

By PwC Deutschland | 11 January 2021

# Italy reshapes format, contents and requirements for transfer pricing documentation

## In brief

The Italian Revenue Agency on November 23 issued the long-awaited Act of the Director of the Revenue Agency no. 360494 (New Act). The New Act introduces significant and substantial changes to the rules related to the 'appropriate' Transfer Pricing documentation that must be prepared in order to support the application of the arm's-length principle to intercompany transactions, and hence establishes the new requirements for opting-in the Italian penalty protection regime.

Several new requirements have been introduced that must be taken into account by MNE groups operating in Italy starting from the current fiscal year (i.e., fiscal year 2020, for taxpayers with the calendar year).

## In detail

The New Act fully replaces the previous one (Act of the 29 September 2010), as part of the process of aligning the domestic transfer pricing legislation to the OECD standards, and in particular to Chapter V of the OECD Guidelines as of July 2017 (as modified by Action 13 of the BEPS project on transfer pricing documentation). **Note:** In this regard, comparing the new structure required for the Master File, Local File, and the new documentation for low-value-adding services with, respectively, Annex I (Master File) and Annex II (Local File) of Chapter V and paragraph D3 (on low value adding services) of Chapter XVII of 2017 OECD Guidelines shows a substantial alignment in terms of information contents.

**Observation:** The new documentation requirements apply to intercompany transactions between Italian and foreign entities, profit attribution to Italian permanent establishments (PEs) of nonresident entities, foreign PEs of Italian entities that opted for the 'branch exemption' regime, and also, as it could be argued, in relation to the attribution of profits to non-exempted PEs of resident entities (for the computation of the foreign tax credit).

## Master File and Local File

According to the New Act, the 'appropriate' documentation for all Italian taxpayers that want to access the penalty protection regime must include both the Local File and the Master File (the latter previously required only by resident enterprises or Italian PEs qualifying as holdings or sub-holdings). The new set of transfer pricing documents is characterized by substantial format changes (with different chapters and paragraphs), as well as by a significant increase in data and information — previously not requested — that must be included in the Master File and in the Local File in order to meet the new requirements.

The New Act introduces the possibility to select — upon taxpayer choice — the perimeter of intercompany transactions to be included in the Master File and the Local File, by allowing the taxpayer to prepare such documents only with reference to some of the intercompany transactions (so called 'cherry picking'). In such a case, the penalty protection regime will be applicable with exclusive reference to covered transactions, to the extent information provided is judged as 'appropriate.'

## Master File

Regarding the Master File, the possibility to present one (or, alternatively, more Master Files) to the extent the group operates different business activities under different transfer pricing policies has been confirmed. Observation: It would not seem possible — consistently with the exclusion of any specific requirement for holding and sub-holding companies — to prepare a Master File including only information related to the perimeter of the sub-group under the Italian entity.

With reference to the content and structure, relevance is given to the identification of the key value-driver of the group's profitability, operating structure, and value chain. Thus, detailed information must be provided with reference to the group's intangible assets — e.g., a full list of the group's IPs, related intercompany agreements, significant transactions that took place between associated enterprises and related transfer pricing policies — and the intra-group financing activities, requiring the inclusion of information related to the group's financing structure, identification of any entity within the group that provides central financing functions, and the description of the transfer pricing policies related to intra-group financial transactions. It also is required to attach group consolidated financial statements, as well as a list of any advance pricing agreement (APA) and other tax rulings entered into with the tax authorities of the countries in which the group operates.

### **Local File**

Regarding the Local File, in addition to the general information already required by the previous Act and related to the Italian entity (history, recent evolution, reference market, operating structure), as well as to each intra-group transaction (indication of the nature of the transaction, amount, counterparties, comparability analysis and transfer pricing method applied), the Local File now should include: (1) a description of the reporting lines for the human resources employed in each local organizational unit, as well as of any reorganization or transfers (including intangible assets) that affected the local entity; (2) an explanation of the reasons for performing a multi-year analysis and of any comparability adjustments for the purpose of greater reliability of results; (3) indication of the main 'critical assumptions' adopted in the application of the transfer pricing method, with indications of the impacts resulting from any changes thereto; (4) further information on economic financial data (such as annual financial statements, information, financial data used for the application of the transfer pricing method, and financial data for comparable companies selected in the analysis; and (5) a copy of the unilateral, bilateral, or multilateral APAs and of the cross-border rulings which the resident entity is not a party to, but that is connected to the intra-group transactions described in the Local File.

### **Small and medium-sized enterprises (SMEs) simplification**

In line with the previous rules, SMEs (i.e., companies with a turnover or revenues not exceeding Euro 50 million) are exempted from updating chapters related to intra-group transactions in the two following fiscal years, provided that the comparability analysis is based on publicly available sources and no significant changes between the fiscal years has occurred. Note: The New Act excludes from the SME definition, local entities directly or indirectly controlled by an entity not qualifying as a SME. As a consequence, the simplification will not be available to local entities (including PEs in Italy) that are part of foreign MNE

groups.

### **Low-value-adding services documentation**

Specific documentation is required as a necessary condition for applying the simplified approach concerning the (non) performance of benefit test and the application of 5% mark-up on relevant costs, for 'low value adding services.' In this regard, an ad hoc documentation — in addition to Master File and Local File — should be prepared, by including: (1) a description of the intercompany services (with details on the beneficiaries involved, the reasons for which such services are to be intended as low value adding, and allocation keys used to allocate costs), (2) related intercompany services agreements, and (3) supporting files through which such transactions are computed (by including direct and indirect costs pooling, profit margin application, and related allocation keys). **Observation:** Such documentation arguably could also be included within the Local File for penalty protection purposes.

### **Electronic signature, digital timestamp, and language**

Among the main changes concerning the electronic format of the TP documentation, the electronic signature (for both the Master File and the Local File) of the legal representative or his/her delegate, jointly with a digital timestamp, must be executed no later than the date of filing of the relevant tax return. **Observation:** Such timestamp — which seems to be an essential condition for transfer pricing documentation 'appropriateness' (and hence for penalty protection purposes) — will have relevant operative impacts on the timeline for preparing such documentation. In this respect, clarifications by the Italian Tax Authorities are required with regard to the perimeter of the data and documents (i.e., attachments) that must be 'certified' with the timestamp, considering the significant increase in the information required, which may not be readily available to the Italian entity.

The transfer pricing documentation should be prepared annually and in the Italian language, except for the Master File, which can be prepared also in the English language.

### **Election for penalty protection regime**

The New Act confirms that the election for the transfer pricing documentation regime must be made through the annual tax return filing. However, as a new rule, the New Act provides that in case of subsequent filing of an unfavorable supplementary annual tax return (i.e., the taxpayer amends a tax return related to a prior fiscal year increasing the related taxable income) — applicable only in this case — to spontaneously amend errors or omissions referred to the application of the arm's-length principle, the taxpayer has the possibility to 'integrate' or 'modify' the documentation (and hence not paying penalties for the amendment to the extent that under a subsequent tax audit the documentation is considered 'appropriate'), by giving notice in such supplementary tax return.

**Note:** In addition, a transitional measure is foreseen as for previous fiscal years up to 2019 (still open to tax audits) with the possibility to file an unfavorable supplementary tax return and to prepare the documentation provided by the New Act **by December, 31 2020**, without application of administrative penalties and late

payment interests. However, the functioning and conditions for applying such provision are unclear and hence immediate additional clarifications are needed, particularly considering the upcoming strict deadline.

### Timing for providing the documentation

The deadline starting from the day of the formal request for the provision to the Tax Authorities is extended to 20 days (previously 10). The seven days (which may be extended based on the degree of complexity) within which additional or supplementary information should be provided is confirmed.

Moreover, the New Act provides that tax auditors must explicitly judge and provide reasons on the appropriateness, without prejudice to the power of the assessment office to make the final administrative decision. In this regard, the New Act clarifies that the documentation shall be considered 'appropriate' in case it is apt to provide all cognitive elements and data necessary to analyze conditions and prices.

Observation: In this regard, especially important is the specification referred to the accurate delineation of the transactions and the comparability analysis (including the functional analysis). Partial omissions or inaccuracies are not relevant, provided that they do not compromise tax audit activities.

### The takeaway

The New Act represents a key step in the process of aligning the domestic transfer pricing framework to the OECD standards on transfer pricing documentation. At the same time, the new requirements, in light of the several changes introduced — some of them to be clarified by the Tax Authorities with a Circular Letter — and the increase in data and information to be disclosed within the timeline imposed by the timestamp, will result in an increase in compliance burdens, as well as efforts required by MNE groups operating in Italy in order to fulfill the new documentation standards. This likely will suggest a review of the current transfer pricing documentation preparation process, as well as of the supporting data/information gathering activities.

### Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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