Tax news

November 2018

Transfer Pricing Adjustment and VAT

In Ruling answer No. 60, the Italian Tax Authorities provided for the first time guidance on how to assess whether a TP adjustment can be relevant for VAT purposes. On the basis of this guidance, businesses should review their TP policy, in order to assess the potential VAT implications of their TP adjustments.

The Italian Tax Authorities conclude that the factual and legal circumstances that qualify the payment of contributions/adjustments should be verified on a case-by-case basis.

The transfer pricing model examined by the Tax Authorities refers to the case in which a company achieves a margin in a financial year that falls outside the interquartile range of reference; in this case, the intercompany agreement provides for "specific adjustments" to be made with regard to this company, which in any case are compliant with the arm's length principle.

Qualification of the adjustment

For the purposes of VAT application, it is necessary to classify the amount paid as an adjustment, in order to verify whether that amount:

1. constitutes the payment for a supply of services, resulting from an obligation to do or not to do, or
2. should be treated as an increase or decrease in the taxable amount of the original transactions.

With reference to the first case, the Court of Justice of the European Union has established that a supply of services is made against a consideration and, therefore, constitutes a taxable transaction only where there is a legal relationship between the supplier and the user, expressed in an exchange of services, in which the payment received by the supplier constitutes the actual value of the service provided to the user and there is a direct link between the service provided and the value received.

While as regards case no. 2, i.e. the possibility to include the adjustment among the changes in the taxable amount, the European Commission, in document no. 923 of 28 February 2017, considered that transfer pricing adjustments (either increases or decreases) may have implications for VAT purposes, for example, where such adjustments can be considered more or less as a payment made for a supply of goods or a supply of already taxable services, provided that the payment is directly related to such supply.

VAT profiles

In the opinion of the Tax Authorities, in order to characterize the TP adjustment as a relevant modification of the VAT taxable amount of an intercompany transaction, the following conditions must be met:

1. the TP adjustment must result in a payment, either monetary or in kind;
2. the payment must be attributable to a specific supply of goods or services;
3. there must be a direct link between the supply of goods or services and the payment.

According to the Tax Authorities, a TP adjustment can be considered as a relevant increase or decrease of the VAT taxable base of an intercompany supply of goods or services and is therefore subject to VAT only if all the above three conditions are met. As the Tax Authorities established that these conditions were not met in the case under ruling, the adjustment had to be considered as out of the scope of VAT.

Flash News

Legislative Decree implementing ATAD approved by the Council of Ministers

On 28 November 2018, the Council of Ministers approved the Legislative Decree implementing the Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, as amended by Council Directive (EU) 2017/952 of 29 May 2017 (Anti-Tax Avoidance Directive (ATAD)).

In particular, the Legislative Decree will amend current legislation on:

- interest limitation rules;
- exit taxation rules;
- controlled foreign company (CFC) rules;
- taxation of foreign dividends and capital gains; and
- hybrid mismatches.

Details on the new measures will be reported upon publication of the Legislative Decree in the Official Gazette.

Italy Clarifies Treatment of Loss Resulting from Application of Patent Box Regime

The Italian Tax Authorities published Ruling No. 74 of 19 November 2018 on the treatment of losses resulting from the application of Italy's patent box regime, which provides for a 50% exemption of qualifying income from qualifying IP. The ruling concerns a company that wanted to opt for the regime from 2016 in respect of software income. In calculating the effect of applying the regime, the company determined that the amount of income qualifying for exemption would exceed the statutory profit for the year, resulting in a loss, and requested confirmation on the treatment of such a loss in subsequent years. The Ruling clarifies that the negative result (loss) that is derived from the application of the patent box regime may be carried forward to subsequent years in accordance with the ordinary loss carry-forward rules.

PA between Italy and Moldova – authorization for negotiations by Moldova

On 14 November 2018, the government of Moldova authorized the start of negotiations for an investment protection agreement (IPA) between Italy and Moldova. The IPA between Italy and Moldova, signed on 19 September 1997, expired on 26 August 2016, in accordance with article 14 of the agreement. However, for investments made before 26 August 2016, the agreement shall remain in force for a period of 5 years.

Protocol to treaty between Austria and Italy – authorization for negotiations by Austria

On 14 November 2018, the Austrian Council of Ministers authorized the Minister of Finance to start negotiations for an amending protocol to update the Austria - Italy Income and Capital Tax Treaty (1981), as amended by the 1987 protocol.

Interest deduction – clarifications issued

On 5 November 2018, the Italian Tax Authorities issued Ruling Answer No. 62 providing clarifications on interest deduction rules.

Under article 96 of the Italian Income Tax Act, interest expenses are deductible up to an amount equal to interest income accrued in the same fiscal year. Any excess over that amount is deductible up to 30% of the gross operating income (earnings before interest, taxes, depreciation and amortization, EBITDA) derived through the core business of the company. However, this limitation does not apply, *inter alia*, to qualifying companies established for the construction and operation of freight terminals.

In the case at issue, company A, established for the construction and operation of freight terminals, absorbed the existing company Z, which provided a number of freight terminal management services. Company Z had interest expenses not yet deducted and was subject to the ordinary interest deduction rules. ITA confirmed that, following the merger, company A may deduct such interest expenses. However, the limitation provided by the ordinary interest deduction rules continues to apply, due to the fact that the relevant interest expenses were incurred by a person to which the exception does not apply.

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Clients are encouraged to seek appropriate professional advice.

We will be pleased to discuss with you the particular application of the changes to your own circumstances.
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Some pieces of news herein contained may be material to Advisory Services issues. Clients who are interested in delving into these items are encouraged to contact Stefano Salvadeo, Advisory Services specialist, at the following email address:
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