

Italy implements changes to its transfer pricing and patent box regime

Law Decree n. 50/2017 replaces the concept of “normal value” with a transfer pricing method that is in line with the **OECD arm’s length principle**, adds **corresponding adjustments** to Italian tax law, and updates the list of intellectual property that can qualify for the **patent box** regime.

A. ITALY TRANSFER PRICING

Transfer pricing has gained increasing attention in recent years in Italy. In 2010, Italy introduced a penalty protection regime together with early recognition of the 2010 OECD Guidelines. Italy also requires reporting of the totals of inter-company transactions in the annual income tax return (“Modello Unico”). These latter developments have significantly enhanced the profile of transfer pricing in Italy with a much broader level of awareness and general interest, both from MNE’s side and tax Authority one.

Before Law Decree n. 50/2017 was enacted, transfer pricing analysis were based on the “**normal value**” **standard**, according to which transactions occurred between related parties that were not in line with said criterion may have been challenged by the Italian Tax Authorities.

According to the replaced criterion, the “normal value” was meant to be “the average price or consideration paid for goods and services of the same or similar type, carried on at market conditions and at the same level of business, at the time and place in which the goods were purchased or the services were performed”.

Furthermore, for the determination of the normal value, reference should have been made to the extent possible to the price list of the

provider of goods or services. In the absence of the provider’s price list, reference should have been made to the price lists issued by the Chamber of Commerce and to professional tariffs, taking into account usual discounts.

In the recent years, the Italian doctrine and professionals pointed out that the “normal value” standard was not always consistent with the OECD arm’s length criterion, and even though the 2010 Decision of the Commissioner of Italy Revenue Agency directly recognized the 2010 OECD standard, the Income Tax Law still referred to the “normal value” criterion.

In addition, transfer pricing adjustments were directly applicable if the result of the tax audit was an increase of the taxable income. If the result was a decrease in taxable income (**corresponding adjustment**), transfer pricing adjustment could be admitted only in compliance with agreements concluded by the competent authorities of foreign States in accordance with the mutual agreement procedures provided for by international conventions for the avoidance of double taxation.

Law Decree n. 50/2017 replaces the “normal value” standard with a transfer pricing method that is in line with the OECD arm’s length principle. Accordingly, Italy’s tax authorities may make transfer pricing adjustments if operations carried out between related parties are not in line with conditions and prices that unrelated parties performing in a free/open competition and in comparable circumstances would have agreed.

Furthermore, the Law states that the Ministry of Finance may issue regulations to set up best practices in line with the international consensus to implement the principles stated in the new provision of the Income Tax Law.



Moreover, the Law includes provisions for **corresponding adjustments** following a transfer pricing adjustment that results in a decrease in taxable income.

Said corresponding adjustments can now be made:

- to respect agreements concluded with foreign state competent authorities pursuant to a tax treaty mutual agreement procedures;
- after tax audits carried out in the context of international cooperation activities whose results are shared by the participating States;
- **at the request of a taxpayer if a transfer pricing adjustment involves a country with which Italy has an in-force tax Treaty with adequate exchange of information provisions.**

B. ITALY'S PATENT BOX

Italy has enhanced in 2015 its first Patent Box regime, an optional tax benefit allowing reduced taxation for income arising from the direct use or licensing of intellectual property assets by companies and commercial entities performing research and development activities. Italy's patent box regime follows the recent European trend (Action 5 – Final Report on “Countering harmful tax practices more effectively, taking into account transparency and substance”) to assess appealing tax measures in order to attract foreign investments and relocate IP assets.

The tax benefit consists of an exclusion from the taxable base – for both corporation tax (IRES, with an ordinary rate of 27.5% / 24% since tax year 2017) and regional tax (IRAP, with an ordinary rate of 3.9%) purposes – of a percentage of the income sourced from the exploitation of qualified intellectual property assets. The percentage of income excluded is set at 50% from tax year 2017 onwards.

All businesses whose income derive from the direct exploitation or the licensing of IP assets and who performed R&D activities in order to maintain, enhance or develop their IP assets, are entitled to benefit from the tax allowance.

Furthermore, the OECD principles and in particular the “nexus approach” rule, provide that all the beneficiaries of the incentive shall be the real holders of business income originating from IPs and who bore the R&D costs related to the relevant IP assets.

Before D.L. 50/2017 the concept of intellectual property set by the Italian law considered a wide range of assets, in particular to trademarks, know-how and design models.

The new Law (D.L. 50/2017) updates the list of intellectual property that can benefit from the tax deduction of the patent box regime. The list now includes software protected by copyright; industrial patents; business, commercial, design models that are capable of legal protection; industrial and scientific information and know-how that is secret and capable of legal protection.

Incomes arising from registered or unregistered trademarks are excluded from the tax benefit if the application for the patent box regime are exercised from tax year 2017.

The tax benefit still applies to patent box procedures started in tax year 2015 and 2016.

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