Transfer pricing spotlight: Italy, Spain, and other global hot topics
The Dbriefs Transfer Pricing series

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Polling question #1

Have you already prepared country-by-country (CbC) reporting in advance to know how your “tax picture” looks like before December 2017?

• Yes
• No
• Don’t know/Not applicable
Agenda

Country-by-country reporting and TP landscape
- Italy
- Spain

Tax audit plan and new functions assigned to the Advance Pricing Agreement (APA) Office
- Italy
- Spain

Patent box elective tax regime
- Italy
- Spain

Recent important cases
- Italy
- Spain

Question & answer
Country-by-country reporting and TP landscape
Italy
Country-by-country reporting


The Italian 2016 Budget Law introduced the CbC reporting requirement effective from January 2016.

On February 2017 implementation of CbC Reporting by means of the issuance of a specific Decree.

It is still to be issued the Regulations of the Italian Revenue Agency on the operating aspects of the filing.

Scope of CbC reporting

- **Ultimate parent company** (the entity of a multinational group, not controlled by any other company, ultimately required to prepare the consolidated financial statements)

- Consolidated turnover greater than or equal to € 750 millions for the preceding annual accounting period

Timing of CbC reporting

- First taxable year for which the CbCR is required: FY 2016

- Submission deadline: 12 months after end of reporting period

Notification requirements

- Notification with tax return. Deadline: 9 months after year end (30 September 2017 for companies which closed the FY as of 31.12.2016)
## Country-by-country reporting

### Content of CbC reporting

<table>
<thead>
<tr>
<th>Topic</th>
<th>Description</th>
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<tbody>
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<td><strong>Information included in the template</strong></td>
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</table>
| **Information on the allocation of income and resources of the Group for Tax Jurisdiction** | • Sum of the revenues achieved in a given country, with evidence of those from related and third parties;  
• Sum of the profit (loss) before income tax for all the entities resident for tax purposes in the relevant tax jurisdiction;  
• Sum of the current tax expense of the group in each country (both in terms of tax due and cash flow);  
• Sum of the stated capital (including the free capital of the permanent establishments) of all the entities resident for tax purposes in the relevant tax jurisdiction;  
• Sum of the total accumulated earnings of all the entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year;  
• Number of employees working in the various countries in which the group operates;  
• Net book values of tangible assets (other than cash and equivalent) of all the entities resident for tax purposes in the relevant tax jurisdiction. |
| **Information on the individual group entities** | • Tax jurisdiction of residence;  
• Tax jurisdiction of the entity at the time of the incorporation;  
• Activities carried out by each entity of the group. |
Spain
Spain—Transfer pricing landscape (I)

• Spain has introduced about 90% of BEPS Actions (hybrids, TP documentation, “substance over form”, PE, Treaty benefits (LOB), Intangibles, etc.)

• Model 231: “Country-by-Country Reporting” Due Dec 2017 (FY2016)

• Model 232: Due Nov 2017 (FY2016). Due May 2018 (FY2017)
  – Intercompany transactions
  – Transactions with tax havens
  – Patent Box transactions

• APA: 4 year roll back
Tax audit plan and new functions assigned to the Advance Pricing Agreement (APA) Office
Italy
New functions assigned to the APA Office

- Ministry of Finance was the Competent Authority for MAPs until 31st December 2016.
- Starting from 1st January 2017 the competence of MAP procedures related to cases in which the Taxpayer is identified was switched to the Ruling Office (Tax Agency).
- Ministry of Finance will continue to be competent for MAP on general issues related to the interpretation or application of Tax Conventions.

**Ministry of Finance**

Starting from 01st January 2017 the competence of MAP procedures switches to Ruling Office (Tax Authority).

**Ruling Office (TAX Authorities)**

Competent for:
- APA Program
- APA for Patent Box
- MAP (since January 17)
- Support and coordination of TP and Patent Box audits
- Rulings on the existence of a PE
Spain
Spain—Transfer pricing landscape (II)
Controversy

**Tax audit plan:**

- Transfer pricing:
  - Review complex corporate restructuring transactions
  - Intragroup services
  - Intangible transactions
  - The correct use of TNMM
- The use of hybrid instruments or double dip instruments
- Leveraged acquisitions of shares
- Transactions with entities resident in tax havens
- The use of conduit companies, especially for royalties and dividends
- Investigate the existence of permanent establishments in Spain and its profit allocation
Transfer pricing spotlight: Italy, Spain, and other global hot topics

Controversy (cont.)

Spain—Transfer pricing landscape (II)

The Spanish Tax Agency, (AEAT, from its Spanish acronym), has created the National Bureau of International Taxation (ONFI).

• Assist tax agencies around the country on TP related matters
• Maintain a specialized valuation team (intangibles, business valuation, non-listed shares, etc.)
• Act as the competent authority for APAs and MAPs
• Control and coordinate joint tax audits with foreign tax authorities
• Issue technical reports to establish tax criteria, guide tax decisions and propose legislative changes in line with EU and OECD (BEPS) initiatives
Polling question #2

Have you seen an increase in tax scrutiny compared to the pre-BEPS period?

• Yes
• No
• Very similar
• Don’t know/Not applicable
Patent box elective tax regime
Italy
### Patent box elective tax regime

- Introduced by Italian **2015 Budget Law**.
- On **July 30, 2015** a Decree by the Ministry of Finance and the Ministry of Economic Development implementing the Patent Box regime was issued.

<table>
<thead>
<tr>
<th><strong>Aim of patent box regime</strong></th>
<th><strong>Scope of patent box regime</strong></th>
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<tr>
<td>Elective tax regime that allows companies to benefit from a 50% exemption from corporate income tax (&quot;IRES&quot;), and local tax (&quot;IRAP&quot;), on income derived from the direct/indirect exploitation of qualifying IP.</td>
<td>Patent Box regime can be elected by taxpayers carrying out business activities including, among the others, Italian branches of non-resident entities provided that these entities are resident in a country with which Italy has a bilateral tax treaty ensuring an effective exchange of information and that the qualifying IP is attributable to them.</td>
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<td>The exemption was equal to 30% for fiscal year 2015 and to 40% for fiscal year 2016.</td>
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Patent box elective tax regime (cont.)

**Qualified IPs**

- Industrial patents (already granted or in the process of being granted),
- Software protected by copyright,
- Trademarks (including collective brands) already registered or in the process of being registered—until fiscal years initiated in 2016,
- Models and designs capable of being legally protected,
- Business and technical-industrial know-how.

**Qualified income**

- In case of indirect use of the IP: royalties earned in the year net of expenditures related to IP assets being relevant for tax purposes
- In case of direct use of the IP: embedded IP income from the sale of products and the use of processes net of expenditures related to IP assets being relevant for tax purposes directly

**Nexus ratio**
Option

• The option of the elective tax regime is characterized by a 5 years lock-in period, it is irrevocable and renewable.

• The option of the elective tax regime had to be disclosed through a specific communication form for fiscal years 2015 and 2016. Starting from fiscal 2017 the option will be disclosed directly through the tax return.

• If the qualified income is determined through a ruling procedure, the option is effective from the fiscal year in which the ruling was filed.
Spain
Spain—Patent box regime

• Can get APA on (i) IP qualification and (ii) pricing
• Changes in 2016:
  − Tax credit = 60% of profit from IP exploitation
  − Tax credit reduced if creation of IP is partly performed by another entity (Nexus approach – BEPS Action 5)
  − Patent Box is applicable to 3rd party transfer of IP (not intercompany)
  − IP does not need to be booked as an Asset
  − No specific limit to tax credit (only general Corporate Income tax limit)
  − IP eligible: Design models, patents and Know-how
  − IP not eligible: Brand, literary, music, audiovisual, image rights, software, or any other not included above
Polling question #3

Are you applying patent box tax credits within your organization?

- Yes
- No
- Don’t know/Not applicable
Recent important cases
Italy
Recent important cases

**Importance of “TP Analysis”**

- **Decision No 4904/2016 issued by Provincial Tax Court of Milan**

- **Decision No 3590/2016 issued by Regional Tax Court of Lombardia**

The mentioned decisions stated the paramount importance of an appropriate selection of the transfer pricing methods, the analysis of the functions and risks and the selection of comparable companies with regards to the assessment the arm’s length value of the intercompany transactions.

The intention of the judges is to inhibit the application of arbitrary mechanism which are in contrast with the correct comparability standards set forth by the Italian and international rules.
Recent important cases (cont.)

**Interest-free loans**

- **Decision No. 15005/2015 issued by Supreme Court**
  - Lawfulness of interest-free loan, but inapplicability of TP rules in such cases because they do not imply any income component (in line with previous Supreme Court Sentence N. 27087/2014).

- **Decision No. 7493/2016 issued by Supreme Court**

- **Decision No. 13387/2016 issued by Supreme Court**
  - Both the decisions contradict previous conclusions about inapplicability of TP rules in case of interest-free loans. They highlight the need to analyse the substance of the financial transaction in question and refer to benchmark analysis as suggested by the OECD TP Guidelines.
Spain
Spain—Recent important cases

**Depreciation of Portfolio:** Supreme Court, May 31st, 2016 (rec. nº 58/2015)

- Challenge for tax deduction: Intragroup acquisition of shares and further depreciation
  - Depreciation of acquiring value. Challenged the purchase value (Net Book Value) by indicating that assets were not booked at fair market value
  - Increase of value by purchasing and capitalizing subsidiary’s debt
    - Court indicated that 3rd parties would have not acquired loans
    - Company indicated that there is an active market to purchase loans that are apparently uncollectible
Spain—Recent important cases (cont.)

Management Fees

• UK Parent. Service charges to Spanish subsidiary
• Court acknowledged that the taxpayer provided “abundant” and “diverse” documentation (e.g. contracts, invoices, profit and loss accounts of the parent company departments whose expenses were being re-invoiced, description of the services, functional analysis, etc.).
• But concluded:
  – The required connection between the taxpayer’s expenses and income was not proved
  – A reallocation of the group expenses underlies the transactions
• Non-deductibility and penalty (even though documentation requirements were met)
Polling question #4

Have you encountered challenges to deductibility assertions when charging management fees abroad?

• Yes
• No
• Don’t know/Not applicable
Question and answer
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Acronyms used in presentation

- **CbC**—Country-by-country
- **APA**—Advance Pricing Agreement
- **BEPS**—Base Erosion and Profit Shifting
- **OECD**—Organization for Economic Co-operation and Development
- **CbCR**—Country-by-country reporting
- **MAP**—Mutual Agreement Procedure
- **IRES**—Italian Corporate Income Tax
- **IRAP**—Italian Local Business Tax
- **IPs**—Intellectual properties
- **TNMM**— Transactional net margin method
- **LOB**—Limitation on benefits
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