



CRA Insights: Transfer Pricing

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France and Italy Documentation Requirements—A Comparative View

By Alberto Pluviano



Both Italy and France have recently finalised their transfer pricing documentation regulations by issuing administrative instructions on, respectively, December 15, and December 23, 2010.

The two countries' regulations differ quite significantly despite the fact that both are explicitly inspired by the European Union Code of Conduct on transfer pricing documentation. This article provides a comparative review of some of the key features of each set of regulations. The objective is not to provide an exhaustive list of all of the detailed requirements but rather to highlight some significant differences and key practical aspects to be taken into account when developing transfer pricing documentation for either country.

Formal requirements

France: Transfer pricing documentation is a formal requirement (applying to fiscal years as of January 1, 2010).¹

Italy: Transfer pricing documentation is optional but highly recommended in many cases because:

- It protects from the very significant penalties that are normally applied in case of a tax adjustment, and
- Its existence (or not) will be considered as an element of the risk assessment analyses performed by the tax administration.

Penalty protection will be granted only if the documentation strictly adheres to the detailed Italian requirements in terms of document structure, format, content, language, formal communication to tax authorities, and delivery deadlines. The Italian regulation applies to fiscal years as of May 31, 2010.

¹ An articulated set of exemptions apply to small and medium enterprises normally referring to a threshold of 400 million euros for the revenue or total assets of the company or its parent companies or its subsidiaries.

Previous years

France: Previous years will be audited following the prior rules. This means that the French tax authorities can also ask for detailed explanations and documents for the previous years based on the existing rules.

Italy: Taxpayers could also obtain penalty protection for previous years by preparing documentation and notifying its existence to the tax authorities by December 28, 2010; however, if no audit has started or been notified yet, this option is still available.

Structure

France: The required documentation structure is similar to the “master file” and “country file” structure recommended by the European Union Code of Conduct.²

Italy: Taxpayers are divided into four categories: holding companies,³ sub-holdings,⁴ subsidiaries,⁵ and permanent establishments. The structure of the documentation is different for each category. The segmentation seems to be aimed at allowing each type of entity to prepare documentation based on information it should have reasonable access to. Accordingly, a holding company is required to develop a full package (master file plus country file); a sub-holding company must also provide both master and country files but its master file need only cover the entities in its sub-group;⁶ subsidiaries have to develop only a country file; and permanent establishments must follow the same requirements applying to the category to which their foreign “head office” belongs.

Level of detail

France: The list of subjects to be covered by the documentation is similar to the list provided by the European Union Code of Conduct.⁷ The administrative instruction states that documentation should consist of a relatively general document (in practice, not expected to exceed 50 pages) that should provide the key information necessary for the tax authorities to assess the consistency of the transfer pricing policy with the arm’s-length principle and “OECD standards.” The instruction also notes that the tax auditors have the right to request additional details on specific transactions.

Italy: The list of subjects to be covered by the documentation is similar to the list provided by the European Union Code of Conduct, but the Italian regulations also include very detailed descriptions of specific items that must be included in each section of the document. This approach raises some real concerns for taxpayers:

- that the effort required to prepare such a document might be significant;
- that there appears to be very limited flexibility to adapt the prescribed structure and details to specific features of the entity or its business; and
- that a formalistic approach could lead the tax authorities to readily challenge documentation that has been prepared if it appears to lack some of the compulsory elements.

² Under the model of the European Union (EU) Code of Conduct, each EU country’s documentation will consist of two elements:

- The master file, common to all EU companies of the multinational group, containing all common information, and
- The country file, including only the set of data and information specific to the country.

³ A “holding” company is defined by the Italian administrative instruction as a company residing in Italy, not controlled by any other company, and controlling one or more foreign subsidiaries and/or sub-holdings.

⁴ “Sub-holding” is defined by the Italian administrative instruction as a company residing in Italy, controlled by another (resident or non-resident) company, and controlling one or more foreign subsidiaries.

⁵ “Subsidiary” is defined by the Italian administrative instruction as a company residing in Italy, controlled by another (resident or non-resident) company, and not controlling any foreign company.

⁶ Alternatively, a sub-holding company can provide the entire group’s master file.

⁷ E.g., description of the activity, description of the legal and operational structures of the group, functions and risks, list of intangibles, description of the group transfer pricing policy, etc.

Contemporaneity

France: Documentation only needs to be submitted in the event of an audit, but the administrative instruction stresses the importance of building documentation on a contemporary basis and of monitoring the arm's-length nature of transfer prices.

Italy: Taxpayers must notify tax authorities of the existence of transfer pricing documentation at the time of filing the annual tax return although it only needs to be submitted at the beginning of a tax audit.

Deadlines

France: Documentation must be available on the first day of an audit. If not available, or only partially available, the tax administration will make a formal request for the requested documentation within 30 days. A longer delay may be granted under special circumstances on a case-by-case basis.

Italy: Documentation must be delivered within 10 days of a request. In the case of supplemental requests, the deadline is seven days. An extension may be granted under special circumstances on a case-by-case basis.

Language

France: The administrative instruction specifies that the tax administration *may* request the translation into French of documents written in a foreign language. The French rules appear, therefore, to be in-line with the European Union Code of Conduct recommendation that Member States should accept documents in a foreign language as much as possible.

Italy: In general, the documentation must be in Italian, including the master file of the “holding” category. The only exception where a master file in English may be accepted is for the “sub-holding” category if it is compliant with the specific Italian requirements although this would mean submitting information on entities outside the sub-holding group. A master file that covers only the sub-holding group must be in Italian. In all cases, the country file must be in Italian. The administrative instruction states that additional attachments can be provided in English (but this seems to refer only to documents that would provide details beyond the compulsory requirements).

Practical implementation

France: For groups that have already adopted the master file structure for their documentation in other countries, the adaptation to French requirements will normally not require major adjustments. Care must be taken to ensure compliance with the list of specific French requirements, but this should not represent a major concern for many taxpayers. It is also important to note the spirit in which the instruction is written, which suggests that substance of documentation is more important than the form, i.e., that there should be a focus on a useful explanation.

Italy: Even groups that have already adopted the master file structure for their documentation in other countries may need to make significant adaptations in order to ensure compliance with the detailed structure and content required by the Italian rules.

Communication aspects

For both countries, it is important to consider the preparation of documentation package as one element of a broader communication strategy with tax authorities. Proper communication with tax authorities during an audit is always very important in order to prevent misunderstandings and to favour a balanced and constructive approach. In the case of France and Italy, the communication aspects are particularly important due to local practices.

France: Traditionally, tax authorities tend to show a pragmatic approach to transfer pricing issues and an interest in hearing the taxpayer's business arguments. In addition, it is often possible, even in the case of a tax adjustment, to discuss the issue at higher levels of the tax administration and bring practical arguments that support the taxpayer's defence.

Italy: Traditionally, the audit approach is more formalistic. This raises some concern that a formalistic approach could prevail in the audit of transfer pricing documentation prepared on the basis of the new regulations. On the other hand, the Italian administrative instruction states that the new documentation rules are a step toward enhanced relationships with the taxpayers.

Conclusion

Despite significant differences in the detail, both the French and Italian documentation regulations explicitly refer to the European Union Code of Conduct and the OECD *Transfer Pricing Guidelines*.

From an operational perspective, the new regulations provide further support for adopting a master file-based approach given the number of European countries that now refer to it and the practical solution it provides for achieving consistency and handling an increasing number of documents.

Both France and Italy have been perceived in the past by some taxpayers as "difficult" countries from a transfer pricing perspective. It will therefore be important to monitor the actual behaviour of the tax authorities in transfer pricing audits in light of the new regulations.

Alberto Pluviano
Principal
Paris
+33-1-7038-5440 tel
apluviano@crai.com

www.crai.com/transferpricing



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