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**Tax assessment in the field of transfer pricing**  
**A comparison between Italy and Germany**  
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*The regime of proof in the Italian perspective (domestic provisions and case-law)*

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# INTRODUCTION

- In Italy there are about 13.741 companies controlled by non-residents (statistics for 2010 issued by the Italian Institute of Statistics, ISTAT, in 2012)
- The “transfer price” issue is becoming more important than in the past
- Tax Authority and taxpayers shall cooperate in the tax assessment with regard to the correct price of the goods and services transferred within a group. For this reason the burden of proof issue is relevant
- In Italy there are two different approaches about the burden of proof in transfer pricing tax assessment and litigation depending on the interpretation given to the transfer pricing rules



Anti-avoidance rule or not?



## 1. THE RELEVANT RULES IN ITALY

- **Article 110, par. 7**, Income Tax Code:

*«The components of income arising from transactions with non-resident companies, which directly or indirectly control the resident company, [...], are valued based on the market value [...], if it results an increase in the income;*

*the same shall also apply if it results a decrease in income, but only in the implementation of the agreements concluded with the competent authorities of foreign states to following the special "mutual agreement procedure" provided by international conventions against double taxation of income [...].».*

- **Article 2697** of the Italian Civil Code provides, as a general rule governing the burden of proof, that:

*«Whoever wants to enforce a right before a court must prove the facts on which the right is based. Who pleads the invalidity of such facts [...] must prove the facts on which the defense is based».*



## 1. THE RELEVANT RULES IN ITALY

In order to understand how the burden of proof is distributed in case of tax assessments relating to the transfer price in Italy, it is necessary to keep in mind:

- a) the OECD Guidelines (2010) on transfer pricing;
- b) the interpretation given by the Court of Justice of the European Union;
- c) and, finally, the interpretation given by the Italian Supreme Court.

## 2. The burden of proof according to the OECD and the EU Court of Justice

OECD Guidelines (2010) Chapter I, par. 1.2. point out that:

- *«the need to make adjustments to approximate arm's length transactions arises irrespective of any contractual obligation undertaken by the parties to pay a particular price or of any intention of the parties to minimize tax»*
- *«a tax adjustment under the arm's length principle would not affect the underlying contractual obligations for non-tax purposes between the associated enterprises, and may be appropriate even where there is no intent to minimize or avoid tax»*
- *«The consideration of transfer pricing should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer pricing policies may be used for such purposes»*



## 2. The burden of proof according to the OECD and the EU Court of Justice

With specific reference to the burden of proof, the OECD Guidelines have pointed out that (Chapter IV, par. B.2):

- the burden of proof rules for tax cases differs among OECD member countries
  - If in a country the burden of proof is on the tax administration, the taxpayer may prove the correctness of its transfer pricing unless the tax administration proves that the price applied is inconsistent with the arm's length principle
  - it would be appropriate for both taxpayers and tax administrations to take special care and to use restraint in relying on the burden of proof in the course of the examination

**EU Court of Justice 21 January 2010 in Case C-311/08:** the Court has stated, *inter alia*, that the TP rules shall not have an anti-avoidance purpose.



### 3. The burden of proof in Italy

#### Two different approaches:

- **the first (minor approach)** – Article 110, par. 7, Income Tax Code has *not* an anti-avoidance purpose

- **the second (major approach)** – Article 110, par. 7, Income Tax Code has an anti-avoidance purpose



Different conclusions about the burden of proof in the TP analysis



### 3. The burden of proof in Italy: the FIRST approach

#### According to the first approach:

- Article 110, paragraph 7, Income Tax Code does not have anti-avoidance purposes because:
  - a) the TP rules regards firstly the taxpayer
  - b) the taxpayer has no choice, he must use the criterion of the arm's length principle
- Supreme Court 31 March 2011, No. 7343
  - a) *«the only legal criterion to be adopted for the evaluation is the market value... with absolute irrelevance of the economic reasons for which the taxpayer has fixed a lesser price»* and, hence,
  - b) *«the domestic provision requires (primarily) to the taxpayer ... the criterion of "market value"»*.



### 3. The burden of proof in Italy: the FIRST approach

#### According to the first approach:

- Supreme Court 19 October 2012, No. 17953
  - a) TP rules «*does not contain a presumption (even if rebuttable, or not rebuttable) of the perception of a fee other than those agreed*»
  - b) the Tax Authority may not justify a tax assessment for TP based on the lower tax rate of the other country.
  - c) the Tax Authority must prove the correct price without any economic analysis of the specific case.
  - d) the taxpayer shall (only) prove the contrary (i.e. by the documentation)



### 3. The burden of proof in Italy: the SECOND approach

#### According to the second approach:

- Article 110, paragraph 7, Income Tax Code have anti-avoidance purposes because:
  - a) it prevent unfair transfer of profits
  - b) it faces the abuse of law
- Supreme Court 13 October 2016, No. 22023
  - a) *«the only legal criterion to be adopted for the evaluation is the market value... with absolute irrelevance of the economic reasons for which the taxpayer has fixed a lesser price»* and, hence,
  - b) *«the domestic provision requires (primarily) to the taxpayer ... the criterion of "market value"»*
- Supreme Court 16 May 2007, No. 11226 (casella Ford Italia)  
*«The Tax Authority, [...], should, first of all, assess **if the taxation level is lower in the other country than in Italy**. Second, determine the market value of vehicles purchased by Ford Italia».*



### 3. The burden of proof in Italy: the SECOND approach

**This approach, also, comes to the conclusion that:**

- The burden of proof depends on the event that the Tax Authority would recover to the taxpayer a LOWER COST or a HIGHER REVENUE (Supreme Court July 13, 2012, n. 11949):
  - a) if LOWER COST: the taxpayer must prove that such costs are real and related to the business
  - b) If HIGHER REVENUE: no burden of proof on the taxpayer of the existence of the revenue and the relation with the business.
- The case of Supreme Court July 13, 2012, n. 11949: tax recovery of an adjustment (increasing) of some costs made by an Italian company on the last day of the fiscal year
- According to the Supreme Court:
  - a) the TP rule is an anti-avoidance rule
  - b) the burden of proof, therefore, is on the Tax Authority BUT the taxpayer shall demonstrate that his transaction is not tax



## 4. Conclusion

- The second approach (anti-avoidance rule) does not seem correct according to the OECD Guidelines
- The prove of the absence of a lower level of taxation in the other State seems quite impossible
- On the contrary, the first approach seems correct. In this case the burden of proof concerns only the analysis of the price not also other indexes as the lower level of taxation of the other State.

*THANK YOU FOR YOUR KIND ATTENTION*

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