Tax Administration Releases Data on International Standard Ruling Procedures and First International Advance Pricing Agreements

The authors consider the recently published report by the Italian tax administration containing data on international standard ruling procedures and the first APAs agreed in Italy.

1. Introduction

On 19 March 2013, the Italian tax administration (Agenzia delle Entrate) published the second International Standard Ruling Report on international standard ruling procedures (the Report) that includes also data on the first advance pricing agreements (APAs) in which the Italian tax administration has participated in collaboration with foreign tax administrations. The Report deals with the procedures undertaken and signed in the period 2009-2012 and compares the data concerning, in particular, the Italian international standard ruling procedures with surveys carried out on the same procedures as initiated in the period 2004-2008.¹ The data relating to APAs refer only to the period 2010-2012.

The international standard ruling, introduced with article 8 of Decree-Law 269 of 30 September 2003 and which came into force in 2004, is a procedure that allows enterprises engaging in international activity to agree in advance with the Italian tax administration as regards:
- the correct transfer pricing methodology applicable to transactions carried out with related parties, as provided for by paragraph 7 of article 110 of Presidential Decree 917 of 22 December 1986 (Testo Unico delle Imposte sui Redditi);
- the tax treatment provided for by law, including tax treaties, in respect of dividends, interest, royalties or other income paid to or received from non-resident persons in specific cases; and
- the application of provisions of law, including tax treaties, to specific cases involving the attribution of profit or loss to permanent establishments in Italy belonging to non-resident enterprises, as well as to permanent establishments abroad belonging to resident enterprises.

treaty so provides, the dispute will be resolved through recourse to independent arbitration (article 25(5) of the OECD Model).2

The first APA procedures involving the Italian tax administration were initiated by taxpayers (enterprises) in the final months of 2010.

Compared to the agreement signed under article 8 of Decree-Law 269 of 30 September 2003 which binds only the Italian tax administration, bilateral or multilateral APAs are shared and signed between Italian and the relevant foreign tax administrations. This ensures that international groups are able to avoid double or multiple taxation in respect of cross-border transactions falling within the scope of the mutual agreement.

As highlighted by the tax administration in the Report, the involvement of the Italian tax administration in the activation of APAs in accordance with an international treaty, improves and strengthens the process, already taken by the Italian standard ruling, of tax compliance, cooperation, transparency and information symmetry between the tax administration and taxpayers. This is to the benefit of taxpayers, as it mitigates and eliminates double taxation, as well as to the benefit of the tax administration by reducing recourse to litigation.

2. Analysing the Data

According to the Report, 95 applications were filed in the four-year period between 2009 and 2012, which is a significant increase when compared to the 40 applications filed in between 2004 and 2008. Of those 95 applications, 21 concern bilateral or multilateral APAs.

Of the overall total of 135 procedures commenced since 2004, 56 have been completed and 54 were still at the preliminary stage at the end of 2012. The remainder are those applications that were either rejected or withdrawn by one or both parties.

Out of the 54 mentioned above, there were 19 APA procedures pending as of 31 December 2012 involving the Italian tax administration and the tax administrations of France, Germany, Japan, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States.

For those procedures that were discontinued, according to the Report of the tax administration, the main reasons for interruption by the taxpayer included changes to the objective or subjective requirements as a result of corporate restructuring which took place during the preliminary stage. Reasons for interruption on the part of the tax administration include a lack of cooperation on the part of the taxpayer when responding to the requests made during the preliminary stage.

Duration of the procedures

With regard to only Italian international standard ruling procedures, the average time for completing the final agreement is estimated at 16 months. This duration is calculated as the difference between the date on which the agreement was signed and the date the application was filed. Also taking into account periods of inactivity or delays by the taxpayer in providing documentation and information requested during the preliminary stage. According to the Report of the Italian tax administration, many procedures required 7 to 12 months to complete, and as many were concluded in 13 to 24 months, whereas the remaining were concluded within six months or after two years.

The most important and encouraging data, according to the tax administration, is that the average time taken over the last four years is significantly less than the processing times recorded in the period between 2004 and 2009 (20 months). This demonstrates the increased efficiency and speed of the preliminary stage owing to the improved understanding over time of the institutes. Of the 37 agreements entered into between 2010 and 2012, as many as 20 were concluded within one year, bringing the average duration down to 15 months and thus marking a gradual improvement.

Type of taxpayer

Taxpayers that have filed an application to initiate one of the procedures in question are mainly medium-sized to large firms in terms of turnover. Approximately 68% recorded a turnover of over EUR 100 million in 2010, while almost 17% recorded a turnover of between EUR 25 million and EUR 100 million.

The business sectors of the taxpayers that submitted applications include different sectors of industry, commerce and services. The distribution between taxpayers that engage in production activities (52%) and taxpayers operating in the commercial and services sectors in general (48%) is fairly well balanced.

The production sectors that are more involved are the chemical industry and mechanical, electrical and electronic industries; in commerce, wholesale distribution is the most represented sector; and as regards services, IT services, financial services and business-to-business services are among the most represented. More specifically, the tax administration emphasized that among the firms engaged in production activities, almost one third operate in highly specialized and high-tech areas (such as the IT or electronics sector).

2. G. Peracin & S. Benettin, New Guidelines from Tax Authorities on Management of Tax Disputes under Mutual Agreement Procedures,19 Intl. Transfer Pricing J. 6, Journals IBFD. (The introduction of paragraph 5, according to the Commentary on Article 25 of the OECD Model, has the primary purpose of increasing the actual success of the resolution of disputes with a MAP (with paragraph 5 representing the final stage) through independent decisions that are binding on the contracting states. However, its application and effectiveness depend on the compatibility of arbitration with the domestic rules of each state and on the binding nature of an arbitration decision. For this reason, each state may decide to introduce its bilateral income tax treaties paragraph 5 in its standard treaty formulation or to include paragraph 5 but limiting its application to certain specific cases.)

3. The same analysis was not possible for initiated APAs because at the end of 2012 they were all still at the preliminary stage.

4. The parameter used to analyse taxpayer size is the turnover produced in highly specialized and high-tech areas (such as the IT or electronics sector).
Subject matter of agreements

At the end, the Report provides a table (shown here in full) in which agreements concluded as of 31 December 2012 are listed according to the international tax issue in question, based on the taxpayer’s requirements: transfer prices; attribution of profit or loss to a permanent establishment; and the application of regulations (including tax treaties) to paid or received interest, dividends, royalties and other cross-border income items. See Table 1.5

<table>
<thead>
<tr>
<th>Type of transaction</th>
<th>2004-2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer prices: Production</td>
<td>11</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>22</td>
</tr>
<tr>
<td>Transfer prices: Distribution</td>
<td>5</td>
<td>3</td>
<td>4</td>
<td>7</td>
<td>19</td>
</tr>
<tr>
<td>Transfer prices: Performance of services</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>Transfer prices: Royalties</td>
<td>1</td>
<td>0</td>
<td>3</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Application to the specific case of the regulations concerning paid or received dividends, interest or royalties</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Attribution of profits or losses to a permanent establishment</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Cost-sharing agreements</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>23</td>
<td>8</td>
<td>13</td>
<td>20</td>
<td>64</td>
</tr>
</tbody>
</table>

The majority of the agreements signed (89%) concerned the correct determination of intra-group transfer prices according to free market values. The tax administration reports that the transactional net margin method was adopted in 56% of the agreements with taxpayers, among the internationally recognized methods for evaluating the correct transfer price for companies in the same group.6

This signals a decline in the use of traditional methods (CUP method, cost-plus method and resale price method) (21%), in favour of so-called transactional profit methods (TNMM and profit split) (79%), and better represent the complexity of the elements affecting the structure of operations within international groups.

In some cases, in order to eliminate any differences (with regard to the functions carried out, risks assumed and assets held) between the comparables identified during the preliminary stage and the taxpayer, the tax administration made appropriate adjustments to the balance sheet data, as indicated by OECD practice.

3. Conclusion

The data and information published and illustrated by the tax administration about mutual resolution procedures between the tax administration and taxpayers to avoid double taxation involving cross-border intercompany transactions, shows the increasing interest of the concerned parties (taxpayers and the tax administration) to achieve lasting agreements that allow taxpayers (enterprises especially) to engage in international businesses according to the arm’s length principle, while observing the fair and proper distribution across the states of economic results and taxable income.

According to the Report of the tax administration, the greatest difficulties related to improving the compliance process between the tax administration and taxpayers are seen during the preparatory stage of the procedure, when the tax administration requires information or further documentation in order to obtain more in-depth knowledge of the taxpayer. This difficulty in cooperation, at times, causes an interruption of dialogue and of the mutual procedure, and often extends the time required to draw up the final agreement, thus slowing down the procedure.

5. The total number of agreements given in the current table does not coincide with the number of “Ruling agreements concluded during the 2004-2009 period” according to Table 1, as an agreement may also include more than one kind of transaction between related parties. Agenzia delle Entrate, supra n. 1.

6. The most widely used profit level indicators (PLIs) are the markup on total costs and return on sales.