



- Introduction

On September 20th, 2021, the Italian Revenue Agency (the “**IRA**”) released for public consultation until October 12, 2021, the draft circular letter (the “**Circular**”) containing clarifications on the correct application of the transfer pricing documentation rules (the “**TP documentation**”) contained in the Administrative Provision n. 360494 of November 23rd, 2020 (the “**Provision**”). The preparation of the documentation serves to benefit of the penalty protection regime in the event of a tax audit.

The following paragraph contains a summary on the main relevant clarification to the Provision as indicated in the Circular. We expect the final version of the Circular to be released not before the end of October with no or small amendments.

- **TP documentation compliance requirements:** eligible TP documentation must be prepared on annual basis and comprises both Master File (the “**MF**”) and Local File (the “**LF**”). The structure and content of the TP documentation must strictly adhere to what prescribed by the Provision, except for partial amendments and integrations not altering the information required (in the event of doubts reference should be made to the OECD Guidelines). It is also confirmed that the previous distinction between holding, sub-holding and subsidiary no longer applies, so that the preparation of the MF becomes a mandatory document for all Italian taxpayers that want to

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access to the elective penalty protection regime (including subsidiaries for which, under the previous regime, no MF was required).

- **Possibility of bounding the perimeter of the operations to be documented:** the possibility for the taxpayer of limiting the intercompany transactions covered in the TP documentation is confirmed. In such case, the penalty protection will be granted exclusively with reference to the operations described and for which the information provided is considered compliant with the law requirements.
- **Clarifications specific to the content of the MF:** the Circular confirms the possibility for the Italian taxpayer to rely on the group MF and specifies that in case where the document does not provide the set of information required by the Provision, the Italian taxpayer must integrate such missing information in one or more annexes. As an alternative to the group MF, the IRA admits the possibility for groups with decentralized operational structure model to prepare a MF referred to the division in which the Italian taxpayer operates.
- **Intercompany amounts to be indicated in the LF:** all intercompany transactions should be indicated in the LF on accrual basis, except for royalties and interests transactions, which should be documented based on the amount received/paid in cash (relevant for withholding tax purposes).
- **Intercompany transaction to be documented in the LF:** all intercompany transactions need to be disclosed and reconciled with the data to be provided in the yearly tax return. To benefit from the penalty protection regime, the Italian taxpayers must document and analyze all the intercompany transactions considered as not “marginal”. The Circular clarifies that a transaction (or a homogeneous category of transactions) is considered not marginal when the income or cost of the relevant transaction exceeds 5% of the total positive or negative components shown in the tax return. IRA further clarifies that taxpayers must disclose but do not necessarily have to document the intercompany transaction defined as “marginal” when their exclusion do not jeopardize the reliability of the overall analysis.
- **Comparability analysis:** in describing potential variations as compared to the previous fiscal years, it is required to evaluate the effects, positive or negative, of support programs implemented by local Governments to face Covid-19 emergency in countries where related companies involved in intercompany transactions operate.
- **Reconciliation of economic and financial data used in the TP analysis:** the Circular confirms the obligation for the Italian taxpayer to provide a reconciliation of the economic data used to determine the economic and financial indicators (e.g., price, royalty rate, ROS, etc.) of the tested party with the local statutory accounts or equivalent document, even in cases where the tested party is a foreign associated entity. It further specifies that when Profit Split Method is adopted,

detailed disclosure must be provided on the combined profits and the calculations performed to determine the profit split, as well as the financial data used must be reconciled with the accounts of all the entities considered in the analysis.

- **Clarification on the TP documentation for PEs:** the Circular confirms that the new Provision applies to Italian PEs of non-resident enterprises as well as to Italian enterprises with foreign PEs. In particular, Italian entities can disclose in their TP documentation transactions occurred with their foreign PEs as well as between their PEs and other group's entities, irrespective of whether they operate under the branch exemption regime or the foreign tax credit regime. With the aim to document internal dealings reference should be made to the so-called Authorized OECD Approach (“**AOA**”) and Chapter V of the OECD Guidelines. The comparability analysis, included in the LF, should also cover step 1 of the AOA. Finally, it is further clarified that Income Statement and Balance Sheet of the PE must be attached, as well as the Financial Statements of the foreign legal entity to which the PE belongs.
- **Simplified Small and Medium Enterprises (“SMEs”):** it is confirmed the simplification granted to SMEs (i.e., possibility not to update economic analyses under certain conditions for a maximum of three years) to reduce the documentation burden (and compliance costs) on smaller taxpayers. The Circular also confirms that a company can be considered SMEs when the annual turnover does not exceed € 50 million for the fiscal year covered by the TP documentation. Entities do not qualify as SMEs if any of their controlling and/or controlled entities exceed the above threshold.
- **Local language TP documentation requirements:** the Circular confirms that the LF must be written in Italian, except for the MF which can be prepared in English. The attachments to both LF and MF can be either in Italian or English.
- **Conditions for the effectiveness of TP documentation:** the novelty of the electronic signature made by the legal representative with time stamp having the same date as the tax return filing date is confirmed. It should be noted that this fulfillment concerns both the LF and the MF and that it has been introduced to confer the certain date to the TP documentation prepared and its late affixing is equivalent to its omission. All the relevant TP documentation referred to by the Provision must be submitted in electronic format.
- **Eligibility of the documentation for penalty protection purposes:** the TP documentation can be considered eligible for penalty protection purposes in all cases where it provides the tax officers with all the information necessary to carry out an independent transfer pricing analysis (i.e., accurate delineation of transactions and comparability analysis), regardless of whether the transfer pricing method or the selection of transactions or comparable entities adopted by the Italian taxpayer differ from those selected by the tax officers. It is further clarified that minor omissions or inaccuracies that are not likely to compromise the transfer pricing analysis will be

ignored (e.g., such as the partial omission of attachments to the LF or the omitted documentation of marginal transactions). Finally, any negative judgment on the eligibility of the documentation needs to be justified and clearly mentioned by the tax police in the tax audit report.

- **Timing for the provision of TP Documentation:** the Circular confirm the extension of the deadline for the delivery of TP Documentation that must be provided to the tax authorities by an increased term of 20 days from the relevant request (rather than the 10 days provided under the previous rules). Any additional documents required by the tax authorities should generally be provided by 7 days after the relevant request or a broader period depending on the complexity of the request.
- **Communication of the possession of the TP documentation:** taxpayer must communicate the possession of TP documentation with the submission of its annual tax return (currently to be filed 11 months after fiscal year end). The Circular clarifies that late communications are admitted in certain circumstances and upon certain conditions, including payment of specific penalties. Likewise, under specific circumstances, amendments and modifications to the TP documentation are allowed only through the submission of a supplementary tax return.
- **Low value-adding services:** the Provision includes specific documentation requirements for intercompany transactions relating to low value-added intercompany services. The Circular specifies that to allow the application of the simplified approach, Italian taxpayers must include the mandatory information required by the Provision in the LF, without the need to prepare a dedicated set of additional documentation.

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We remain available for any further clarification on the above topics.

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