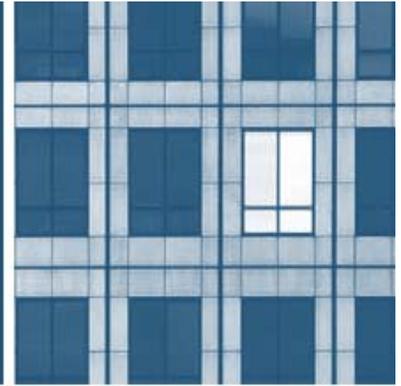


On the Subject



U.S. & International Tax Advisory

October 5, 2010

Multinational enterprises engaged in intercompany operations with their Italian subsidiaries need to make a significant effort in the coming months to comply with the new Italian TPD standards.

Italian Revenue Agency Publishes Detailed Regulations on Transfer Pricing Documentation

On 29 September 2010 the Italian Revenue Agency issued detailed regulations setting out the contents of the standard transfer pricing documentation (TPD) necessary to avoid penalties in the case of transfer pricing adjustments.

As anticipated by our *On the Subject* of 30 June 2010, new legislation has been enacted in Italy which, for the first time, introduces a specific provision on TPD (article 26 of Law Decree no. 78 of 31 May 2010). This new provision basically states that where an adjustment to intercompany transfer prices is made by the tax authorities, no penalty can be imposed on the taxpayer if the latter, during the audit, provides the tax auditors with appropriate documentation to allow them to inspect the arm's length nature of the transactions.

The documentation to be provided by the taxpayer must comply with the requirements specified by the Revenue Agency's detailed regulations (the Regulations), issued on 29 September 2010.

In line with general expectations, the Regulations require a standard set of TPD, which follows the approach taken by the EU Council Resolution of 27 June 2006 on a Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (the EU Code of Conduct). In fact, the standardised TPD consists of two separate sets of documents:

- The Masterfile, containing common standardised information relevant to all the group members. The Masterfile should provide information such as a general description of the

business and business strategy, the group transfer pricing policy, the transactions involving associated enterprises, and the functions performed and risks assumed

- Country-Specific Documentation, which should include information such as amounts of transaction flows within Italy, a comparability analysis including contractual terms and functional analysis, an explanation of the particular transfer pricing methods used, and information on internal and/or external comparables if available

For Italian holding companies of multinational groups the TPD required consists of both the Masterfile and Country-Specific Documentation. For Italian subsidiaries of foreign-based multinationals, only the Country-Specific Documentation is required. If a foreign-based multinational has an Italian subsidiary which controls one or more companies resident outside of Italy, the Italian subsidiary qualifies as a "sub-holding" and is required to set up the Masterfile (even though the information provided may be limited to the business carried out by the "sub-group") in addition to the Country-Specific Documentation. The same requirements also apply to permanent establishments of foreign enterprises in Italy.

The Regulations specify that the TPD must be updated annually. Only small and medium-sized enterprises (defined as those with a turnover not higher than EUR 50 million) are allowed to update certain items of information (such as the comparability analysis) every three years.

All documents must be in Italian language. The only possible exception to this requirement applies to "sub-holding" companies that deliver the Masterfile containing information related to the whole group and not limited to the "sub-group": In this case the Masterfile can be provided in English.

The Regulations provide for a 10-day term for the taxpayer to deliver the TPD starting from the relevant request made by the tax auditors during an inspection. If the need arises for further information, the taxpayer must provide the additional documentation within seven days of the request, or within a longer term assigned by the tax auditors in the case of complex

controls, provided that such longer term is compatible with the timing of the inspection. If the taxpayer fails to deliver the TPD or the additional documentation requested within the prescribed term, the Revenue Agency is not bound to refrain from imposing penalties in the case of transfer pricing adjustments.

Similarly, the Revenue Agency may still impose penalties if it finds that the TPD delivered by the taxpayer, though formally in line with the required standards, is incomplete or provides false information, unless the missing or incorrect information does not undermine the effectiveness of the tax auditors' inspection.

One particular feature of the new law is that the existence of the TPD and its timely delivery to the tax auditors are not *per se* sufficient to avoid the imposition of penalties on the taxpayer. In fact, a communication to the tax authorities of the existence of the required TPD is also a necessary condition for the non-imposition of penalties. In this respect, the Regulations specify that the communication of the existence of the TPD must be made in the annual tax return. As regards previous fiscal years, the law states that the relevant communication must be filed within 90 days of the issuance of the Regulations (*i.e.*, by 28 December 2010). While the Regulations, of course, could not change the strict deadline provided for by the law, the Revenue Agency has specified that a communication filed after such deadline will still be considered valid upon the condition that it is filed before any audit or inspection activity is commenced by the tax authorities.

There are a number of critical issues arising from the new law and its detailed Regulations. Among others, the discretionary power of the tax auditors to request additional documentation (possibly assigning a short term for its delivery) seems too broad, as there are no specifications or limitations to define the cases in which such power can be exercised. This may constitute a major factor of uncertainty for taxpayers: The effectiveness of the efforts necessary to comply with the burdensome TPD requirements may be at serious risk if the tax authorities will be exercising their power to submit additional requests extensively, and claiming the applicability of penalties in cases where the

taxpayer does not fulfil those additional requests in a timely manner. Given the aggressive attitude showed by the Italian tax authorities in recent years, it can be expected that this point will be very controversial.

Multinational enterprises engaged in intercompany operations with their Italian subsidiaries need to make a significant effort in the coming months to comply with the new Italian TPD standards. It is hoped that these efforts will be worthwhile.

For more information, please contact your regular McDermott lawyer, or:

Mario Martinelli: +39 06 4620241 mmartinelli@mwe.com

For more information about McDermott Will & Emery visit: www.mwe.com

IRS Circular 230 Disclosure: To comply with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained herein (including any attachments), unless specifically stated otherwise, is not intended or written to be used, and cannot be used, for the purposes of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter herein.

The material in this publication may not be reproduced, in whole or part without acknowledgement of its source and copyright. *On the Subject* is intended to provide information of general interest in a summary manner and should not be construed as individual legal advice. Readers should consult with their McDermott Will & Emery lawyer or other professional counsel before acting on the information contained in this publication.

© 2010 McDermott Will & Emery. The following legal entities are collectively referred to as "McDermott Will & Emery," "McDermott" or "the Firm": McDermott Will & Emery LLP, McDermott Will & Emery/Stanbrook LLP, McDermott Will & Emery Rechtsanwälte Steuerberater LLP, MWE Steuerberatungsgesellschaft mbH, McDermott Will & Emery Studio Legale Associato and McDermott Will & Emery UK LLP. McDermott Will & Emery has a strategic alliance with MWE China Law Offices, a separate law firm. These entities coordinate their activities through service agreements. This communication may be considered attorney advertising. Previous results are not a guarantee of future outcome.