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Cooperative Compliance And Tax Control Framework

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COOPERATIVE COMPLIANCE AND TAX CONTROL FRAMEWORK



1. International background

Since the OECD and G20 have launched their BEPS initiative (Base Erosion and Profit Shifting), a broader attention is paid to cooperative tools between Tax Authorities and taxpayers, in order to properly address the risk of tax violations and empower the prevention instruments both for businesses (mostly, multinational enterprises, i.e. MNEs) and Administrations.

BEPS Project indeed represented a significant shift in international tax policy, aiming to create a fairer and more effective global tax environment, to counter tax avoidance strategies of MNEs which artificially transfer their profits to low-tax or no-tax jurisdictions and ensure that they pay their appropriate share of taxes in the countries where the business is carried on.

It is well known that these goals require an high level of transparency and a coordinated action by all the Countries.

In this scenario, the utmost importance is given to cooperative compliance regimes, whose strategical role is clearly highlighted in BEPS Action 13.

While primarily focusing on transfer pricing documentation requirements and the implementation of Country-by-Country Reporting (CbCR), Action 13 recognizes and encourages the use of cooperative compliance approaches to ensure transparency and cooperation between taxpayers and Tax Authorities, stimulating a preventive dialogue between them.

In the framework of the BEPS project, the cooperative compliance approach leans upon some fundamental principles and criteria:

- voluntary participation: enterprises may choose to join the program to prove their commitment to responsible tax behavior;
- enhanced transparency: MNEs that join the program commit to increased transparency in their tax affairs, providing comprehensive information about their global operations, intra-group transactions and transfer pricing policies;
- bilateral and multilateral cooperation: a bilateral and multilateral cooperation between Tax Authorities in different Countries is encouraged, sharing information in order to assess transfer pricing arrangements, ensure compliance with international tax rules and minimize double taxation or tax disputes;
- advanced pricing agreements (APAs): MNEs can enter into APAs with tax authorities to establish agreed-upon transfer pricing methodologies in advance, reducing uncertainty and the risk of disputes;

- risk assessment and mitigation: this is granted by a joint work between Tax Authorities and MNEs, with the aim of preventing aggressive tax planning and ensuring that the allocation of profits aligns with economic substance;
- transparency reports: MNEs are stimulated to submit annual reports providing detailed information on their global allocation of income, taxes paid and economic activity per jurisdiction;
- leniency programs: MNEs participating in the cooperative compliance programs may benefit from reduced compliance burdens, decreased risk of disputes, and a more efficient tax compliance process; Tax Authorities may also offer incentives such as reduced penalties for eligible taxpayers.

Overall, the cooperative compliance regime within the framework of the OECD-G20 BEPS Project aims to create a more level playing field for businesses, promote fair tax competition among Countries and reduce the potential for double taxation and tax disputes in the international arena, stimulating MNEs to responsible approach to their tax obligations and collaboration with Tax Authorities.

Inter alia, one of the key points of cooperative compliance programs is represented by the tax control framework model (the TCF). This indicates the set of rules, procedures, organizational structures and safeguards, aimed at allowing the detection, measurement, management and control of tax risk.

In this regard, it is also worth noting that the adoption of TCF, while mandatory within cooperative compliance programs, is recommended even outside the scope of application of the cooperative compliance regime, since it provides a complete overview of the business model and tax affairs of the enterprise and allows Tax Authorities to focus their audit efforts on risk assessment and risk-based approaches.

2. The Italian scenario

As well known, the Italian tax system, such as the vast majority of OECD and EU Countries', is ordinarily based on a self-assessment mechanism, where taxpayers are responsible for calculating and reporting their income as well as the tax burden by means of annual tax returns, and the intervention of Tax Offices has in principle an ex-post nature, by means of audits and inspections aimed at verifying the accuracy of taxpayers' self-assessments (which can be initiated for various reasons, including random selection, specific issues of concern, or information obtained through international tax information exchange).

In the recent past years, Italy has however progressively moved towards a more competitive tax system, starting a "new deal" of relationships between taxpayers and Tax Authority based on principles of collaboration and good faith and promoting a preventive dialogue with the purpose of a more certain, predictable and attractive tax environment.

In this perspective, general ruling procedures have gained a central role in the relationships between taxpayer and the Italian Tax Authority. These tools allow taxpayers to request tax rulings from the Tax Authority for clarification on specific tax issues or transactions, and are binding for the Administration, which cannot issue measures that conflict with positions previously held.

Furthermore, other kinds of special ruling, but with analogous binding effects, have caught on, aiming at

eliminating uncertainties especially where complex corporate reorganizations are involved (e.g. anti-tax avoidance rulings or the so called “disapplication” rulings, which are meant to prevent the application of specific anti-avoidance provisions).

The same can be said about Advanced Pricing Agreements (APAs), which have a crucial importance to achieve certainty and predictability about the transfer pricing treatment of specific transactions and gain more and more importance in order to reduce the risk of transfer pricing disputes and related penalties. By establishing transfer pricing arrangements in advance, APAs reduce the need for extensive transfer pricing audits and examinations, leading to more efficient tax administration.

APAs’ model has been declined also in the framework of the tax ruling on new investments, a tool which enables resident and non-resident investors, going to realize long-lasting and relevant investments in the Italian territory, to obtain the preventive opinion from the Italian Tax Authority about the tax treatment applicable to business programs and related M&A transactions. The main aim is to give more certainty in the determination of fiscal burdens connected to relevant investments in Italy. The reply to the ruling query is binding for the Italian Tax Authority with respect to the specific business project as described by the investors and it is valid in so far as the legal and factual circumstances remain unchanged.

Furthermore, other initiatives – mainly based on EU instruments (e.g., DAC6 on the automatic exchange of information on transnational mechanisms) – have favored an even closer link between businesses and the Administration, with the purpose of preventing aggressive tax planning phenomena at an early stage.

In short, the current Italian scenario envisages a lot of incentives and tools to establish a preventive – albeit episodic – dialogue between taxpayers and the Tax Authority on specific matters.

3. The Italian cooperative compliance regime

The Italian cooperative compliance regime takes a step forward in the direction of a closer and broader cooperation between taxpayers and the Tax Authority.

Set forth by the Legislative Decree No. 128/2015 (“Provisions on legal certainty in relations between Tax Authorities and taxpayers”), the Italian cooperative compliance regime is currently intended for large taxpayers and allows to establish a constant dialogue with the Italian Tax Authority for the prevention and resolution of disputes in tax matters, prior to the submission of tax returns (and sometimes even before the execution of the relevant transactions or business activity).

In particular, the regime – as well as the model stemming from BEPS Action 13 – has a facultative nature and is limited to taxpayers which fulfill certain quantitative and qualitative requirements.

In particular, eligible entities are:

- resident companies, as well as non-resident entities having a permanent establishment in Italy, with a total turnover or operating revenues exceeding 1 billion euros (this threshold has been progressively reduced from the first one of 10 billions euros and it is expected to be further reduced in the future);

- entities granting execution to the opinion of the Italian Tax Authority in response to the advance ruling on new investments, regardless of the amount of turnover or revenues;
- entities member of a VAT Group, whether one or more entities yet included into the program, regardless of the amount of turnover or revenues.

Eligible entities must file an application including fundamental information on the enterprise, their business model and their governance assets, as well as information about the tax control framework adopted.

Being admitted to the cooperative compliance program allows taxpayers to benefit from several advantages:

- fast track ruling (no more than 45 days since the receipt of request or the integration of documents, instead of ordinary terms - 90 or 120 days - settled down for rulings) regarding the application of tax rules;
- reduction of administrative tax penalties, which, in any case, cannot exceed the minimum provided by tax penalties law;
- no guarantees required to obtain refunds of direct and indirect taxes.

The most significant and innovative point of the regime - especially if compared to pre-existing transparency tools - lies however in the special "way" the taxpayer and the Tax Authority can dialogue.

Indeed, interactions amongst them take place on a ordinary and ongoing basis and are grounded on criteria of "common evaluation" and "anticipation of control". In this role, administrative officials become de facto an articulation of the enterprise's tax function.

In the framework of the cooperative compliance regime, the Italian Tax Authority provides officials dedicated to interacting with the company with regard to tax issues. Moreover, both the approach for the investigation of relevant data (dates and places of the meetings and agreed accesses, methods and times of the requests and related production of documents, etc.) and identification of quantitative and qualitative materiality thresholds are previously shared with the taxpayer.

Although the dialogue between taxpayers and the Tax Office is based on more streamlined and informal channels, the goals of certainty, clarity and stability of the tax relationship are granted. In fact, taxpayers - even without submitting a formal ruling - exhibit to the Administrative Office situations which can generate significant tax risks and transactions that may fall within aggressive tax planning, as well as further cases which seem uncertain, controversial or, in any case, a source of potentially significant tax risk. Answers by the Office are binding on the Tax Administration and

are valid as long as the factual and legal circumstances on the basis of which they were provided remain unchanged.

In short, the cooperative compliance regime grants with more efficiency, predictability and clearness of tax situations concerning the taxpayer, in exchange for greater transparency and access to enterprises'

data by the Tax Administration (with the “price” of provoking sometimes a slowdown in the decision-making process).

4. The tax control framework. Key elements

As above said, one of the pivots of the Italian cooperative compliance regime is represented by the tax control framework model (the TCF).

The TCF model – whose adequacy is duly evaluated by the Italian Tax Authority – is a mandatory fulfillment for taxpayers who want to enter into the cooperative compliance regime.

From another hand, TCF can be adopted even outside the cooperative compliance program, i.e. its implementation is self-standing and does not automatically determine nor mean enterprise’s will of entering into cooperative compliance.

Whether or not it is linked to a cooperative compliance program, the TCF model has to be structured in order to highlight:

- the tax strategy adopted by the enterprise, approved by the board, which defines the principles and limits inspiring the management of tax risk;
- the tax risk matrix, which identifies potential tax risks, including frauds, which could affect the enterprise, and the appropriate safeguards aimed at intercepting them and mitigating their effects;
- the model of governance adopted by the enterprise, aimed at screening roles and responsibilities of bodies involved in the management of the tax variable, as well as at identifying the information flows between these bodies and processes for the effective and preventive control of tax risk;
- monitoring, i.e. verification activities carried out on an ongoing basis aimed at assessing the adequacy and effectiveness of the implemented tax control framework;
- reporting, i.e. structuring a consistent and constant flow of information directed to the board as regards the management of tax risks.

It is worth noting that, even if from a juridical standpoint the adoption of the TCF does not affect the assessment powers of the Tax Authority nor implies tax incentives in the hands of the taxpayer (contrary to cooperative compliance regime), it is out of doubt its de facto relevance since it underlies a cooperative approach with Tax Administration and shows the transparency and good faith of the enterprise in conducting its tax affairs.

Therefore, whether a TCF is put in place, tax audit procedures can shift on the way the business and tax function are managed, privileging a risk-based approach rather than focusing on tax violations themselves.

In other words, even if TCF – to date – does not involve formal rewards effects to the benefit of the taxpayers, it is quite clear that the adoption of a TCF model is able to reduce tax disputes with the Administration and alleviate penalty consequences.

5. The future of cooperative compliance and tax control framework in Italy

Cooperative compliance regime and tax control framework are gaining a central role in the public discussion on tax policy in Italy.

In the perspective of a general review of the current tax system, with the recent Law No. 111/2023 the Italian Parliament has instructed the Government to adopt new Legislative Decrees in order to improve, inter alia, cooperation and information sharing tools between taxpayers and the Italian Tax Authority.

In particular, Art. 17 of the abovementioned Law provides principles and criteria which should support the review of the current cooperative compliance regime, i.e.:

- to increase the number of eligible taxpayers, from one hand reducing revenue thresholds and, from the other hand, simplifying the access for entities belonging to groups of companies;
- to strengthen the effectiveness of TCF in the framework of cooperative compliance programs, introducing the possibility of its certification by qualified professionals, also with reference to the compliance with accounting principles (the certified TCF);
- to implement the staff available to the Tax Administration to manage cooperative compliance dossiers;
- to empower the right to early hearing for taxpayers which enter into a cooperative compliance program;
- to provide simplified procedures for the regularization of the taxpayer's position;
- to enhance the reward effects by providing, in particular, the further reduction – up to the possible exclusion – of administrative tax penalties for taxpayers equipped with certified TCFs;
- to exclude criminal tax penalties against taxpayers adhering to the cooperative compliance regime who behave collaboratively and communicate in advance and comprehensively the existence of relevant tax risks;
- to shorten the deadlines for the assessment procedures by the Italian Tax Authority against taxpayers equipped with certified TCFs;
- to introduce special tax settlement procedures for taxpayers adhering to cooperative compliance programs.

The Legislative Decree which are going to be issued by Italian Government will say how the aforementioned principles and criteria will be concretely implemented. Furthermore, lot of their success will depend upon the means and resources that will be

available to the Administration in order to properly manage cooperative compliance dossiers.

Anyway, it is already quite clear that cooperative compliance – and the TCF as its key element – is going to become the ordinary tool for managing tax risk and tax controls in big organizations, inverting the current dynamics towards a world where the tax return reflects the results of a joint-assessment between Tax Authority and taxpayers, and ex post audits will represent the “unfortunate exception”

rather than the “threatening rule”.

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