



## ARM'S LENGTH CHRONICLE

### APA: a lighthouse in the transfer pricing vast sea

On 30 March 2022 the Internal Revenue Service (IRS) released the latest statistics on Advance Pricing Arrangements (APAs) in the United States for 2021. The number of new applications, including renewals, increased compared to previous year and represent 5% of the total number of requests lodged across a period of 30 years (1991-2021). This demonstrates the growing interest of multinationals to approach cooperation and compliance, which are key instruments to reduce tax risks.

Albeit data focus on US procedures, they give us the opportunity to make a comparison between US and Italian figures, provide an overview of the Italian framework and try to predict some future trends. In a global environment where macroeconomic trends show soaring energy prices, shortage of raw materials with the related disruption of supply chains, an uneven global economic recovery, geopolitical disruptive events such as the current war in Ukraine and the continued transition towards digitalization, multinationals have several business challenges to face.

APAs are strategic instruments to tackle transfer pricing complexity, leaving CEOs focusing on the development of their business rather than spending time and money in long-standing tax litigations with uncertain results with tax authorities in different jurisdictions.

#### What does reaching an APA mean for a multinational?

An APA is an arrangement involving a taxpayer and one or more tax jurisdictions aimed at determining in advance methods and criteria to be applied in specific intercompany transactions over a fixed period of time. A taxpayer can initiate unilateral, bilateral or multilateral APAs, depending on how many tax authorities are involved in the process. The decision whether to include other authorities besides the one of the country of residence of the taxpayer starting the procedure requires a case-by-case analysis, regarding e.g. the nature of the intercompany transactions, the development of the APA program in that country and also the level of tax risks of foreign jurisdictions to be involved. If it is true that unilateral procedures require less efforts to be agreed, since the arrangement concerns only the taxpayer and one tax administration, one should note that only bilateral and multilateral

APAs ensure that arrangements will reduce the risk of double taxation being equitable to all tax administrations and taxpayers involved, thus providing greater certainty to the taxpayers concerned. The Italian APA program is quite recent, having been started in 2005 and later modified in 2015. While the main objective of an APA generally regards the proper application of the arm's length principle, Italian rules allow APAs to cover also potential deemed permanent establishment risks. In fact, a foreign investor can initiate an APA to assess in advance whether certain activities to be carried out in the Italian territory constitute a permanent establishment, before starting the business. This specific type of procedure benefits from a sort of "fast track" to meet the needs of business. Benefits of APAs are evident: thanks to the strict interaction between the taxpayer and the authority during the negotiation process, APAs provide legal certainty on the matter, reduce or even eliminate the likelihood of double taxation and proactively prevent future tax disputes. Company's resources usually dedicated to solve tax controversies can then be allocated to more profitable investments.

### A comparison between US and Italian data

Before making any comparison between US and Italian statistics on APA, a disclaimer is necessary: although the number of procedures in place is now similar, the economy of the two countries significantly differs and, especially in past years, companies operating in the two countries have had a different awareness of transfer pricing and APAs.

The US APA program (the official name is Advance Pricing Mutual Agreement, "APMA Program") was established by IRS in 1991, while APA regulations were introduced in Italy twelve years later, initially allowing unilateral procedures only.

APAs in the US have traditionally been the domain of large taxpayers, even if dedicated programs for small and medium companies exist. In general, large north American taxpayers have the resources to start a voluntary compliance program and are engaged in complex intercompany transactions with several counterparties. Furthermore, US entry fees might be discouraging: to enter into the program, companies have to pay an admission fee equal to \$113,500 for new APAs and \$62,000 for renewals, reduced to \$54,000 for small and medium sized companies (i.e. companies with consolidated gross income less than \$500 million, intercompany transactions to be covered not exceeding \$50 million in any proposed APA year and an aggregate value of any transfer of rights in, or rights to use, intangibles not exceeding \$10 million in any proposed APA year). In Italy admission fees apply from 2021 and for bilateral or multilateral APAs only (fees range from €10,000 to €50,000 depending on consolidated turnover, reduced to half in case of renewals).

The Italian multinational enterprises (MNEs) environment is different: Italy is characterized by an entrepreneurial pattern made of very small, small and medium size companies (the so-called pocket-sized MNEs, i.e. with turnover not exceeding €50 million according to the European definition of small and medium enterprises) that generally do not have refined transfer pricing policies or have started to define an adequate policy only in recent years. Such an attitude towards transfer pricing has been leaving the door open for tax authorities to issue tax adjustments. The frequent consequence of these tax audits is that Italian companies decide to settle transfer pricing assessments to avoid long discussions with the authorities and the unpredictability of litigation outcomes, even if the rationale behind settlements is often not fully compliant with the arm's length principle and generates a juridical or economical double taxation which in most cases can no longer be resolved. Moreover, these settlements do not guarantee any level of certainty regarding possible new tax adjustments in future years or in the countries where associated entities reside.

At the same time, the proliferation of transfer pricing audits made Italian companies more aware of the risks connected to tax controversies, also from a reputational perspective. Other key aspects to be considered when a tax audit starts are the potential criminal ramifications and the significant amounts of administrative penalties (although both limited in transfer pricing cases when the taxpayer prepared a compliant transfer pricing documentation, but almost always applied in deemed permanent establishment assessments).

We have then observed a continuous increase of interest in APAs among Italian entrepreneurs and investors, which has almost equaled the attention shown by US companies.

According to the latest publicly Italian data available on APAs (2019):

- 152 new APA requests were submitted;
- 54 APAs were granted;
- 186 APAs were already in force.

For new APAs requests, Italy placed in 4<sup>th</sup> position in the EU after Belgium, Netherlands and Poland. In 2018 Italy was in 2<sup>nd</sup> position after Belgium.

Italian figures are aligned with 2021 US data. IRS statistics show that in 2021:

- 145 new APA requests were submitted;
- 46 new APAs were executed and 78 renewals were granted;
- 185 renewals of already reached APAs were pending.

US companies appear more willing to initiate interactions with IRS and other authorities through bilateral and multilateral procedures, as only 25 out of 124 APAs granted were unilateral. Bilateral APAs were 98 and only 1 was multilateral.

In contrast, Italian companies have in place almost only unilateral APAs, being unilateral procedures approx. 90% of agreements reached (even if based on our experience, bilateral procedures are increasing also in Italy). This is mainly due to the fact that bilateral and multilateral APAs have only been made available in Italy starting from 2012.

Finally, also the timing to conclude procedures is aligned. Reaching a bilateral APA might be a long journey, which takes in Italy on average 45 months when the foreign tax authority involved is a European Member State and 29 months when the foreign tax authority involved is outside EU. For North American companies the average time to reach a bilateral APA is 43 months. Statistics on Italian unilateral procedures are not available, but based on our experience timing does not differ significantly from bilateral ones, although being most of the time a bit shorter.

### Takeaways

Transfer pricing is one of the most significant areas of tax risks for multinational enterprises and these risks will likely intensify in coming years, due to the increased level of disclosure and information shared among tax authorities, the long-term effects of Covid-19 and also the uncertainty generated by the current geopolitical crisis. Other relevant aspects impacting the way companies operate, such as remote working policies and the digitalization of economy, might amplify risks of deemed permanent establishment challenges.

Even modest transfer pricing adjustments can have large impacts on taxpayers, especially when challenges are issued across all open fiscal years. In this regard, pre-controversy risk management is crucial and APA is a concrete strategic mechanism available to MNEs, being the most appropriate instrument able to shed light on transfer pricing complexities.

Moreover, timing to conclude procedures should not be of concern for the management: if it is true that the conclusion of the agreement might take a few years, at the same time the Italian revenue agency repeatedly clarified that once a company filed an APA request, tax officers should refrain from conducting any investigation on transfer pricing issues to avoid any duplication of efforts both for authorities and taxpayers. Moreover, roll-back permits to cover also past years still open to assessment for which audits have not started yet, potentially granting MNEs to get certainty even for 7/8 years with one procedure only.

Even if the entire procedure can last years, from a mere cost management perspective overall costs to pursue an APA are in general lower than those to be sustained for regular compliance activities. Once an APA is reached, the costs of the procedure are offset by those that would be requested to prepare and maintain a proper transfer pricing documentation, also in terms of internal resources allocation.

Finally, reputational perspective should be considered. Reaching an APA means that the MNE tax risks are properly mitigated and managed and that the company positively contributes to the community, building public and stakeholder trust. ESG considerations are becoming more and more central in the business agenda and tax transparency is a critical factor.

GPBL's transfer pricing team is available to provide you with any further details on the above and support you in undertaking detailed analysis of specific cases.

### **Gatti Pavesi Bianchi Ludovici**

#### **Transfer Pricing**

**Paolo Ludovici** [paolo.ludovici@gpblex.it](mailto:paolo.ludovici@gpblex.it)

**Livio Zallo** [livio.zallo@gpblex.it](mailto:livio.zallo@gpblex.it)

**Marlinda Gianfrate** [marlinda.gianfrate@gpblex.it](mailto:marlinda.gianfrate@gpblex.it)

**Luca Tortorella** [luca.tortorella@gpblex.it](mailto:luca.tortorella@gpblex.it)

#### **DISCLAIMER**

This publication is provided by Gatti Pavesi Bianchi Ludovici studio legale associato and has been duly and professionally drafted. However, the information contained therein is not a legal advice and cannot be considered as such. Gatti Pavesi Bianchi Ludovici studio legale associato cannot accept any liability for the consequences of making use of this issue without a further cooperation and advice is taken.

**GPBL**

MILAN - ROME - LONDON

[Home page](#) | [Highlights](#) | [Contacts](#) | [Linkedin](#)

© Copyright Gatti Pavesi Bianchi Ludovici 2022. All rights reserved.