9 November 2018

Indirect Tax Alert

Italian Revenue Agency issues landmark clarifications on VAT implications of transfer pricing adjustments and implementation of Skandia to Italian VAT grouping

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VAT implications of transfer pricing adjustments

Executive summary

According to Ruling Answer No. 60, issued on 2 November 2018, the Italian Revenue Agency (ITA) has deemed that transfer pricing (TP) adjustments may fall within the scope of VAT only if all the following conditions are met:

a) The TP adjustment must result in a payment, either monetary or in kind

b) The payment must be attributable to a specific supply of goods or services

c) There must be a direct link between the supply of goods or services and the payment

Ruling Answer No. 60

In Ruling Answer No. 60, issued on 2 November 2018, the ITA has officially expressed, for the first time, its view in respect of the possible Value-Added Tax (VAT) implications of TP adjustments.

The case, addressed by the ITA, deals with a supply chain setup involving an extra-European Union (EU) entity acting as Principal, as well as a Contract Assembler and a Contract Manufacturer both resident in Italy, all belonging to the same multinational group.

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The Contract Assembler has undertaken the contractual obligation to organize the assets necessary for the production and distribution of the goods produced by the Manufacturer. To this end, the Assembler makes available its facilities to the Manufacturer, buys the products produced by the Manufacturer and sells them to the Principal, which then distributes the finished products in the United States market.

All the above intra-group purchases and sales are performed at arm's length, according to the relevant group transfer pricing policy. Also, based on the same group transfer pricing policy, the Principal has agreed with the Contract Assembler on a compensation adjustment (adjustment) in order to guarantee an alignment to an arm's-length remuneration of the assembler, in spite of any unexpected change of assembly or production cost.

The Contract Assembler asked the ITA to state whether the adjusted remuneration falls within the scope of VAT.

In order to express its view, the ITA made a two-step analysis:

(i) The ITA first analyzed whether the adjustment could be considered the consideration for an autonomous VAT taxable service, different from and incremental to the original intercompany supply of goods.

(ii) The ITA then considered whether the adjustment – which is most typically a positive adjustment – could be characterized as an increase of the sale price of the goods supplied in the intra-group transactions between the Contract Assembler and the Principal.

The price adjustment as a VAT taxable service

The ITA first clarified that:

- Pursuant to Article 3 of the Italian VAT Law, implementing Article 2.1.c of Directive 2006/112/EC, a supply of service is subject to VAT when it is effected for consideration.
- According to the interpretation of the Court of Justice of the European Union (CJEU) a supply of services is effected for consideration "only if there is a legal relationship between the provider of the service and the recipient, pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient."[1]
- The expression "In return for the services" has to be interpreted as meaning that there must be a direct link between the supply and the consideration paid.

In light of the above, the ITA held that the payment of a positive adjustment cannot be deemed to be a remuneration of a specific service, provided by the Contract Assembler to the Principal in addition to the supply of goods, because according to the agreement between the parties the Assembler did not undertake any additional obligation towards the Principal for which the adjustment could represent the relevant compensation.

The incremental compensation as a TP adjustment for the sale of goods

The ITA then considered whether the adjustment could be considered as an increase or decrease of consideration for the supplies of goods made under the relevant intercompany agreement.

In this regard, in accordance with the general rule set out in Article 73 of Council Directive 2006/112/EC, the ITA declared that "the taxable amount for the supply of goods or services for consideration is the consideration actually received for them by the taxable person. That consideration is thus the subjective value, that is to say, the value actually received, and not a value estimated according to objective criteria."

Therefore, the ITA pointed out that, in order to verify whether the adjustment constitutes an increase or a decrease of the VAT taxable basis of the sale of the goods, it is necessary to analyze whether there is a direct link between such adjustment and the underlying sales of goods or supplies of services.

In this regard, the ITA made reference to the conclusions of Working Paper 923 taxud.c.1(2016)1280928 (WP). In the WP, the European Commission concluded that "transfer pricing adjustments (upwards or downwards) might have VAT implications, for instance, where such an adjustment could be seen as more or less consideration given in exchange for a taxable supply of goods or services already made. If an adjustment is found to constitute more or less consideration for a supply, this could arguably lead to an increase or decrease in the VAT taxable amount of that transaction, where the VAT to be paid has been calculated according to Article 73 of the VAT Directive."

Based on the above, the ITA held that in order for the TP adjustment to be characterized as a relevant modification of the VAT taxable amount of an intercompany transaction, the following conditions must be met:

d) The TP adjustment must result in a payment, either monetary or in kind

e) The payment must be attributable to a specific supply of goods or services

f) There must be a direct link between the supply of goods or services and the payment

According to the ITA, a TP adjustment can be considered as a relevant increase or decrease of the VAT taxable base of an intercompany supply of goods or services and is therefore subject to VAT only if all the above three conditions are met. As the ITA determined these conditions were not met in the case under ruling, the adjustment had to be considered as out of the scope of VAT.

Impact

In Ruling Answer No. 60, the ITA provided for the first time guidance on how to assess whether a TP adjustment can be relevant for VAT purposes. On the basis of this guidance, businesses should review their TP policy, in order to assess the potential VAT implications of their TP adjustments.

The ITA clarifies application of Italian VAT grouping and implementation of Skandia

Executive summary

On 31 October 2018, the ITA issued Circular letter 19/E providing instructions and extensive clarifications about the application of VAT grouping legislation; the Circular letter also addresses the local implementation of the Skandia CJEU judgement (C-7/13) and definitively confirms that the Skandia principles apply to transactions made as from 1 January 2018.

Circular letter 19/E

On 31 October 2018, the ITA issued Circular letter 19/E providing instructions and extensive clarifications about the application of VAT grouping legislation, enacted in 2017 and effective on an optional basis as from 1 January 2019.

The Circular letter touches upon sensitive topics, such as:

- Participation of securitization vehicles in the VAT group
- Eligibility for VAT grouping of foreign-owned Italian companies
- Segregation of different activities within the Vat group and the VAT treatment of a transfer of goods and services from one activity to another

One of the most important topics addressed in the Circular is the implementation of the Skandia CJEU judgement (C-7/13).

As described in EY Global Tax Alert, *Italian VAT law implements Skandia principles affecting intra-group supplies*, dated 4 January 2018, Italy implemented the principles stated in the Skandia judgement in Article 70-quinquies of the Italian VAT Law, which state the following:

- Transactions (both supplies of goods and services), made by an Italian VAT-grouped company (or branch) to its overseas branch (or head office) are treated as supplies made by the Italian VAT group to a third party. Likewise, supplies from the overseas branch (or head office) to its Italian VAT-grouped head office (or branch) are also within the scope of VAT.
- Transactions made by an Italian company or branch to its overseas branch (or head office) which is locally VAT grouped in another EU Member State are supplies for VAT purposes. Similarly, supplies made by the overseas branch or company VAT grouped in another EU Member State to its Italian branches or head office (whether grouped or not in Italy) are within the scope of VAT.

In this respect, the Circular letter definitively confirms that the Skandia principles apply to the transactions made as from 1 January 2018.

Impact

A number of businesses have accounted for reverse-charge VAT for periods prior to 1 January 2018, because of previous guidance, provided in an unpublished ruling,[2] which suggested that Skandia principles had retroactive effect. Businesses which have done so may wish to consider whether they have overpaid VAT for pre-2018 periods and file refund claims within the relevant deadline of 48 months since the relevant payments were made.

Endnotes

1. See also see judgments of 3 March 1994 in *Tolsma*, C 16/93, EU:C:1994:80, paragraph 14; 29 October 2009 in *Commission v Finland*, C 246/08, EU:C:2009:671, paragraph 44; and 27 October 2011 in *GFKL Financial Services*, C 93/10, EU:C:2011:700, paragraph 18.
2. See EY Italy's Tax Alert, *Implementation of the Skandia principles in Italy*, dated 16 December 2016.

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