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1. Introduction

The process of aligning national transfer pricing provisions with OECD standards and, in particular, with Action 13 of the BEPS project and the OECD Guidelines published in July 2017 ("**OECD Guidelines**") continues.

The Revenue Agency, with the measure n. 360494 of 23 November 2020, implementing the provisions of the D.M. 14 May 2018 ("**MEF Decree**"), updated the provisions on transfer pricing documentation to be observed by taxpayers to benefit from the penalty protection regime.

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The new provisions replace those laid down by the previous measure n. prot. 2010/137654 of 29 September 2010 and will be effective starting from the financial year in progress at the date of the publication, i.e. from 2020 for companies whose financial year corresponds to the calendar year.

2. Main new provisions

Structure and content of the documentation

The content and the structure of the Master File and the Local File (“Documentazione Nazionale”) aligns with those introduced in Chapter V of the OECD Guidelines following the implementation of the BEPS project.

Based on the OECD approach, the Master File should provide a global overview of the multinational group activities, allowing tax administrations to obtain an understanding of the group transfer pricing policies in the economic, legal, financial and tax environment where the group operates, and to formulate an overall risk assessment.

The Local File, on the other hand, provides detailed information on the specific intra-group transactions necessary to assess their compliance with the arm’s length principle.

Compared to the approach adopted by the previous measure, we note a clearer definition of the objectives assigned to the Master File and the Local File that should allow in the future to avoid duplications in their content.

The new documentary set is, however, richer in terms of content than the one prepared so far. The required information is more detailed and well-structured and involves disclosing of elements previously not specifically requested.

In relation to the Master File, for example, the following elements are specifically required:

- i.* Description of important business drivers, i.e. the economically relevant activities contributing to value creation within the group.
- ii.* Description of the supply chain for the group’s main products or services.
- iii.* Description of the capabilities of the principal locations providing important services.
- iv.* Description of principal contributions to value creation by individual entities within the group.
- v.* Description of the overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management.
- vi.* Description of how the group is financed, including important financing arrangements with unrelated lenders.
- vii.* Identification of associated entities performing central financing functions, including the country under whose laws the entity is organised and the place of effective management of such entities.

viii. Group consolidated financial statements.

Even with reference to the Local File, the burden is heavier for the taxpayer.

In addition to local entity information (general description, operational structure and business strategy) and intra-group transactions (amount, parties, comparability analysis, transfer pricing methods and results deriving from the application of the chosen method) already provided for by the previous measure, the Local File shall also contain:

- i. Indication of the individuals to whom the local management reports and the countries in which such individuals maintain their principal offices.
- ii. Indication of the main competitors and their activities.
- iii. The main assumptions (cd. *critical assumptions*) used in the application of the chosen method, with indication of the effects resulting from their changes.
- iv. Financial information (financial statements of the local entity, detailed calculations prepared to assess the arm's length value reconciled with the financial statements).

In addition, if the Italian entity is part of any transaction related to the so called low value-added services, the measure requires the preparation of appropriate documentation to justify the application of the simplified approach, namely:

- i. Description of services and the reasons why they are considered low value adding.
- ii. List of all beneficiaries.
- iii. Business rationale for the provision of such services.
- iv. Benefits received or expected to be received.
- v. Allocation criteria and the reasons why these criteria are considered to yield results that reasonably reflect the benefits received.
- vi. Main service agreements.
- vii. Documentation and illustration, including by means of spreadsheets, of the computation made to arrive the service fee, i.e. the aggregate of direct and indirect costs *related to the service provision* and of the profit margin applied. To this end, "*a detailed representation of all the costs, including those incurred to provide services for the benefit of a single member*" shall be provided.

Again, this is an alignment with the provisions of Chapter VII of the 2017 OECD Guidelines on "Low Value Added Services" and an addition to the provisions of Article 7 of the MEF Decree which allows the taxpayer to adopt a simplified approach to determine the remuneration of the service provider.

The new provision confirms that the documents must be written in Italian, except for the Master File which can be prepared in English.

Suitability and conditions for the effectiveness of documentation for penalty protection purposes

The measure introduces changes that will have a significant impact on *compliance*, especially during the first year of implementation of the new rules.

First, suitable documentation means the set of the Local File and the Master File. In other words, unlike in the past, subsidiaries resident in Italy are required to provide not only the Local File but also the Master File.

Moreover, the differentiation between holding and sub-holding has been eliminated and the preparation of both the Master File and the Local File is requested, "if compatible", also to the Italian permanent establishments of non-resident companies.

Secondly, the measure requires that the legal representative must sign the documentation by mean of electronic signature with time stamp having the same date as the tax return filing date. It should be noted that this fulfillment concerns both the Local File and the Master File.

Finally, from a substantive point of view, the measure reiterates the provisions of the MEF Decree, according to which the documentation must be considered suitable in all cases where it provides the tax inspectors with the data and information necessary to carry out an analysis of the transfer terms and prices applied, regardless of whether the transfer pricing method or the selection of transactions or comparable entities adopted by the taxpayer are different from those eventually chosen by the tax inspectors. Similarly, minor omissions or inaccuracies that are not likely to compromise the analysis will be ignored.

Interesting compared to the past, the new measure specifies that any negative assessment made by the tax inspectors must be justified and that the power of the competent tax office to critically assess the inspectors' judgment remains unaffected.

Communication of the possession of documentation

In line with the current regulations, the taxpayer must communicate the possession of transfer pricing documentation with the submission of its annual tax return.

An element of novelty that the measure provides is that, in the event of a subsequent submission of a supplementary tax return "against the taxpayer" to correct errors or omissions resulting from non-compliance with the arm's length principle, the taxpayer has the possibility to supplement or modify the transfer pricing documentation and to communicate the amendment in that declaration.

In addition, in the case of submission of the supplementary tax return, made by 31 December 2020, and with exclusive regard to tax periods up to 2019 (and still subject to verification), no penalty or default interest shall be imposed where the taxpayer has complied with information contained in acts of the Tax Authority or where its conduct is the result of events directly resulting from delays, omissions or errors of the Tax Authority itself (principle of "protection of trust and good faith").

Simplified approach for small and medium-sized enterprises

It is confirmed the simplification granted to small and medium-sized enterprises ("SMEs"), for which it is possible to update those chapters describing the intra-group transactions in the Local File every three years, provided that the benchmark analysis is based on database searches, and provided that no significant changes occurred in those tax periods.

However, the audience of people who can benefit from this simplified approach has been significantly narrowed. The new measure confirms that a company can be considered SMEs when turnover does not exceed € 50 million; however, the SME definition does not cover entities that directly or indirectly control "or are controlled" by an entity that does not qualify as an SME.

In essence, with this addition, the vast majority of Italian resident companies that are controlled by multinational groups will be actually excluded from the benefit.

Deadlines for delivery of documentation

A further novelty is the extension of the deadline for the delivery of transfer pricing documentation in case of an audit, that goes from 10 to 20 days from the request by the Tax Authority.

In case of additional information requests, however, the deadline is in line with the past provisions, i.e. 7 days from the request or a broader period depending on the complexity of the request, provided that this period is compatible with the timing of the check.

Conclusions

As anticipated in the initial considerations, on the basis of the new approach introduced by the measure the Master File should provide an overview of the factors that contribute to value creation within the group and, in this way, should allow the Tax Authority to carry out a global risk assessment.

The Local File, or "Documentazione nazionale", should instead allow the audit of the arm's length principle compliance in the main intra-group transactions of the individual local entity. For large groups, the information will finally be complemented by Country-by-Country reporting.

Overall, the Tax Administration will have a broader and more structured set of information available than in the past.

The innovations introduced by the measure will inevitably increase the burden of Italian taxpayers especially during the first year of implementation, during which a large amount of additional information must be promptly collected and processed, which may not always be an easy task.

We remain available for any further clarification and deepening on the issues mentioned above.

CONTATTI

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