

Unilateral corresponding downward adjustments

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Introduction

Article 59 of Decree-Law 50/2017 introduced improved provisions concerning transfer pricing and instruments for the avoidance or reduction of double taxation.

On the one hand, Article 110(7) of the Income Tax Code endorsed new principles introduced by Actions 8 to 10 of the Base Erosion and Profit Shifting (BEPS) project and the 2017 Organisation for Economic Cooperation and Development Transfer Pricing Guidelines for Multinational Enterprises and Administrations, with a specific reference to the Ministry of Finance's new implementing provisions of 14 May 2018, which are based on international best practices.

Conversely, Article 31^{quater} of Presidential Decree 600/1973 introduced new provisions that allow the Tax Administration to introduce unilateral corresponding downward adjustments to eliminate double taxation where a foreign tax authority makes a primary adjustment as a result of applying the arm's-length principle to transactions involving associated enterprises in a different tax jurisdiction.

This new administrative procedure aims to accelerate the resolution of double taxation deriving from transfer pricing adjustments under the existing context of mutual agreement procedures.

Reductions of Italian taxable income based on the arm's-length principle are allowed only in the following cases set out in the new Article 31^{quater} of Presidential Decree 600/1973:

- on the basis of mutual agreement procedures (pursuant to international tax treaties or EU Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises);
- following tax inspections into international cooperation activities whose outcomes are shared by the participating countries; or
- following the filing of a specific request with the Tax Authorities if the primary adjustment involved a state with which Italy has a tax treaty to avoid double taxation that provides an adequate exchange of information.

With respect to the third bullet, on 30 May 2018 the director of the Revenue Agency issued Decision 108954/2018, according to which Italian companies and permanent establishments of foreign companies that have realised intercompany transactions in the context of Article 110(7) of the Tax Code (including transactions among Italian companies and their foreign permanent establishments) may benefit from the new instrument in order to reduce or avoid double taxation.

Preliminary conditions

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The conditions needed to commence this procedure are as follows:

- the primary adjustment in the foreign country must be final (or at a final stage);
- the primary adjustment in the foreign country must comply with the arm's-length principle; and
- the jurisdiction where the primary adjustment is set must have entered into a double tax treaty with Italy which includes an adequate exchange of information.

In the initial filing, the taxpayer must also point out which instrument for the resolution of international tax issues it wants to activate simultaneously with respect to the downward adjustment requested (ie, a mutual agreement procedure, the arbitration convention or another instrument, which could include the EU Tax Dispute Resolution Directive (2017/1852/EC) once it has been implemented in Italy). The request must be filed within the specific deadline established by the instrument selected.

Elements to be included in filing

The request must include all information usually requested concerning the instruments that the taxpayer selects to resolve an international tax issue. Further, if the upward adjustment in the corresponding jurisdiction is not yet final (eg, it can be challenged or settled), the request must specify the stage of the foreign procedure and the possible facts on which the upward adjustment depends to become final. A courtesy Italian (or English) translation of the foreign tax deeds and all factual, such as legal and background, elements that allow an evaluation of whether the upward adjustment in the foreign country complies with the arm's-length principle must also be attached.

The Revenue Agency will decide the request admissible within 30 days of receipt, provided that it contains all of the required formal elements indicated in the provisions.

If the request cannot be processed due to a failed requirement, the Revenue Agency will inform the taxpayer of the missing documentation and it will have 30 days to complete the initial filing. If the taxpayer does not provide the additional documents within the 30 days or the additional documentation provided is not considered consistent with the request, the filing will be declared inadmissible.

Procedure

The Revenue Agency may invite the taxpayer to discuss the issues examined or require additional documentation when examining such a matter. After each meeting, a copy of the relevant minutes will be provided to the taxpayer. The procedure should be concluded within 180 days with recognition or denial of the unilateral corresponding adjustment. In the case of recognition, the Revenue Agency will inform the tax administration of the foreign country in question of the downward adjustment. After receipt of the certificate issued by the foreign tax authorities or similar documentation proving that the (foreign) upward adjustment is final, a central Revenue Agency office provision will recognise the downward adjustment in correspondence of the definitive adjustment performed by the foreign tax authorities. It will then notify the decision to the competent local Revenue Agency office, which will carry out the procedure needed to make it effective.

Termination

The procedure may be interrupted where:

- the taxpayer fails to provide the required documents or information by the specified deadline without a justified reason; or
- the taxpayer is subject to serious penalties concerning the subject of its request for a downward adjustment.

Mutual agreement procedure in case of negative outcome

If an Italian downward adjustment is denied, the taxpayer can benefit from a mutual agreement procedure (or alternative procedure) activated simultaneously through the initial filing.

Comment

Through the introduction of the unilateral downward corresponding adjustment, taxpayers can benefit from an instrument that enables a faster elimination of double taxation on profits of a resident company or permanent establishment in case of transfer pricing upward adjustments made by foreign tax authorities.

Previously, this possibility was impermissible, as Article 110(7) allowed a downward adjustment only in cases of a mutual agreement procedure concluded in accordance to a specific convention to avoid double taxation.

With the introduction of Article 31^{quater} to Presidential Decree 600/1973, Italy appears to have aligned itself with the international standards set out in Action 14 of the BEPS project and implemented a new instrument to reduce the time taken to resolve mutual agreement procedure requests and the number of unresolved mutual agreement procedures.

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