

# Tax Rulings and Advance Pricing Agreements in Italy

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Reprinted from *Tax Notes Int'l*, January 30, 2017, p. 475

# FEATURED PERSPECTIVE

## Tax Rulings and Advance Pricing Agreements in Italy

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In this article, the author discusses tax rulings and advance pricing agreements in Italy, focusing on whether they can ensure legal certainty and serve taxpayers' needs.

**T**ax rulings and advance pricing agreements are making headlines.<sup>1</sup> The European Commission is undertaking unprecedented investigations into member states' APAs with multinationals and has recently invalidated several of them based on fiscal state aid law.<sup>2</sup> The directive on mandatory automatic exchange of information (AEOI) in the field of taxation has recently been extended to advance cross-border rulings and APAs.<sup>3</sup> Tax rulings and APAs are also affected by the base erosion and profit-shifting project, with an emphasis on improved tax transparency. Action 5 provides for the compulsory, spontaneous exchange of information

regarding taxpayer-specific rulings, while action 13 requires that APAs and tax rulings be included in transfer pricing documentation (master file and local file).

A tax ruling is a confirmation or assurance that the tax authorities give to a taxpayer detailing how its tax will be calculated.<sup>4</sup> One special type of tax ruling is the advance cross-border ruling. It encompasses any communication or action:

- issued by national tax authorities;
- to a specific person or group of persons;
- binding on the former; and
- including an advance<sup>5</sup> interpretation or application of national tax laws to cross-border transactions, or a ruling on the determination of permanent establishment status in a jurisdiction different from that of the head office.

APAs are an even more specific type of tax ruling and attract even greater international attention. APAs are also issued by tax authorities to specific persons or group of persons. Their object is limited to identifying the criteria on which the transfer pricing of a cross-border transaction between (or among) companies in the same group will be determined, before the occurrence thereof.<sup>6</sup>

The primary purpose of tax rulings and APAs is to respond to taxpayers' need for legal certainty.<sup>7</sup> In other

<sup>1</sup>Cf. Simon Bowers, "The Apple Tax Ruling — What This Means for Ireland, Tax, and Multinationals," *The Guardian*, Aug. 2016; and Ulrika Lomas, "EC Investigates Luxembourg's Tax Rulings for McDonald's," *Global Tax News*, Dec. 2015.

<sup>2</sup>Among others, the commission has invalidated APAs between:

- Ireland and Apple;
- the Netherlands and Starbucks; and
- Luxembourg and Fiat.

<sup>3</sup>Cf. Council Directive (EU) 2015/2376.

<sup>4</sup>European Commission, Fact Sheet, "Combating Corporate Tax Avoidance: Commission Presents Tax Transparency" (Mar. 2015).

<sup>5</sup>"In advance" refers to when the transactions that are the subject of the ruling, or the activities that might give rise to acknowledgement of PE status, take place.

<sup>6</sup>Cf. *supra* note 3.

<sup>7</sup>See, e.g., Christophe Waerzeggers and Cory Hillier, "Introducing an Advance Tax Ruling (ATR) Regime," 1 *Tax Law IMF Technical Note* (Jan. 2016).

words, they neutralize the complexity and ambiguity of tax laws, particularly in the case of international taxation.<sup>8</sup> Advance clarification of the tax treatment of transactions or activities prevents tax-related disputes, while also minimizing the need for audits. More legal certainty, fewer audits, and fewer disputes are key to creating an investment-friendly tax environment.

Furthermore, tax rulings and APAs nurture a cooperative relationship between taxpayers and tax administrations. Modern tax systems tend to pursue efficiency through the establishment of transparent relations based on mutual trust.<sup>9</sup> Tax rulings and APAs serve as evidence of and also contribute to transparency in tax administration. By allowing the determination of the correct tax treatment on a real-time basis, either before or at the time the transaction or activity occurs,<sup>10</sup> they enhance tax compliance as well as fair and efficient taxation.<sup>11</sup>

In view of the above, it is no surprise that APAs and tax rulings have become a worldwide practice and that, in turn, they have caught the attention of national legislators and international organizations.<sup>12</sup>

### Historical Background

Italy's tax administration has a lot of experience with tax rulings.<sup>13</sup> This dates back to 1991 when the right of taxpayers to request the issuance of opinions from an advisory committee regarding the application of antiavoidance rules was first instituted.<sup>14</sup> Requests for those opinions had to refer to the application of a limited number of specified rules to concrete factual circumstances presented by the taxpayer (antiavoidance

ruling). The time of the transaction's occurrence was not relevant. In 1997 Italy introduced a procedure (advance clearing ruling) for taxpayers to request non-application of antiavoidance rules that would otherwise limit deductions, limit credits, and other similar tax advantages.<sup>15</sup> Taxpayers were required to file an application detailing the relevant operations, indicating the provisions where application was questioned, and explaining why the circumstance rendered the application of antiavoidance provisions unfair and inappropriate. Another milestone in the Italian tax ruling history occurred with the 2000 Charter of Taxpayers' Rights, which provided for tax rulings intended to clarify tax rules that are objectively unclear.<sup>16</sup> Notably, if the competent authority failed to issue a timely reply, the taxpayers' interpretation was presumed to be valid. Three years later, international tax rulings were introduced.<sup>17</sup>

Today, many different types of tax rulings, including APAs, are available to taxpayers in Italy. First, there are advance agreements for enterprises with international activities (advance agreements), including (i) unilateral, (ii) bilateral, and (iii) multilateral agreements between two or more related companies and the respective tax administrations in the countries where they are located.<sup>18</sup>

Another option is the use of advance tax rulings on new investments. These were recently introduced into Italian law amid other measures for economic growth and internationalization of enterprises.<sup>19</sup>

Further, there are various types of tax rulings that follow the same procedures for request and issuance:<sup>20</sup>

- interpretative or ordinary rulings;
- controlled foreign companies rulings;
- antiavoidance rulings; and
- advance clearing rulings.<sup>21</sup>

This article focuses on advance agreements and the recently introduced advance tax rulings on new investments.

<sup>8</sup>However, this function has been heavily questioned lately due to recent commission decisions to invalidate certain member states' rulings based on violations of EU state aid rules. See Piergiorgio Valente, *Manuale del Transfer Pricing* (2015), at 1560.

<sup>9</sup>Cf. OECD, "Co-operative Tax Compliance: Building Better Tax Control Frameworks" (May 2016). A cooperative compliance regime was introduced in Italy by virtue of Law No. 23 of Mar. 11, 2014; Legislative Decree No. 128 of Aug. 5, 2015; and Regulation No. 54237 of Apr. 14, 2016.

<sup>10</sup>In contrast, waiting until a dispute arises to determine tax treatment — a time that may be well after the subject transaction or activity occurred — can lead to the process being delayed or otherwise hindered by a lack of evidence or changes in personnel.

<sup>11</sup>André Barilari, French ex-general director for taxation, recognizes the advantages of "*procédures des rescrits*" (the tax rulings procedure), which can improve taxpayers' legal protection and promote a new culture of improved relations between taxpayers and tax authorities. Barilari, "Le Consentement à l' Impôt, Fragile Mais Indispensable Aporie," *Presses de Sciences Po* 121 (2000).

<sup>12</sup>Cf. Hugh Ault and Brian Arnold, *Comparative Income Taxation: A Structural Analysis* (3rd ed. rev., Feb. 2010).

<sup>13</sup>Cf. Carlo Romano, *Advance Tax Rulings and Principles of Law: Towards a European Tax Rulings System?* 399 et seq. (2002).

<sup>14</sup>Law No. 413 of Dec. 30, 1991, article 21.

<sup>15</sup>Legislative Decree No. 358 of Oct. 8, 1997, article 7, adding article 37-*bis* to Presidential Decree No. 600 of Sept. 29, 1973.

<sup>16</sup>Romano, *supra* note 13, at 400.

<sup>17</sup>See Valente, *Elusione Fiscale Internazionale* 2985 (2014).

<sup>18</sup>Regulation No. 42295 of Mar. 21, 2016, issued on the basis of authorization by Legislative Decree No. 147 of July 14, 2015, adopting measures for the purpose of development and internationalization of enterprises.

<sup>19</sup>Legislative Decree No. 147 and implementing Circular No. 25E of June 1, 2016. See also Valente, *supra* note 8, at 1956.

<sup>20</sup>Common procedures for issuance are provided among others under Circulars No. 32E of June 14, 2010, and 42E of Aug. 5, 2011.

<sup>21</sup>*Supra* note 17.

## Advance Agreements Under Italian Law

Regulation of advance agreements in Italy was updated by the Italian Revenue Agency (IRA) in early 2016. The new rules reference the procedure for concluding advance agreements,<sup>22</sup> which replace the now-abolished International Standard Ruling.<sup>23</sup> The update was part of efforts to promote economic development. The most important points of the new procedure are illustrated below.

### Scope

By definition, the scope of the advance agreement is limited compared to other types of tax rulings. The matters that may be determined via an Italian advance agreement are exhaustively listed in the applicable laws. Although its scope is broader than that of an APA as per the EU definition, it is still strictly limited to five issues. Specifically, an Italian advance agreement may determine:

- the calculation method for arm's-length price of transactions between group companies (transfer pricing methods), where at least one of the entities is not located in Italy;
- taxation of cross-border dividends, interest, royalties, and similar income;
- allocation of profits and losses between an Italian company and its foreign PE and the inverse;
- the existence of an Italian PE; and
- the value of a company's assets in case of transfer of tax residence.<sup>24</sup>

As indicated, an advance agreement may only be issued for transactions or activities with an international element. The limitation on the subject matter of advance agreements also means that only a limited group of taxpayers can be party to an advance agreement. Only taxpayers that can be involved in international transactions or activities have a legitimate interest to conclude an advance agreement.

Consequently, only those taxpayers may initiate the advance agreement procedure. In more detail, that right is granted to Italian companies:

- engaging in transactions with foreign members of the same group;
- holding or being held by non-Italian tax residents;
- paying or receiving passive income to or from non-Italian tax residents;

<sup>22</sup>*Supra* note 18.

<sup>23</sup>The International Standard Ruling procedure was provided by Legislative Decree No. 269 of Sept. 30, 2003, and abolished by Legislative Decree No. 147 of Sept. 14, 2015, which also authorized the issuance of Regulation No. 42295. See also Valente, *supra* note 8 at 1762 (providing an overview of the previously in force procedure for the *ruling di standard internazionale*).

<sup>24</sup>*Supra* note 18, at article 1, paras. 2-5.

- having a foreign PE;
- considering change of tax residence.

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

### The Advance Agreement Procedure

The procedure for obtaining an advance agreement begins with an entitled taxpayer filing an application with the competent tax authority, in this case with the Office for Advance Agreements and International Disputes of the IRA. Before initiating the application, the taxpayer can contact the competent authority informally for clarifications or instructions. The informal contact may involve a meeting or can even be made anonymously.

Close attention must be paid to the content of the application to ensure its admissibility. Specifically, every application must identify the applicant company in detail (including trade name, registered seat or tax residence, and VAT number), name a contact person, and (when relevant) identify the Italian PE.<sup>25</sup> The application must also demonstrate that it falls within the objective and subjective scope of the advance agreement procedure, as outlined above. Hence, it must clearly identify the subject matter of the requested advance agreement and evidence, through accompanying documentation, that the applicant company is entitled to file the application. The application must be signed by a person legally empowered to this effect.

To the benefit of taxpayers, an application lacking any of the above data is not declared directly inadmissible unless the omissions are not remedied by the applicant within 30 days from receipt of notice regarding the omission. Otherwise, the competent authority shall notify the applicant regarding the application's admissibility within 30 days from its receipt or from the remedy of any omissions.

In all cases, the applicant must illustrate and substantiate its view of the appropriate tax treatment. The application must also contain specific information related to the subject matter of the request. In transfer pricing cases, it must identify the foreign related company or companies and the transactions to be evaluated. To evaluate the attribution of income between a head office and PE, an application must provide evidence of the existence of the PE and the operation of both entities. When the taxation of passive income is at stake, the foreign counterparty must be indicated along with an analysis of its relationship with the applicant. If the advance agreement concerns the recognition or negation of Italian PE status, the activities or facts that might give rise to the existence of PE must

<sup>25</sup>To clarify, the address of the PE must be included when the advance agreement concerns the allocation of income between the PE and its foreign head office.



be detailed and evidenced through appropriate documentation. In cases involving a change of tax residence, information on the country of new tax residence and detailed description of the assets or business transferred must be submitted.

The procedure may last up to 180 days from the receipt of the application<sup>26</sup> and may or may not lead to an advance agreement. If an agreement is reached, it will specify the subject matter of the advance agreement, as per the application, and the terms on which the advance agreement was reached. An advance agreement is binding on the parties signing it regarding those matters alone and only if its terms are observed. When the advance agreement relates to the recognition or negation of Italian PE status, it must specify the factual circumstances that lead to the conclusion as well as the conditions for the validity of the advance agreement. The advance agreement is, in principle, valid for five years, including the year in which it was signed.<sup>27</sup>

In its regulation, the IRA outlines the procedure for considering an advance agreement. The competent authorities may ask the applicant to verify the completeness of the information furnished or produce further documentation<sup>28</sup> in order to decide on further actions to be taken. After making arrangements with the company, the authorities can access the company seat (or the Italian PE, where relevant) and are entitled to use any and all means of cooperation with foreign tax administrations in order to obtain needed information.

If the advance agreement concerns an Italian PE, the procedure is slightly different. There are no specific regulations to rule international cooperation, although the procedure as a whole is divided in stages. First, the tax authority reviews the documentation furnished by the company along with the application. Next, after making arrangements with the applicant, the authority visits the places where the activities that might lead to recognition of PE status take place.

In any case, the authorities may terminate the procedure if they become aware of any situation undermining the applicant's transparency.

<sup>26</sup>According to article 4, para. 4 of Regulation No. 42295, this time limit is extended if the competent authority activates international cooperation procedures (such as the Agreement on Mutual Administrative Assistance in Tax Matters) to obtain information from a foreign tax administration.

<sup>27</sup>An advance agreement may be terminated before its expiration in the following cases: (i) violation of the terms and conditions of the advance agreement by the company, which is not corrected in a timely manner; and (ii) change of factual or legal background, along with lack of agreement on a corresponding amendment, either due to lack of consent or the specific nature of the change.

<sup>28</sup>The procedure may be terminated if the applicant fails to produce any further documentation requested within the specified time frame.

## Compliance and Change of Circumstances

Each advance agreement contains the terms for its conclusion and any conditions for its validity. Noncompliance may lead to its termination while a change in the facts or law may demand its amendment to correspond to the new circumstances.

Compliance with the terms and conditions of the advance agreement may be verified during the period of the agreement. Regularly or upon request, the applicant must prepare and furnish evidence of its compliance. Further, upon previous arrangement, the company must allow access to its business premises<sup>29</sup> by authority representatives.

Following production of documentation or a visit to the premises, the authorities may ask the applicant to provide further information or clarifications. This allows the tax authorities to evaluate compliance with or violations of the advance agreement. Because one of the main purposes of an advance agreement is to enhance transparent and cooperative relations between tax authorities and taxpayers, it is important that the applicant duly fulfills these obligations. A lack of cooperation or transparency that prevents the authorities from effectively verifying compliance may amount to violation in itself.

On the other hand, instances of noncompliance with the terms and conditions of the advance agreement may only amount to violation if the effect is "substantially incompatible with the purpose of the Advance Agreement." A finding of a violation leads to termination of the advance agreement unless the company sufficiently contradicts the allegation within 30 days from receipt of notification. Termination may have a retroactive effect dating back to the effective date of the advance agreement when the time of the violation cannot be established.

If the factual or legal circumstances underlying the advance agreement change, it shall be renegotiated with a view to alignment with the new situation. Discussions may be initiated either by the competent authority or by the company. In the latter case, the company shall file an application for amendment, illustrating:

- the reasons why the change was not foreseeable at the time the advance agreement was concluded;
- the potential for the change to have a substantial impact on the existing terms of the advance agreement;
- the amendment proposed; and
- the factual and legal circumstances on which the amended advance agreement shall be based.

<sup>29</sup>Relevant premises are deemed to include its registered seat as well as any other place where the applicant company conducts its business activities.

The procedure for the renegotiation is similar to the procedure for the initial conclusion of the advance agreement and can last up to 180 days. The amended advance agreement is effective for the remaining term of the original advance agreement, meaning it will expire on the date that the original advance agreement would expire. If no agreement is reached on the proper amendment, the original advance agreement becomes null and void from the date of the change of circumstances.

### Renewal of the Advance Agreement

An advance agreement may be renewed for another 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 advance agreement. The tax authority must respond at least 15 days before the existing agreement is set to expire. Renewal is effective on the date the authority provides that notice.<sup>30</sup> As part of the (re)negotiation, the tax authorities can request that the company provide information and clarifications or furnish documentation. The authorities can also organize meetings with the company representatives as well as visit the business premises of the company/PE.

### Advance Tax Rulings on New Investments

One of the steps taken to attract investments in Italy in recent years was the introduction of advance tax rulings on new investments by virtue of a 2015 law and the IRA's implementing actions in 2016.<sup>31</sup> The regime aims to enhance legal certainty for potential investors in an expeditious manner by allowing for the advance determination of the taxation applicable to transactions or operations that are part of qualifying large investments. It appears to be a clear and user-friendly procedure that should serve as inspiration for other countries that wish to strengthen their investment environment.

#### Objective and Subjective Scope

The advance tax rulings on new investments regime is aimed at providing further clarity on the tax treatment of *significant investments*, including the treatment applicable to the business plan, any specific aspects thereof, or any relevant operations. It is meant to clarify:

- the interpretation, application, or nonapplication of tax rules on aspects of individualized investments;

<sup>30</sup>It may be concluded that lack of notification by the competent authority within the set deadline implies a failure to renew the existing advance agreement.

<sup>31</sup>Legislative Decree No. 147 of Sept. 14, 2015; Implementing Circular No. 25E of June 1, 2016.

- the assessment of any activities in the framework of the investment that may be deemed abusive; and/or
- the availability of tax schemes or arrangements in relation thereto.

Its scope includes any plan:

- for either a new economic activity (to be realized, for example, through the establishment of a company or the expansion of its activities), participation in the equity structuring of an existing economic activity, or a business restructuring;
- related to a company located in Italy;
- that would result in an increase in Italian tax revenue<sup>32</sup> and have positive effects on employment by creating new positions or helping to avoid the risk of losing existing employment opportunities; and
- with a value equal to or exceeding €30 million.

The value of the plan for the above purposes is the aggregate of all financial resources that will be employed for its implementation, regardless of whether they are sourced from the applicant or not. In cases involving an overlap between the scope of the advance tax ruling on new investments and that of the advance agreement, in principle, the latter prevails.

The procedure for the issuance of an advance tax ruling on new investments is available to a very broad range of persons, so long as they plan to proceed with a significant investment in Italy. In particular, the procedure is available to:

- individuals, any type of legal entity,<sup>33</sup> and trusts — irrespective of tax residence, main purpose, and presence in Italy; and
- Italian partnerships or equivalent associations, with the explicit exemption of simple partnerships.

The key precondition for the eligibility is the intention to effect a significant investment, as defined above.

#### The Procedure

Any person falling within the subjective scope of the advance tax ruling on new investments may initiate the procedure for its issuance through an application with the Office for Rulings on New Investments of IRA's Central Directorate for Tax Legislation (the competent

<sup>32</sup>The effects on Italian tax revenue must derive directly from the investment in question.

<sup>33</sup>Legal persons include any type of entity or trust that may or may not have as its main purpose the conduct of the relevant business activity as well as partnerships, with the exception of simple partnerships. This includes groups of companies and other groupings such as joint ventures and European Economic Interest Groupings.

authority for purposes of these agreements).<sup>34</sup> The application must be filed before the deadline for compliance with the rules referenced in the plan or it may be declared inadmissible. However, it may be filed regardless of whether the referenced plan has been implemented. In any case, the filing of the application does not imply suspension of any deadlines under Italian tax laws.

Beyond laying out the foregoing, Circular 25E of January 6, 2016, goes into detail as to the requirements for the content of the application. It must sufficiently identify the applicant as well as any other investor(s), providing the name (or trade name), legal representative, tax residence, VAT number, and similar information. It must be signed by the individual applicant or the representative of the legal person. To allow the authority to verify that the investment in question falls within the objective scope of the advance tax ruling on new investments, an analysis of the investment plan, as well as of any envisaged operations related thereto, must be provided, focusing on the qualities rendering it a *significant investment*, as defined above. For this reason, it is essential to show how the applicant arrived at the estimated value for the investment and the various stages of the investment plan. The application must also note the legal provisions relevant to the proposal and include a substantiated illustration of the view of the applicant as to its application.<sup>35</sup> For applications involving the restructuring of an existing company, the application must also contain details on the recovery plan (the planned steps to achieve the recovery), as well as the action plan (the operations within the scope of the investment).

Any and all supporting documentation must be attached to the application, unless it is already available to the competent authority. Finally, the content of the application may not include issues falling under the scope of assessment activities, such as refund requests and annulment of assessment notices.

Lack of the foregoing information does not necessarily mean the application is inadmissible. Instead, to the applicant's benefit (and to the benefit of the other investors in the project), it can only be declared inadmissible if it lacks information considered essential and those omissions are not remedied within 30 days from receipt of a relevant request from the competent au-

thority. The only essential aspects are the identification of the applicant and the description of the investment. The lack of other content can be remedied in the course of the application procedure itself, including through discussions between the authority and the applicant or during a visit by the authority to the relevant business premises.

The procedure for an advance tax ruling on new investments may, in principle, last up to 120 days from receipt of the application. However, the time may be extended if the application lacks the information needed to determine the issues raised and the omission(s) is not remedied in the course of the ordinary procedure. In that case, the applicant should furnish all relevant documentation, and the deadline for the procedure will expire 90 days from that production.<sup>36</sup> If the competent authority fails to meet these deadlines, the tax treatment stipulated by the applicant, and found to be correct in the respective application regarding the investment plan (including the options and actions needed for its implementation), is deemed accepted.

During the procedure for the issuance of an advance tax ruling on new investments, the actions that the competent authority may take are substantially similar to the ones stipulated above for the conclusion of advance agreements. Hence, the authority can plan meetings with the applicant or its legal representatives and can, following prior arrangement, visit its business premises.

Once stipulated, the advance tax ruling on new investments binds the tax authority and is effective in favor of the applicant, all other investors, and any new legal entity resulting from the investment. It remains effective until a change occurs in the factual and legal circumstances forming its background. This is a notable difference from the advance agreement which has a time frame for expiration. It is not subject to amendment, with sole exception of when the law changes due to regulatory changes or court decisions.<sup>37</sup>

### Invalidity

As with an advance agreement, the competent authority verifies the application of an advance tax ruling on new investments and also verifies the ongoing existence of the factual and legal circumstances that lead to its issuance. The advance tax ruling on new investments is rendered null and void if the competent authority discovers a change in the factual and legal background or its misrepresentation by the applicant during its issuance procedure. ◆

<sup>36</sup>Failure to produce within one year from receipt of the request is deemed a waiver of the application.

<sup>37</sup>Only a decision from the Italian Constitutional Court or Supreme Court, or by the Court of Justice of the European Union, is sufficient to lead to an amendment.

<sup>34</sup>Specific conditions (to submit an APA application) apply for businesses participating in the cooperative compliance regime in accordance with Law No. 23 of Mar. 11, 2014, and its implementing legislation, that is, Legislative Decree No. 128 of Aug. 5, 2015, and Regulation No. 54237 of Apr. 14, 2016.

<sup>35</sup>When the questions raised refer to the correct interpretation of a tax law provision, an additional precondition for the admissibility of the application is that there is objective uncertainty as to the provision's interpretation. Objective uncertainty does not exist when the IRA has issued an official interpretation of the provision in question.