Crowe Horwath

Distributing burden of proof between tax administration and taxpayer in transfer pricing procedures: towards a shared approach

Rome – Ostia Lido – March 15, 2013

Avv. Gaetano Pizzitola – *Cross-Border Tax and Transfer Pricing Partner* at Crowe Horwath

Taxpayers' Bill of Rights

- *The relationship between taxpayer and tax authorities will be based on the principles of bona fide cooperation*

- Revenues – Right to increase the taxable base
  1) The burden of proof is on the Tax Administration (i.e. the plaintiff) – <u>constitutive fact</u> of its claim
  2) The burden of disproving the Tax Administration allegations is on the Taxpayer – obstructive, modifying or extinguishing facts to 1)

- Costs – Right to decrease the taxable base
  1) The burden of proof is on the Taxpayer – <u>constitutive fact</u> of its right to claim
  2) The burden of disproving the Taxpayer allegations is on the Tax Administration – obstructive, modifying or extinguishing facts to 1)

Burden of Proof – General rule

- General rules on the attribution of the burden of proof - Article 2697 of the Italian Civil Code

  "*Whoever wishes to enforce a right in court shall prove the facts constituting the Claim. The party challenging the validity of those facts or claiming that the enforced right has changed or is extinguished shall prove the facts on which such objection is based*"

- Revenues – Right to increase the taxable base
  1) The burden of proof is on the Tax Administration (i.e. the plaintiff) – constitutive fact of its claim
  2) The burden of disproving the Tax Administration allegations is on the Taxpayer – obstructive, modifying or extinguishing facts to 1)

- Costs – Right to decrease the taxable base
  1) The burden of proof is on the Taxpayer – constitutive fact of its right to claim
  2) The burden of disproving the Taxpayer allegations is on the Tax Administration – obstructive, modifying or extinguishing facts to 1)

“Shared” Burden of Proof

- From a formalistic standpoint, the burden to prove the adoption of transfer pricing avoidance mechanism is naturally on the Tax Administration in carrying out its “control” activity on the tax payer auto-computation of tax due

- Taxpayer has to prove the compliance of the prices adopted to the arm’s length principle, by keeping appropriate support documentation / argumentations, … after the tax administration have *prima facie* proved a divergence from the arm’s length principle

> *“the taxpayer is not required to prove the correctness of the transfer prices applied, if the tax authority did not prove <u>prima facie</u> the infringement of the normal value principle.”*

“Shared” Burden of Proof

- OECD Transfer Pricing Guidelines, paragraph 18

  “In seeking to achieve the balance between the interests of taxpayers and tax administrators in a way that is fair to all parties, it is necessary to consider all aspects of the system that are relevant in a transfer pricing case. One such aspect is the allocation of the burden of proof. In most jurisdictions, the tax administration bears the burden of proof, which may require the tax administration to make a prima facie showing that the taxpayer’s pricing is inconsistent with the arm’s length principle. It should be noted, however, that even in such a case a tax administration might still reasonably oblige the taxpayer to produce its records to enable the tax administration to undertake its examination of the controlled transactions. [*omissis*].”

“Shared” Burden of Proof – Tax administration side

- How Tax Administration could prove the existence of transfer pricing avoidance mechanism / the infringement of the normal value principle?

  1) Analysis of the documentation/ argumentations provided by the Taxpayer

  2) Anti-avoidance rule and taxation level

  3) Analysis of the fact and circumstances of the business / of the company (5 comparability factor)

  4) Analysis of the Transfer Pricing policy adopted

  5) Discrepancies between 1) and/or 2) and/or 3) and/or 4)

“Shared” Burden of Proof – Tax payer side

- How taxpayer could prove the compliance of the prices adopted to the arm’s length principle?

1) Documentation and argumentations consigned to the Tax Administation

2) Analysis of the discrepancies identified by the Tax Administration

3) Explanations on the fact and circumstances analyzed by the Tax Administration in order to argument/ provide evidence on the coherence between the latter and the Transfer Pricing adopted
    - *Characteristics of property and/or services* – comparability differences
    - *Functional profile* – higher / lower functions and/or risks
    - *Contractual terms* – different level of commitment / duties
    - *Economic circumstances* – different market / specific circumstances
    - *Business Strategies* – start-up position / new product / aggregated transactions

"Shared" Burden of Proof – Tax audit experiences

- Not a clear-cut between
  1) Tax administration *prima facie* burden of proof
  2) Tax payer *shifted* burden of proof / argumentations

- Being the Transfer Pricing and economic science, a shared analysis/ evaluation is generally required

- Analysis of fact and circumstances that indirectly support / disregard the Transfer Pricing adopted

- Same facts and circumstances v/s different reading keys

- Advance cross-examination procedure as value added required procedure for both (i) Tax Administration and (ii) Tax Payer

“Shared” Burden of Proof – Transfer Pricing documentation

- As a proof of the arm’s length nature of the I/C transactions
- As a proof of the absence of any anti-avoidance scheme
- As a proof that a documental set of information is being provided in order to allow the Tax Administration to control that the transfer prices are consistent
- As a proof of cooperation

… but in case of objections by the Tax administration, proving its facts, the burden of proof is shifted back to Taxpayer