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Mutual Agreement Procedures Case Studies

Dott. Andrea Ferrario, Studio Tributario e Societario – Deloitte

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MAP

Recap on theory

MAP - Recap on theory

MUTUAL AGREEMENT PROCEDURE (MAP)

The MAP is an instrument aimed at the **resolution of international tax disputes** whenever a **person** considers that the **actions** of one or both of the **Contracting States'** Tax Administrations result, or will result, in **a double taxation in the States involved**

The MAP allows the **Competent Authorities** designated from the governments of the Contracting States to **interact** with the aim of solving the international tax dispute and eliminate the double taxation

MAP - Recap on theory

Mutual agreement procedures can be of **two different types**, each characterized by its own scope of application and peculiar features

	MAP pursuant to the Arbitration Convention 90/436/EEC («AC MAP»)	***MAP pursuant to a Bilateral Double Taxation Convention («DTC MAP»)***
Current application	Under the current regulation, the AC MAP allows to cover the following disputes: ▪ Transfer Pricing issues ▪ Attribution of the profits to PEs The States are obliged to settle and when an agreement is not reached between the involved States the decision is passed on to an Arbitration Court	• The DTC MAP allows to cover all disputes related to the elements under the relevant Treaties (e.g. royalty, interests, dividends, transfer pricing, residence, attribution of profits to PEs, etc.) • States are generally not obliged to settle
Future application	The **EU Directive 2017/1852** on tax dispute resolution mechanisms (that will apply to any complaint submitted from July 1, 2019 onwards relating to disputes on income or capital earned in a tax year commencing on or after January 1, 2018) will extend the application of the AC MAP to all double taxation issues	Following BEPS Action 14, the new Treaties signed by Italy (with Hong Kong, Congo and Chile) and the Multilateral OECD Convention provide for the Arbitration clause when States do not eliminate the double taxation. The Decision would be binding on the involved States

MAP - Recap on theory

MAP pursuant to a Bilateral Double Taxation Convention

DTC MAP

Features	Application
1 Subjective scope	Art. 25 of the Model Convention states that any «***person***» considering that he has been, or will be *likely*, subjected to taxation not in accordance with the Convention is entitled to submit the case to the Competent Authority of his State of residence, or (according to Art. 24) of the State of which he is a national Therefore, despite not all the Bilateral DTC contain explicit reference to both the concepts of «residence» and «nationality», they all make reference to the possibility for both **individuals** and **legal entities** (or enterprises, or associations – in general, any person liable to tax and resident for tax purposes in the jurisdiction of the State concerned) to submit a DTC MAP when considering to be, or to risk to be, unfairly and/or double taxed
2 Objective scope	With regard to the objective scope of application of the provisions in the OECD Model Convention (and, therefore, in the Bilateral DTCs) allowing taxpayers to submit a DTC MAP, this has to be considered as comprehensive of **all those cases regarding *juridical* and *economical* double taxation suitable to affect both the individuals and legal entities to which the Convention applies**

Juridical double taxation arises when one item of income (e.g., dividends or interest) is taxed twice or more in the hands of the same taxpayer in two or more States

Economic double taxation arises where two or more different taxpayers are taxed by two or more States in respect of the same income

MAP - Recap on theory

MAP pursuant to a Bilateral Double Taxation Convention

Features	Application
3 The role of the taxpayer	The DTC MAP is a dispute resolution mechanism between Contracting States in the exercise of their tax sovereignty: consequently, **the *only* parties involved in the procedure are the Competent Authorities of the two Contracting States**, entitled to sign the bilateral agreement potentially reached The taxpayer is **invited to provide all the relevant information**, assuming a **co-operative, transparent behavior** in accordance with the principle of good faith; in any case, he is **entitled to be informed about the development of the procedure**
4 Arbitration clause	The Competent Authorities are **not committed to an "obligation of result"**. Being **under a mere "obligation of diligence"** the two Tax Administrations "shall endeavor" to eliminate by mutual agreement the taxation not in accordance with the Convention. In fact, according to paragraph 37 of the Commentary to Article 25 of the OECD Model: *"Paragraph 2 no doubt entails a duty to negotiate; but as far reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavors and not to achieve a result".* In practice, this entails that the case submitted to the Competent Authorities may not be resolved
5 Term	Although **the OECD sets a three-year time limit** from the date of the first notification of the action resulting in taxation not in accordance with the provisions of the Convention, many States (Italy included) entered Bilateral DTCs which provide for a **shorter time limit** – usually, **two years**

MAP - Recap on theory

MAP pursuant to a Bilateral Double Taxation Convention

Features	Application
6 **Interplay with domestic legal procedure**	Paragraph 1, Article 25 OECD Model states that **a DTC MAP request can be validly submitted** by a taxpayer "***irrespective of the remedies provided by the domestic law of those States***". Many DTCs (including those entered into by Italy) contain a **reservation** regarding the MAP article whereby the expression "*irrespective of the remedies provided by the domestic law*" shall be interpreted as: "*the mutual agreement procedure* ***is not alternative to the domestic litigation proceedings which shall be****, in any case, preventively initiated, when the claim is related to an assessment of Italian tax not in accordance with the Convention*" (or equivalent)

In Italy, **filing an appeal** to a tax judge aims at avoiding that, pending the MAP, the tax assessment becomes final without the possibility of being modified under the agreement potentially reached by the Competent Authorities involved.

However, the parallel progress of a DTC MAP and a domestic litigation leaves room to a **potentially conflicting outcome** between the domestic court judgment and the agreement achieved by the Competent Authorities involved.

Should the Competent Authorities agree to eliminate double taxation before a judgment is issued by an Italian court, the taxpayer can accept that agreement, renouncing to the domestic proceeding in order to give execution to the agreement. In the opposite scenario, the Italian Competent Authority will inform its foreign counterpart of the outcome of the domestic litigation. In such a case, should the judgment not eliminate the double taxation, the latter could not be avoided, unless the foreign Competent Authority concurs with the position expressed by the Italian tax court. Pending the MAP, it will be up to the taxpayer to decide whether or not to require the suspension of the domestic litigation.

MAP - Recap on theory

MAP pursuant to the EU Arbitration Convention

Features	Application
1 Subjective scope	The taxpayers entitled to submit an AC MAP request to the Competent Authority of a EU Member State are: a. the **resident enterprises**, with respect to their interest ownership existing with enterprises resident in another Member State of the European Union b. the **permanent establishments** in a EU Member State of enterprises resident in another Member State
2 Objective scope	**Article 1 Convention:** ***"This Convention shall apply where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in Article 4 and applied either directly or in corresponding provisions of the law of the State concerned have not been observed".***

As a matter of fact, the only relevant cases enabling taxpayers to access to the AC MAP concern:

- Deemed violation of **Transfer Pricing** rules
- **Attribution of profits to Permanent Establishments**

MAP - Recap on theory

MAP pursuant to the EU Arbitration Convention

Features	Application
3 **Exclusion Clause: "serious penalties"**	As regards the legal grounds preventing an AC MAP from being opened, Article 8, paragraph 1 of the AC MAP stipulates that "the Competent Authority of a Contracting State shall not be obliged to initiate the mutual agreement procedure or to set *up the advisory commission referred to in Article 7 where legal or administrative proceedings have resulted in a final ruling that by actions giving rise to an adjustment of transfers of profits under Article 4 one of the enterprises concerned is liable to a serious penalty*" The Code of Conduct recommends Member States – in light of the practical experience acquired on the issue – to clarify/amend "*their unilateral declarations … in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud*" In Italy "*the term 'serious penalties' means penalties laid down for illicit acts, within the meaning of the domestic law, constituting a tax offence*"
4 **Term**	Pursuant to Article 6, paragraph 1, of the Arbitration Convention, "*The case must be presented within three years of the first notification of the action which results or is likely to result in double taxation within the meaning of Article 1*" The expression "*first notification of the action*" must be construed in the most favorable way to the taxpayer. This entails that the three-year period within which the request must be submitted elapses from the date in which the tax assessment leading to economic double taxation was notified

MAP - Recap on theory

MAP pursuant to the EU Arbitration Convention

Features	Application
5 The Role of the Taxpayer	As for the DTC MAP, **the taxpayer is not directly involved in the discussions** between the Competent Authorities, but only required to be co-operative, describing thoroughly the case at stake and promptly providing requested additional information, if any In any case, there is no explicit nor mandatory rule imposing on the Competent Authorities involved the duty to inform at any step of the procedure the taxpayer, who, therefore, risks to be unaware of the state of the procedure
6 Interplay with Domestic Legal Procedure	The AC MAP can be activated only and insofar as the associated enterprise has allowed the time provided for the appeal to expire, **or has withdrawn any such appeal before a decision has been delivered** In the event the taxpayer simultaneously submits an AC MAP request and appeals against the assessment notice (regarding elements pertaining to the adjustments leading to double taxation), the existence of a litigation proceeding does not prevent the mutual agreement procedure to begin and/or the Competent Authorities to exchange views regarding the case or information on the pending judicial proceeding However, in the event a judicial decision occurs and the double taxation has not been eliminated, the latter will not be removed unless the foreign Competent Authority signs a mutual agreement consistent with the domestic judicial decision In any case, the taxpayer can carry out the appeal on issues other than those falling into the scope of the mutual agreement procedure

MAP - Recap on theory

Taxes due will be final and no longer negotiable in the event the taxpayer agrees to settle with the Revenue Agency before going to court via the so-called "*accertamento con adesione*", tax mediation ("*mediazione tributaria*") and judicial settlement ("*conciliazione giudiziale*").

This will entail that the DTC MAP cannot be aimed at revising taxes settled by means of the above negotiation instruments, although the Competent Authority of the other Contracting State might evaluate the possibility of a unilateral corresponding adjustment to eliminate double taxation.

The choice between the MAP and the domestic litigation is approached, in the contest of the AC MAP, as *alternative*, meaning that the two cannot be carried out simultaneously. Similarly, if **the taxpayer decides to settle the controversy** - via the so-called "*accertamento con adesione*", tax mediation ("*mediazione tributaria*") and judicial settlement ("*conciliazione giudiziale*") - **the possibility of reopening the discussions in the context of an AC MAP is prevented.**

MAP - Recap on theory

New AC MAP pursuant to Directive 2017/1852

MAP pursuant to Directive 2017/1852

In consideration of the limitations affecting MAPs pursuant to DTCs and the EU AC, the recent adoption of **EU Directive 2017/1852** (***on tax dispute resolution mechanisms in the European Union)*** *has to be seen as a natural upgrade toward a more efficient and effective* procedure for the resolution of tax conflicts (especially with regard to transfer pricing adjustments) by means of the **strengthening and enhancing of the already available transnational conflict resolution mechanisms** (the very same ones already provided for by the EU Arbitration Convention)

The measure aims at **uniforming and enhancing the transnational mutual agreement procedures currently in force in EU Member States**, in order to guarantee to taxpayers a far more harmonized, efficient and transparent framework, creating, at the same time, a favorable environment for those companies willing to invest in the EU market

The implementation of the above-mentioned Directive is the **direct consequence of the necessity of filling in the gaps left in the framework of MAPs against double-taxation presently available to taxpayers**, especially as regards **access to the procedure**, the possibility for taxpayers to actually **participate** in it and the **length** and the effective conclusion of the procedures themselves

MAP - Recap on theory

New AC MAP pursuant to Directive 2017/1852

The innovations introduced by Directive 2017/1852

Among the improvements set out by Directive 2017/1852, the most relevant is the **extension of the objective scope of application of the EU AC MAP**

1 **Extension of the Objective Scope for initiating an AC MAP**

In fact, while the 1990 Convention is limited to transfer pricing and the attribution of profits to permanent establishments disputes, the 2017 Directive extends its scope of application to **any controversy among Member States that may emerge from the interpretation and enforcement of agreements and conventions addressing the elimination of double taxation on income and, if applicable, on capital**

2 **Extension of the Subjective Scope for initiating an AC MAP**

Any taxpayer will be able to access this procedure, i.e. any individual who is a resident of a Member State for tax purposes, and whose taxation is directly affected by some disputed question leading to double taxation

MAP - Recap on theory

New AC MAP pursuant to Directive 2017/1852

Features	Application
3 Simultaneous Complaints	Another interesting innovation introduced by the Directive is the possibility for any affected person to submit a **simultaneous complaint** on a question in dispute to each of the Member States concerned; the submission of the complaint shall take place **within three years** from the receipt of the first notification of the action resulting in the question in dispute Each Authority shall acknowledge the receipt of the complaint within two months from having received it and communicate, within the six months following the reception of the complaint (or of the integrative information requested), whether the complaint is accepted or rejected
4 Term	In the event that the complaint is accepted, in order to solve the dispute, the **Competent Authorities will have to commit to the two-years term** (since the last notification of acceptance of a Member State) provided for MAPs; that deadline may be **extended for one further year**, **upon written justification** of one of the Member States involved
5 Information and Involvement of the Parties	There are provisions regulating the way in which the affected parties should be informed –contrary to what currently happens, **taxpayers may ask to be directly involved in the procedure**, being constantly updated on its development

MAP - Recap on theory

New AC MAP pursuant to Directive 2017/1852

Features	Application
6 In the event that the Competent Authorities were not able reaching any agreement…	**The Advisory Commisison**: In the event that the Competent Authorities were not able reaching any agreement, upon a request made by the affected person to the Competent Authorities of the Member States concerned, it shall be possible to set up an **Advisory Commission** (whose composition and mode of operation are defined by the Directive), which will be asked to express an independent opinion The Competent Authorities, at that point, could still distance themselves from the opinion of the Commission, which will become binding exclusively in the event that the Competent Authorities are still unable to reach an agreement
	The Alternative Dispute Resolution Commisison: Alternatively, the establishment of an **Alternative Dispute Resolution Commission** can be agreed between the Competent Authorities of the Member States interested to reach an agreement by means of the so-called alternative dispute resolution procedures, as, for instance, the “final offer” arbitration proceeding (otherwise known as “last best offer” arbitration)

MAP - Recap on theory

New AC MAP pursuant to Directive 2017/1852

The EU Directive 2017/1852 lays the ground for the establishment of a much more **solid legal and procedural framework with regard to MAPs**, guaranteeing taxpayers not only the **elimination of double-taxation triggered by transfer pricing adjustments** on the transactions between EU associated enterprises (as in the current scenario), but the **access to a more equal, uniform and efficient MAP system**

These mechanisms are now required to be implemented across the EU within **June 30, 2019**, i.e. the same date envisaged for the adoption of the Directive by all EU Member States. The Directive would therefore become applicable to any **complaints submitted from July 1, 2019 onwards**, relating to **disputes** on income or capital earned in a **tax year commencing on or after January 1, 2018**

MAP

Timeframe, content and submission

MAP - Timeframe, content and submission

<table>
<tr><th colspan="4">DTC MAP</th></tr>
<tr><td>Opening date</td><td colspan="3">The opening date of the MAP concurs:
• With the date in which the taxpayer's request was submitted together with the required documentation
• Otherwise, in case supplementary documentation is required, the MAP is deemed open from the date of the filing of the supplementary documentation</td></tr>
<tr><td rowspan="2">Term for the submission of the MAP request</td><td rowspan="2"><u>OECD Model</u>:
3 year time limit from the date of the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.*

Each Bilateral DTC has its own timing set (within max term of 3 years).</td><td colspan="2"><u>Bilateral DTCs</u> to which <u>Italy</u> is a party: generally 2 years</td></tr>
<tr><td><u>Case 1</u>: taxation not in accordance with the provisions of a DTC claimed by the taxpayer arises from the application of a domestic tax or withholding tax (e.g. interests)

The term for a valid submission of a MAP request runs either:
• from the date of notification by the Tax Administration of the refund denial submitted in respect to the application of a withholding tax;
• from the 90th day following the submission of the refund request without a reply by the Tax Administration</td><td><u>Case 2</u>: taxation not in accordance with the provisions of a DTC is triggered by adjustments carried out by the tax administration (e.g. TP adjustment)

The initial term of the period within which the taxpayer may submit his case concurs with the date of notification of the formal assessment triggering taxation not in accordance with the provisions of the DTC</td></tr>
<tr><td>Term for the conclusion of the MAP</td><td colspan="3">There is no fixed term for the conclusion of the MAP. However, with BEPS Action 14, countries have agreed (as a minimum standard to be respected) to seek to resolve MAP cases within an average timeframe of 24 months</td></tr>
</table>

* According to paragraph 21 of the Commentary to Article 25 of the OECD Model Tax Convention, this should **be intended in the most favorable way to the taxpayer**

The taxpayer can submit the MAP request *before* receiving a formal assessment – e.g. following the *notification of an audit report* (so-called "*processo verbale di constatazione*"). In any case, the MAP is opened from the date in which the Competent Authority has received the minimum set of information to start the procedure

MAP - Timeframe, content and submission

	AC MAP		AC MAP subsquent to the implementation of Directive 2017/1852
Opening date	**<u>Acceptance of the request</u>**: The day in which the request was duly submitted with minimum documentation attached	**<u>Request for further information</u>**: The date in which the additional requested documentation was submitted.	**[No changes to the timeline]**
Term for the submission of the MAP request	"*The case must be presented **within 3 years** of the first notification of the action which results or is likely to result in double taxation*" [Art. 6(1) A.C.] *		**[No changes to the timeline]**
Term for acknowledging the request of a MAP	The Competent Authorities acknowledge the receipt of a request to initiate a MAP **within 1 month** from the receipt of the request		Each competent authority shall acknowledge receipt of the complaint **within 2 months**

* The term must be interpreted in the most favorable way to the taxpayer. This entails that the 3-year period within which the request must be submitted **starts from the date in which the tax assessment leading to the double taxation was notified**, although the taxpayer may opt to present the MAP request **prior** to the date of notification of the assessment

MAP - Timeframe, content and submission

	AC MAP	AC MAP subsquent to the implementation of Directive 2017/1852
Term to inform of the acceptance of the MAP or requesting further information	The Competent Authorities will inform the taxpayer **within 2 months** from the submission of the opening request, either confirming its acceptance or requesting additional information	The Competent Authorities may request the relevant additional information **within 3 months** from the receipt of the complaint -- The taxpayer should reply within **3 months** -- The Competent Authorities shall take a decision on the acceptance or rejection of the complaint: • **within 6 months** of the receipt thereof or • **within 6 months** of the receipt of the information, whichever is later.
Suspension of tax collection (optional)	The final term for the effectiveness of the suspension of tax collection usually corresponds to **the date in which the AC MAP is concluded**	**[No changes to the timeline]**
Timeline for discussions between the Competent Authorities **	• **6 months** for submitting the position paper to the other authority • **8 months** for exchanging written replies (4 and 4 months each) • **6 months** for reaching a potential agreement	**[No changes to the timeline]**

**As a rule, the Competent Authority of the Country where the tax assessment was made, will first send its "position paper" to the Competent Authority of the other State/s involved in the case

MAP - Timeframe, content and submission

<table>
<tr><th></th><th colspan="3">AC MAP</th><th colspan="2">AC MAP subsquent to the implementation of Directive 2017/1852</th></tr>
<tr><td rowspan="3">Advisory Commission and ADR Commission</td><td colspan="3" rowspan="3">If the competent authorities concerned fail to reach an agreement that eliminates the double taxation within two years from the date on which the case was first submitted to one of the competent authorities they shall set up an advisory commission</td><td>Advisory Commission</td><td>ADR Commission</td></tr>
<tr><td>Request for setting up the Commission: not later than 50 days from the date of receipt of the notification of:
• the rejection of the complaint;
• the lack of an agreement reached within the 2 years term

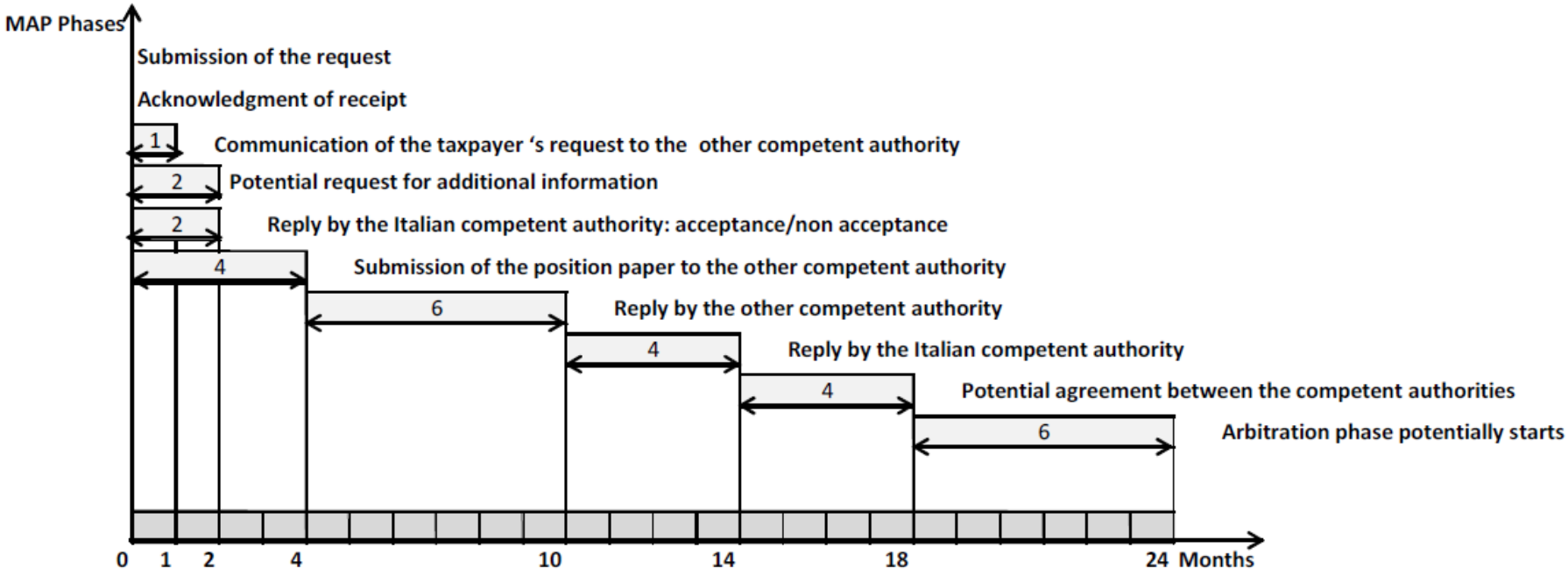
The Commission shall be set up not later than 120 days from the receipt of such request

Decision on the acceptance of the complaint: within 6 months from the date of establishment of the Commission, which shall notify to the Competent Authorities its decision within 30 days</td><td>Decision on the acceptance of the complaint: to be adopted within 6 months from the date of its establishment

If it considers that the question in dispute is such that it would need more than 6 months to deliver an opinion, this period may be extended by 3 months (same for the Advisory Commission)</td></tr>
<tr><td colspan="2">The final decision shall be implemented subject to the affected person(s)' acceptance and waiver to any domestic remedy within 60 days from the final decision notification</td></tr>
<tr><td rowspan="2">Term for the conclusion of the MAP</td><td rowspan="2">The term available to the Competent Authorities to reach an agreement for the elimination of double taxation is 2 years</td><td colspan="2">If they do not reach any agreement within 2 years:</td><td colspan="2" rowspan="2">The period of 2 years may be extended by up to 1 year at the request of a competent authority of a Member State concerned to all of the other competent authorities of the Member States concerned, if the requesting competent authority provides written justification.</td></tr>
<tr><td>(a) The taxpayer and the Competent Authorities, may agree to a longer term …</td><td>(b) …An Advisory Commission must be established for the arbitration phase: it has 6 months to issue an opinion</td></tr>
</table>

MAP - Timeframe, content and submission

Time-line of the 2 years timeframe for an AC MAP



MAP - Timeframe, content and submission

- **The MAP opening request can be submitted**:
  - by **the resident enterprise receiving the assessment notice**
  - by **the foreign associated enterprise**, to the Competent Authority of its State
- In the event the MAP request is submitted by a **taxpayer resident in Italy**, it has to be **drafted in free form** and:
  - **sent via letter** with advice of receipt to the Ministery of Economy and Finance; or
  - **hand-delivered**.
  - Sending also an **electronic version** is recommended
- The submission of a DTC MAP request is **free of charge**

- The **taxpayer resident in Italy (i.e. in the state where the relevant claim has been raised)** has to **submit the opening request in free form**:
  - **sending it via letter** with advice of delivery to the Internal Revenue Agency, or
  - **hand-delivering it to the Internal Revenue Agency – Central Assessment Office – Ufficio Accordi Preventivi e Controversie Internazionali**.
- The submission of an AC MAP request is **free of charge**

Following the implementation of EU Directive 2017/1852, there won't be any relevant modification to the content and modalities of submission of AC MAPs

MAP - Timeframe, content and submission

The **DTC MAP request** should contain the **following information**:

- the **taxpayer's identification data**;
- the **tax domicile** of the taxpayer or of any legitimate recipient(s), for communication purposes;
- an illustration of the **facts and circumstances** of the **case**;
- a **description** of any **administrative or legal proceeding undertaken** in Italy;
- a **description** of the **remedies**, if any, **activated** in the other Contracting State **to eliminate the double taxation**;
- a copy of the **tax documents** which resulted, or that might result, in **taxation not in accordance with the provisions of the bilateral Convention**;
- any other form of documentation instrumental to ease the analyses by the competent authorities involved;
- the **commitment** of the taxpayer **to answer** timely to any **query from the Competent Authority**

The **AC MAP request** must **contain** at least the **following information**:

- **identification** of the **enterprise** presenting the AC MAP and the other **parties** to the transaction;
- **details** of the **relevant facts and circumstances of the case** (e.g. description of trade relations between the enterprise);
- **identification** of the relevant **tax periods**;
- **copies** of the **tax assessment notice** and **tax audit report** leading to the double taxation;
- **details** of any **litigation procedures initiated**;
- an explanation by the enterprise of **why it considers that the principles set out in Art. 4 AC have not been observed**;
- an **undertaking** of responsibilities to respond promptly and provide the necessary documentation;
- any specific **additional information**;
- an **indication** that the **transactions** falling within the scope of the MAP were **properly documented**

MAP
Case Studies

MAP - Case studies

Fiscal Domicile – DTC MAP

The famous tenor case

A famous Italian tenor decides to **move from Italy to London** (UK), starting living there in a rented apartment and working the greater part of the year for the London Opera House. His **family prefers to stay living in Italy** in their original home. The tenor comes back to Italy on a regular basis to stay with them, although spending in Italy less than 162 days per year. He retains one bank account in Italy, but his remuneration is remitted by the London Opera House and by the other Theaters where he performs, around the world, on a bank account at a UK bank. He still holds a telephone contract with an Italian telco company. The tenor is registered to the A.I.R.E. (*Anagrafe Italiani Residenti all'Estero*).

- Work and employment relationships
- Business relationships
- Bank accounts
- Manager and other business partners / assistants
- Office / place of work

Under the Italian administrative practice and rules (Circ. 2/12/1997, n. 304; Ministry of Finance Resolutions n. 351/2008 and n. 17/1999), the concept of «**center of vital interests**» has to be **extensively** intended, entailing not only economic and patrimonial relationships, but also to social and family ones

- Family
- Key social relationships
- Membership to Italian clubs and associations (e.g. Rotary)
- Participation to TV programs
- Family home

MAP - Case studies

Fiscal Domicile – DTC MAP

Art. 4 (2) Bilateral Convention

Where by reason of the provisions of paragraph 1 of this Article an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules:

(a) he shall be deemed to be a resident of the Contracting State in which he has a **permanent home available to him**. If he has a **permanent home available to him in both Contracting States**, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests);

(b) if the Contracting State in which he has his **centre of vital interests** cannot be determined, or if he has no permanent home available to him in either Contracting State, he shall be deemed to be a resident of the State in which he has an habitual abode;

(c) if he has an **habitual abode** in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national;

(d) if he is a **national** of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

With regard to the relevant provision included in the Convention, in the context of a DTC MAP pursuant to the **bilateral convention** between Italy and United Kingdom, the case of the tenor can be framed considering that:

- On the one hand, he has a permanent home available in London, where he lives the greatest part of the year and entertains, organizes and manages his work activities and performances;
- On the other hand, the centre of his vital interests could be deemed in Italy, considering that his personal, key relationships are all in Italy.

The Competent Authorities shall address the issue considering the provision of Art.4 (2) of the Double Tax Convention between Italy and UK.

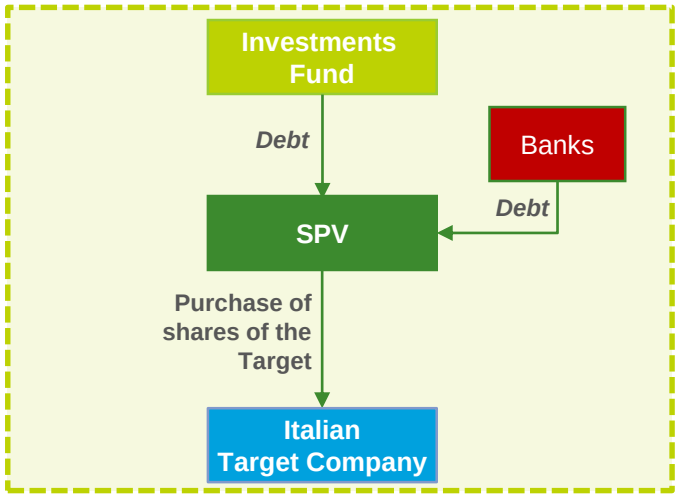
MAP - Case studies

Interests – DTC MAP

The LBO case

Leverage Buy Out – Pre-merger

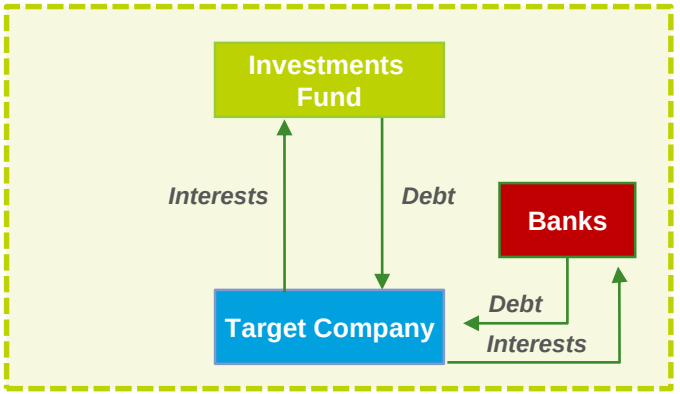
A German Investment Fund acquires an Italian Target Company through a LBO, financing a SPV that then acquires the Target Company by means of the financial resources obtained from the Investment Fund and Banks



Merger between SPV and the Target Company

Leverage Buy Out – Post-merger

After the acquisition, the Target Company and the SPV are merged and the Target Company becomes the entity liable for the SPV's debts and interests payments



The Italian Tax Authorities deem that the intercompany loan **should qualify as «equity»** and the related interest payments as «dividends», considering the entire operation as «elusive» for tax purposes. **Interests** are consequently treated as **not deductible** in Italy and **taxable** in Germany, configuring a **double taxation case**

MAP - Case studies

Interests – DTC MAP

Art. 11(1) Bilateral Convention: Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

Art. 11(2) Bilateral Convention: The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures.

Art. 11(6) Bilateral Convention: Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Reasons supporting the requalification

- Repayment of the capital and interest is deferred after the full repayment of third party lenders (Banks)
- The financial ratios and default conditions defined in the covenants with Banks do not include in the definition of debt and interest the intercompany financing
- The payment of interest and capital is subject to similar restrictions as for dividends and reductions in capital

Reasons against the requalification

- The LBO is an operation with a clear economic rationale
- The Target Company has the financial capability to repay debts and interests
- Any business entity is free to decide its financing sources, combining equity and/or debt

MAP - Case studies

Transfer Pricing – AC MAP

The business restructuring case

An Italian company, subsidiary of a Belgian multinational group, operating mostly in the EU, within the context of a project to pursue a higher degree of efficiency at Group level, in terms of both the allocation of functions performed by each Group entity and the allocation of business and financial risks among the Group companies, changes its profile from **Fully-Fledged Distributor** to **Limited-Risk Distributor** (***LRD***), by means of a so-called "**business restructuring**" operation, in the meaning of Chapter IX of the OECD Transfer Pricing Guidelines.

Pursuant to the business restructuring, the Italian subsidiary transfers the ownership of the existing inventory of finished products to a Belgian **Principal Operating Company** (***POC***) and enters into a distribution agreement expressly providing for the possibility that the LRD transfers its credits to the POC.

Further to the business restructuring:

- The POC performs activities related to **logistics management** and **working capital management**, with particular reference to the financing of inventory and receivables (both activities previously under the competence of the Italian company's management);
- The POC bears entirely the **financial risks** connected with the **holding of inventory** and the acknowledgement of delayed **payment terms** to customers, being the legal owner of the inventory of finished products and the transferee of the LRD's outstanding receivables.

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Transfer Pricing – AC MAP

Business Restructurings and Transfer Pricing

The functions in which the business of a multinational group articulates are usually allocated to various companies, and typically include:

(a) **research and development , design and engineering**

(b) **manufacturing**, either as full-fledged manufacturer or as contract or toll manufacturer

(c) performance of **services**

(d) **distribution**, agency and sales support services

(e) **logistics**

(f) **management**, finance and administrative and other **support functions**

To rationalize and make more efficient their business, many multinationals tend to **centralize some functions and risks at the level of a POC**, thus allowing local entities to focus resources and efforts on their core functions (e.g. manufacturing, distribution)

Business restructurings are aimed at changing the organizational structure and processes of businesses, aligning them to **new business models**. Business restructurings generally entails the "**conversion**" of local entities and/or changes in the allocation of functions, tangible and intangible assets and risks ("something of value"), together with the relevant profit opportunities

A business restructuring operation generally has a particular relevance not only under a business perspective, as far as economic and strategic reasons are concerned, but also under a **tax perspective**, to the extent the restructuring implies the **transfer of "something of value" – generally relevant for transfer pricing purposes**, if the restructuring involves counterparts resident in different jurisdictions

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An operation of business restructuring within a multinational can be viewed as **the cross-border redeployment of functions, assets and/or risks** … and the relevant **profit opportunities**

… business restructurings may involve **cross-border transfers of "something of value"**, and/or imply **the termination or substantial renegotiation of existing arrangements** … with significant changes in the **intercompany transactions** flows

… in application of Article 9 (*Associated Enterprises*) of the OECD Model Tax Convention and the OECD Guidelines on transfer pricing aspects of business restructurings, business restructurings must be examined in the light of the **arm's length principle**, to verify **whether there are conditions made or imposed** - in the business restructuring - **among entities of a multinational group that differ from the conditions that would have been applied between independent enterprises**

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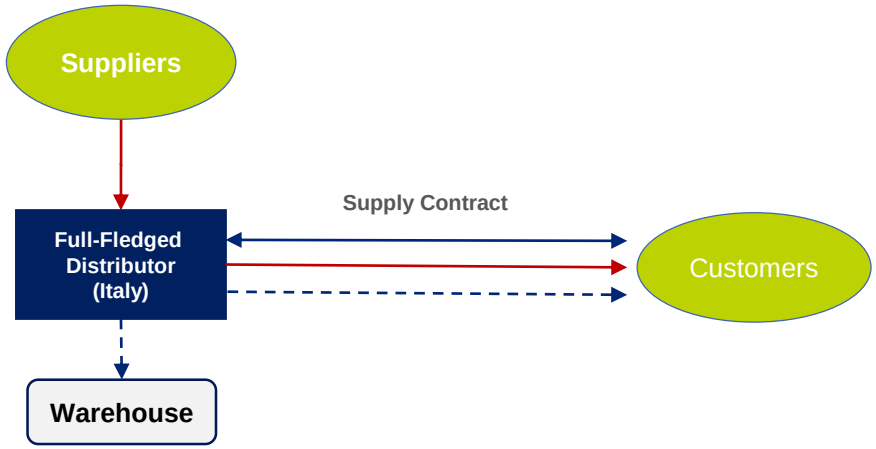
Transfer Pricing – AC MAP

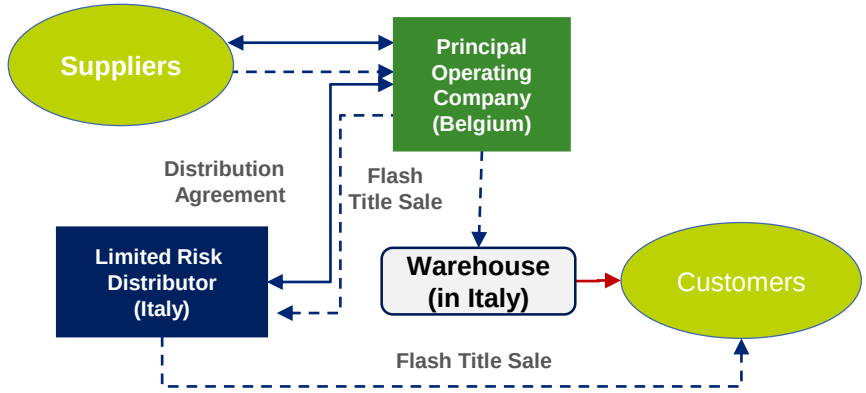
Before business restructuring – Old Business Model



- The Full-Fledged Distributor (FFD) owns the **inventory** of goods stored in the warehouse and performs all the related management activities
- The FFD bears entirely the **financial risk and costs** relevant to the inventory
- The FFD takes care of both the **procurement of products** and the logistics management

Contractual Arrangements
Material Flows
Legal Rights

After business restructuring – New Business Model



- In the context of the NBM, the ownership of the inventory is transferred to the POC, at a transfer price set based on a specific evaluation
- The POC undertakes functions relevant to the procurement of products and **logistics**
- The POC assumes the **financial costs** and **risks** relevant to the **inventory**
- The POC bears also the **financial risks** for the **outstanding receivables**, as the LRD has the faculty of transferring credits to the POC

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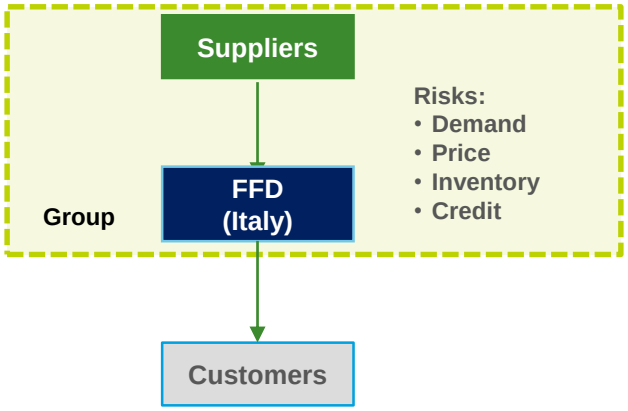
Transfer Pricing – AC MAP

Full Fledged Distributor (FFD)

The **FFD** purchases products from the Supplier and resells them to customers, taking on significant business risks and financial costs.

The **FFD** takes on all **market, inventory and credit risks** and the relevant **financial costs**.

Its remuneration varies, depending on many factors and the FFD is potentially exposed to the risk of making losses.

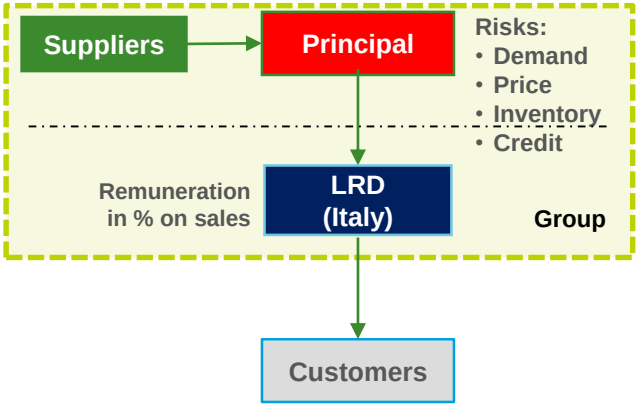


Limited Risk Distributor (LRD)

The **POC** takes on the business risks.

The **LRD** purchases products from the POC, resells them to customers, receiving a **fixed-remuneration** expressed as a % on sales.

The POC owns the inventory and performs the related management activities, bearing the financial risk. The POC is entitled to **the residual profit after having paid suppliers and remunerated the LRD**.



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To assess whether the FFD has to be rewarded for its conversion to LRD, **since no variation is expected with regard to sales volumes**, it is possible to compare the forecasted profit margins over the 5 years following the conversion, under the "old" and the "new" business model respectively.

Expected profits under the old business model (FFD)							
	2017	**2018**	**2019**	**2020**	**2021**	**TV**	
Sales revenues	1,600	1,700	1,800	1,905	2,058		
Tax rate	27.5%	24%	24%	24%	24%	24%	
Operating Margin	3.0%	3.5%	4.0%	3.5%	4.0%	4%	
Net profit	34.8	45.22	54.72	50.67	62.56	481.25	
WACC	13%	13%	13%	13%	13%	13%	**Business value**
Discounted flows	30.80	35.41	37.92	31.08	33.96	261.21	**430**
Expected profits under the new business model (LRD)							
	2017	**2018**	**2019**	**2020**	**2021**	**TV**	
Sales revenues	1,600	1,680	1,781	1,905	2,058		
Tax rate	27.5%	24%	24%	24%	24%		
Operating Margin	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	
Net profit	29.00	31.92	33.84	36.20	39.10	306.68	
WACC	13%	13%	13%	13%	13%	13%	**Business value**
Discounted flows	25.72	25.11	23.61	22.40	21.46	168.31	**287**
					Compensation		**143**

The expected profit under the old FFD business model is higher than under the new LRD model. By **discounting the differential**, the parties estimated an **"exit fee"** (compensation) payable by the Belgian POC in favor of the Italian distributor.

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Transfer Pricing – AC MAP

In the context of a tax audit, the Italian Revenue Agency challenges the "exit fee" estimated by the parties, claiming that the appraised compensation should be recomputed to a higher value, amounting to Euro 500K.

In order to avoid the double taxation arising from the taxation of a higher income in Italy, against a non-deductible cost in Belgium, the Italian taxpayer applies for a MAP pursuant to the EU Arbitration Convention (thus, starting an AC MAP), claiming the proper application of the principles disciplining the adjustment of profits among associated enterprises.

EU Arbitration Convention - Art. 4 (1)

Principles applying to the adjustment of profits of associated enterprises

Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of another Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one Contracting State and an enterprise of another Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ form those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

The taxpayer opted for the AC MAP as the procedure **guarantees the resolution of the double taxation case**, **differently from the DTC MAP**, where the Competent Authorities of the involved States are non obliged to find an agreement or to solve the case under an international arbitration.

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Transfer Pricing – AC MAP

DTC MAP – PROs & CONs

PROs

- The DTC MAP is **not limited to TP issues between EU Member States**, but is potentially viable with any State with which Italy signed a DTC and for all subjects under the DTC
- The taxpayer has **not to abandon its appeal to the tax Court**, but can ask for the suspension of the domestic litigation, until the MAP is concluded
- The taxpayer has the **faculty to accept or refuse the Competent Authorities' decision** and, in case of refuse, continue the domestic litigation

CONs

- The DTC MAP generally **does not generate any binding obligation on the States** to solve the dispute – a circumstance that often brings to a negative outcome of the DTC MAP

AC MAP – PROs & CONs

PROs

- The AC MAP **commits to solve the double taxation**, by means of an agreement between the Competent Authorities or by an Arbitration procedure
- There is a **timeframe** for the Competent Authorities to come to a solution

CONs

- In case the adjusted intercompany transaction involves more entities, including extra-EU residents, the AC MAP **does not allow solving the double taxation with residents of extra-EU States**
- The taxpayer **must abandon any appeal** to domestic tax Courts.
- The taxpayer is left with **no choice but to accept or refuse the agreement** between the Competent Authorities (if he refuses, the double taxation remains)

MAP - Case studies

Permanent Establishment – DTC MAP

The dependent agent PE case

A Tobacco Company in UK avails of an Italian subsidiary whose employees perform exclusively **sales support activities** to the benefit of the UK Company, meeting clients and managing the ordering process.

The Italian personnel **collects orders from the Italian clients, defining the volumes of products sales** on behalf of the UK Company. Sales prices are defined by the market regulations and the Italian personnel does not negotiate prices.

The UK Tobacco Company deems that the activity performed by the Italian subsidiary on its behalf does not entail any sales activity, but qualifies as a **simple service**.

On the contrary, the Italian Tax Authorities deem that **the sales activity is indeed performed by the Italian subsidiary**, since its personnel defines and negotiates the relevant conditions (volumes, products mix, logistics) directly with the clients, on behalf of the UK Company.

Art. 5 (5) Bilateral Convention: where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

MAP - Case studies

Permanent Establishment – DTC MAP

Under the Convention, a PE of the UK Company can be deemed to exist in Italy, nested into the Italian subsidiary, considering that:

- The Italian subsidiary acts exclusively on behalf of the UK Company, which entails a dependency relationship
- The personnel of the Italian subsidiary defines locally the sales conditions with the Italian clients, binding the UK principal

Under the Treaty between Italy and UK, the Italian subsidiary could start a DTC MAP to eliminate the double taxation arising from the taxation of the same income in both Italy and UK.

- Filing a DTC MAP would eliminate any double taxation
- Under a DTC MAP the methodology for the attribution of profit to the PE would be agreed between the involved States

- Penalties would remain in any case applicable. The reductions obtainable under a negotiated assessment procedure would no longer be available, but ordinary penalties, ranging from 120% to 140% of payable taxes would apply
- It might be advisable to settle "*hidden PE*" issues under a negotiated assessment procedure, to support the taxpayer's good faith and try commuting the PE remark in a transfer pricing remark (not relevant for criminal purposes)

Questions?

Andrea Ferrario
Partner | Transfer Pricing
Studio Tributario e Societario
Member of Deloitte Touche Tohmatsu Limited
Via Tortona 25, Milano, 20144, Italia
Tel: +39 02 8332 4111 | +39 02 8332 4060
Fax: +39 02 8334 9183
aferrario@sts.deloitte.it | www.deloitte.it