



## ARM'S LENGTH CHRONICLE

### Revenue Agency tax audit guidelines for 2022: APAs, between lights and shadows

On 20 June 2022, the Italian Revenue Agency published the Circular Letter no. 21/E (the “Circular Letter”) containing “*Guidelines on preventing tax evasion, as well as activities related to tax litigation, advice and services to taxpayers for 2022*”.

The indications therein provided are aligned with the contents of the “*Act of Guidance for the achievement of fiscal policy purposes for the years 2022 – 2024*” issued by the Italian Ministry of Economy and Finance. Also, they are fully consistent with the forecasts included in the National Recovery and Resilience Plan concerning the “reduction of tax gap”, which set forth specific measures to:

- enhance those incentives mechanisms for compliance based on the transmission of notices to taxpayers;
- increase the tax audit activity, raising its effectiveness.

Considering the above, the Circular Letter touches on three main topics:

- a. prevention, anti-evasion, and tax litigation;
- b. advice;
- c. services;

providing specific guidelines to perform the following operational actions:

- activities to prevent and promote voluntary tax compliance, also by the implementation of procedures aimed at establishing a preventive dialogue between the tax authorities and taxpayers taking into account the peculiarities of the latter;
- tax audit activities addressing different categories of taxpayers and aimed at reducing the risks of evasion/avoidance through differentiated strategies according to the taxpayer’s profile;

- advice activities as well as other transversal activities (e.g., activities aimed at the interpretation of tax regulations, activities with international relevance, activities to countering unlawful conducts, activities pursuing a deflation and reduction of litigation and appeals or an increase of court victories, activities to reduce the risk of evasion from the collection);
- various services and assistance to taxpayers.

One of the main objectives pursued by this Circular Letter is to address the tax audit activities towards taxpayers with a high tax risk profile as a priority, and, in particular, those who engage in fraudulent schemes, including the improper use of tax credits and public funds.

The Circular Letter provides specific instructions concerning the analysis of the risk profile of medium and large-sized companies as well as companies with international operations and their selection for tax audit activities. The taxpayers' profile is built-up by: using databases to identify positions with a higher tax risk; evaluating the taxpayers' more or less cooperative approach; monitoring the implementation of tax rulings; and referring to international exchanges of information through the Country by Country Reports ("CbCR"), tax ruling reports, and cross-border arrangements.

Regarding the tax audit activities of medium and large-sized companies, particularly noteworthy is the renovated interest of the Revenue Agency in: keep ensuring the consistency of auditing activities throughout the country (by identifying potential lines of investigation to be disseminated/coordinated on a national basis); empowering the coordination and connections with foreign tax authorities such as the activation of simultaneous/multilateral tax audits; and creating discussion tables between the Revenue Agency and Tax Police to promote consistent approaches for relevant and complex issues.

In this regard, in recent years we are assisting in a boost in tax audits concerning transfer pricing ("TP") matters and permanent establishment ("PE") related issues: such as capital inadequacy of the PEs of foreign companies, especially banks, and recognition of PEs hidden at the local subsidiary premises/within the Italian personnel. Other significant areas that are more and more subject to the tax authorities' scrutiny are extraordinary transactions in light of the anti-abuse tax rules, VAT frauds, and treaties abuse (e.g., application of nil or reduced withholding tax rates in lack of the specific requirements).

Aside from the emphasis on the above-mentioned activities that are strictly focused on defeating aggressive tax planning phenomena, in line with the previous edition (i.e., Circular Letter no. 4/E of 7 May 2021), the guidelines issued in 2022 by the Revenue Agency confirm the paramount importance of the tax compliance through instruments aimed at establishing a collaborative relationship between taxpayers and tax authorities, based on transparency, trust and proper use of information sources already available to the tax authorities. These instruments include first and foremost the advance pricing arrangements ("APAs") provided for by the Italian legislation (Article 31-ter of Presidential Decree No. 600/1973, "APA rules").

It is in this perspective that the guidance provided by the Revenue Agency relating to APA procedures should be read. Hence, here follows a more detailed analysis of the guidelines included in the Circular Letter about APAs within the section of the document dedicated to the prevention, anti-evasion, and tax litigation.

### How do the tax audit provisions apply to matters covered/to be covered by an APA?

Before analysing in detail the contents of the Circular Letter on this matter, it is useful to recall certain essential features of the APAs.

An APA is an agreement between a taxpayer and one or more tax jurisdictions. Depending on how many tax authorities are involved in the process, an APA can be (i) unilateral: if the parties involved are only the taxpayer and the tax authority of the country where the taxpayer is resident for tax purposes; (ii) bilateral: if it involves the taxpayer, associated enterprise of the taxpayer in the foreign country, tax authority of the country where the taxpayer is resident for tax purposes, and the foreign tax authority or (iii) multilateral: if it involves the taxpayer, two or more associated enterprises of the taxpayer in different foreign countries, tax authority of the country where the taxpayer is resident for tax purposes, and the tax authorities of the abovementioned associated enterprises.

The APA binds the parties for the fiscal year during which (i) it is signed (in case of Unilateral APA) or (ii) the application is submitted (in case of Bilateral/Multilateral APA), and for the following four years unless there are changes in the factual and legal circumstances, and it is renewable.

Per the latest amendments introduced by Budget Law 2021 on the 1<sup>st</sup> of January 2021, if specific conditions are met, taxpayers that already had reached an APA can now extend its effects to fiscal years still open for assessment (“roll-back”). The roll-back applies to Unilateral, Bilateral, and Multilateral APAs.

More specifically, regarding Unilateral APA, rolling-back the effects of APA with no administrative penalties is possible if (i) the same factual and legal circumstances underlying the APA apply; (ii) tax audits or other assessment activities of which the taxpayer has formal knowledge have not been started. Concerning Bilateral/Multilateral APA, the roll-back with no administrative penalties is also possible if explicitly requested in the application and if the foreign tax authorities involved agree on such extension (provided that the same factual and legal circumstances underlying the APA apply and that no access, inspections, tax audits or other assessment activities have been initiated).

On the APAs, the Circular Letter first recalls that only the competent APA Office can periodically verify the application of the agreed terms and conditions, and the validity of the facts and circumstances under the APA (i.e., the critical assumptions). As per the APA rules, during the fiscal years in which the APA is in force, the tax audit activities may concern exclusively other issues than those set up in the agreement.

In principle, this would also mean that once the APA application is filed, since this information is included in the Tax Register, tax auditors should refrain from investigating the issues as they are already under discussion with the APA Office.

However, considering that, due to the complexity of the matter, the due diligence/negotiation phase of the procedure may require a long period, it is not uncommon for the competent local Tax Offices to initiate tax audit activities concerning the same issues to be covered by the APA for the fiscal years still open for assessment, which are therefore potentially eligible for a roll-back once the agreement is signed. Such events imply greater efforts for the taxpayers and duplication of work from the tax authorities’ side. Moreover, this situation may lead to different approaches to the same issue.

For this reason, as in the previous edition, the Circular Letter reiterates that the SERPICO tool (i.e., an internal platform adopted by the Italian tax authorities) should be first used by the tax auditors when planning their tax audit activities to verify the existence of an APA procedure in progress or concluded and the related summary information.

The Circular Letter also states that *“if a tax audit is aimed at verifying the correct application by large taxpayers of the rules outlined in article 31-ter, the Regional Tax Office will promptly activate the coordination with the Tax Office that has entered into the agreement, to avoid overlapping actions involving the execution of the same audit activities”*.

On the one hand, if taken literally, this paragraph would seem to call attention to the need for coordination between central and local Tax Offices exclusively in the case of tax audits concerning issues already covered by an APA. If this was indeed the case, according to the Revenue Agency there would appear to be no need for similar coordination when the APA procedures are still ongoing, in clear contrast with the reference to the prior use of the SERPICO tool as well as with the guidelines provided by the Revenue Agency in the past. In particular, reference is made to the Circular Letter no. 25 of 6 August 2014, in which the Italian Revenue Agency has acknowledged that *“in the hypothesis of an audit activity initiated simultaneously with a ruling procedure, it is confirmed the need to proceed with a careful assessment of appropriateness, to avoid an overlapping of actions which, although performed according to different regulations and rules, involve the execution of the same audit activities”*.

To avoid misunderstandings and inconsistencies, the key would be to revise the wording in future releases of the document under exam, by expressly differentiating between “signed agreement” and “agreement under negotiations”. It should also be made crystal clear that, before starting a tax audit, tax auditors are required to check on the SERPICO tool whether an APA procedure has been initiated and to carefully verify whether there are reasonable ground and justified reasons for carrying on their investigation activities.

On the other hand, it would be more than helpful to make explicit the relationship of the above paragraph with the implementation of the roll-back. As previously explained, the roll-back extends the effects of the APA but it does not affect the tax audit powers of the tax administration: the local Tax Offices can scrutinize and challenge the lack of the conditions allowing the roll-back itself while, as said, the terms and conditions of the APA can be audited only by the competent APA Office. Further clarifications from the Revenue Agency would be needed also on the operational aspects of the roll-back procedure.

Indeed, in the absence of specific indications, it is common practice for taxpayers to refer to the competent local Tax Office rather than proceeding autonomously with the submission of an integrative tax return or through a self-adjustment procedure (without the application of administrative sanctions) to rolling-back the effect of the APA for the fiscal years still assessable.

The section of the Circular Letter dedicated to APAs (and also international tax disputes resolution) ends with some brief indications regarding the patent box (“PB”) regime and Mutual Agreement Procedure (“MAP”) which are matters for the same Tax Offices in charge of Unilateral APAs and Bi/Multilateral APAs respectively.

About the PB regime, the Circular Letter notes that the PB rulings will continue to be monitored by the tax authorities and that the competent Tax Offices should share the experience gained so far in this respect to achieve a uniform approach.

An increase in tax audit activities on PB issues is expected in the coming years, especially given the possibility recently introduced by Law Decree No. 34/2019 (the so-called “Decreto Crescita”) for the taxpayers to autonomously take the bonus directly in their tax returns, and the expertise gathered by the tax authorities in handling the PB agreements signed to date.

Regarding the MAP, the Circular Letter reiterates the call for close cooperation between the Regional Tax Offices, which issued the assessment deeds, and the “Direzione Centrale Grandi Contribuenti e Internazionale” that handles the outcome of such assessment activity interacting with the foreign competent authorities involved.

Lastly, confirming what was already indicated in the previous Circular Letter no. 4/E of 2021, it is clarified that the “Direzione Centrale Grandi Contribuenti e Internazionale” will issue specific guidelines to improve the assessment activities on TP.

## Takeaways

The guidelines provided by the Revenue Agency in the Circular Letter are mostly in line with the circular letters previously issued and, in particular, with the above-mentioned Circular Letter no. 4/E of 7 May 2021.

As mentioned above, the main purposes pursued by the Revenue Agency are (i) focusing on tax audit activities aimed at contrasting and preventing aggressive planning behaviours/actions; (ii) underlining the relevance of compliance pursued through procedures aimed at establishing a cooperative relationship between taxpayers and tax authorities.

The tax compliance procedure and the necessity to coordinate the activities performed by tax authorities are emphasised with particular relevance to APAs. In this respect, it is confirmed that:

- local Tax Offices are not allowed to verify the correct application of the APA Rules for the fiscal years covered by the APA (such Offices can conduct their access, inspection, and tax audit activities only with issues not covered by the agreement);
- SERPICO tool should be first used to verify the existence of APA procedures in progress or concluded and the related summary information.

Regarding the coordination among Tax Offices “to avoid overlapping actions involving the execution of the same audit activities”, it would be desirable that in the next tax audit guidelines the Revenue Agency will refer clearly to both ongoing and concluded APA procedures given the ever-increasing importance of the APAs as instruments available to the taxpayers to manage proactively tax risks and dialogue openly with the tax authorities.

As previously illustrated, in line with the now quite established attitude of the Revenue Agency towards virtuous taxpayers, it should be made clearer once and for all in the tax audit guidelines that taxpayers who show a collaborative and transparent approach by initiating an APA procedure with the Revenue Agency – under ordinary conditions – shall not be subject to tax audits for the matters covered/to be covered by the APA.

The presence of APA procedures, whether in progress or already concluded, indeed positively affects the taxpayers' risk profiles and this must necessarily be taken into account by the tax auditors in the selection of taxpayers to be audited (as mentioned in section 1.1.1 of the same Circular Letter, which concerns the analysis of the risk profile).

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

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