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## Italy Clarifies, Amends Transfer Pricing Rules

**TP ALERT 2014-008**  
14 April 2014



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Italy's Finance Act for 2014 delivered a long-awaited clarification on the applicability of the Italian Regional Tax on Business Activities (IRAP) to transfer pricing adjustments, and introduced changes to the transfer pricing rules applicable to businesses involved in online advertising.

Beginning in fiscal year 2008, the computation rules for IRAP, which until then had been based on the profit and loss results (gross of payroll costs and interest paid, but net of interest received), reevaluated pursuant to the provisions of the Income Tax Code, were amended so that the reference to the latter was eliminated. Because compliance with the arm's length standard is a requirement imposed by the Income Tax Code, it was deemed possible to exclude transfer pricing adjustments for IRAP purposes.

The tax authorities and most tax offices always challenged that interpretation, and continued assessing transfer pricing violations for IRAP purposes, forcing taxpayers to make a difficult decision whether or not to accept assessments or resort to complex litigation.

The Finance Act -- Law no. 147 of 27 December 2013, in force from January 1, 2014 -- has solved the issue, confirming that IRAP will apply to transfer pricing adjustments. The law implicitly admits that the previous legislation was confusing, because the new law provides that no administrative penalties will be imposed for IRAP purposes in cases of transfer pricing assessments related to fiscal years 2008 through 2012, except for tax assessments that were already final on or before December 31, 2013.

### **New transfer pricing rules for companies engaged in online advertising services**

The Finance Act also introduced a special regime regarding the determination of profits of multinational enterprises that operate in Italy in the online advertising services industry.

This measure was inspired by OECD discussions regarding base erosion and profit shifting, with particular reference to the electronic commerce sector.

The new rule limits the choice of profit level indicators that may be used to determine the transfer prices of Italian-based companies that belong to multinational groups that operate in the online advertising sector. Specifically, the new regime will apply to companies based in Italy that have intercompany relationships with foreign entities of the same group and are engaged in the sale of online advertisements or undertake ancillary activities relevant thereto.

Those companies will no longer be allowed to be remunerated based on cost-plus methodologies, and that limitation could be overcome only through an advance

pricing agreement.

The new rules are effective January 1, 2014; however, no implementation decree or any tax authority guidance have been issued regarding: the kind of activities that will be included in the definition of “provision of online advertising services.”

### **Scope of advance tax ruling procedure expanded**

Article 7 of the Law Decree called “Destinazione Italia” issued by the Italian government on December 23, 2013, as converted by the Law of February 21, 2014, expands the scope of the advance tax ruling procedure to allow nonresident entities operating in Italy to request a ruling from the tax authorities on whether the nonresident’s activities create a permanent establishment in Italy under Italian domestic law or tax treaty provisions.

According to the decree, the initial ruling application must contain a description of the nonresident’s activities to be carried out in Italy. Based on this information and discussions with the nonresident (and its Italian tax advisors), the Italian tax authorities will determine whether a permanent establishment would be created.

The new measure extends a ruling’s term from three to five tax years -- the year in which the agreement is concluded and the subsequent four years.

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