by ITA.

4. **Conclusions**

The new measures at hand have the virtue of aligning the Italian legislation on TPD to the guidance provided at OECD level, in order to achieve a consistent and effective implementation of the transfer pricing documentation standards.

On the other hand, it is clear that such rules will undoubtedly impact on the management of timing of all multinational groups operating in Italy.

The new requirements to be met and the detailed information needed to set an appropriate TPD before the deadline – considering also that transfer pricing analysis for 2020 will be affected by the unique circumstances introduced by the pandemic[17] – will force multinational groups and professionals to race against time.

Stefano Versino (AndPartners Tax and Law Firm)

[1] The Ministerial Decree of May 14, 2018 provided new guidelines for the application of the Italian transfer pricing rules (cf. Article 110, paragraph 7, of Presidential Decree n. 917/1986). In this context, Article 8 specifically required the issue, by ITA, of an updated version of the guidance concerning transfer pricing documentation requirements.

[2] Provided by Article 1, paragraph 6 and Article 2, paragraph 4-*ter*, of Legislative Decree n. 471 of 18 December 1997.

[3] For taxpayers adopting the calendar year as their fiscal year.

[4] OECD (2015), "*Transfer Pricing Documentation and Country-by-Country Reporting*", Action 13 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[5] OECD (2017), "*Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration*", OECD Publishing, Paris.

[6] See para. 2 of the Provision.

[7] See Action 13, Sec. C and TP Guidelines, sec. C. according to which "[…] *countries should adopt a standardised approach to transfer pricing documentation.* […] *a three-tiered structure consisting of (i) a master file containing standardised information relevant for all MNE group members; (ii) a local file referring specifically to material transactions of the local taxpayer; and (iii) a Country-by-Country Report*".

[8] Under the previous provision of September 29, 2010 controlled companies only had to prepare the Local country file.

[9] Similar to the 2010 guidance, the Provision provides for a simplified approach for SMEs, which are still defined as entities with turnover not exceeding €50 million for the FY covered by the TPD.

[10] See para. 5 of the Provision.

[11] Italian companies must electronically file their corporate income tax return through the internet or an authorized intermediary within 9 months of the end of the fiscal year.

[12] The penalty protection denial as a result of the delayed signature of the TPD seems not to be fully aligned with the principles stated by OECD in TP Guidelines, chapter 6, para. B.

[13] See para. 7 of the Provision.

[14] See TP Guidelines, Chapter VII, Sec. D.

[15] See para. 6 of the Provision.

[16] i.e., whether Article 10 of the Law no. 212/2000 (so called "*Taxpayers' Statute*") is applicable according to para. 6.2. of the Provision.

[17] OECD (2020), "*Guidance on the transfer pricing implications of the COVID-19 pandemic*" OECD Publishing, Paris.

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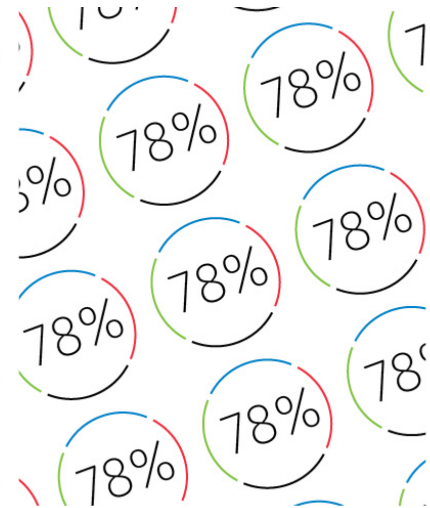

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