

Italy issues instructions for disclosure of hidden PE

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Executive summary

On 16 April 2019, the Italian Tax Authorities (ITA) issued instructions (Instructions) implementing the Cooperation and Enhanced Collaboration Procedure (CECP).¹

The CECP is aimed at allowing eligible multinational companies to disclose the existence of an Italian Permanent Establishment (PE) for income tax and value added tax (VAT) purposes by way of a joint assessment with the ITA.

Companies adhering to the CECP may benefit from a reduction of any tax penalties (generally ranging from 120% to 240% of the unpaid tax) to 20% and from an exemption from any criminal liabilities associated with the failure to file income tax and VAT returns. CECP applicants may also access the Cooperative Compliance Regime (CCR) irrespective of the thresholds required by the CCR provisions.²

Detailed discussion

Companies eligible for the CECP

Nonresident enterprises may apply for the CECP provided that they meet the following criteria:

- (i) They belong to a multinational group (the Group) that, in any of the three financial years (FYs) preceding the one when the CEC application is filed, generated worldwide consolidated revenues higher than €1 billion.
- (ii) In any of the mentioned three FYs the Group generated more than €50 million of revenue from the sales of goods or provision of services in the Italian territory by availing themselves of the support of an Italian entity of the Group or an Italian PE of a foreign entity of the Group (Auxiliary Entities).
- (iii) They (and any of the Auxiliary Entities) have not been formally acknowledged of any tax audits or criminal procedures concerning the existence of an Italian PE.

The “support” function under (ii) above must be considered in a wide sense and, specifically, by considering (a) the overall activity carried out by the Auxiliary Entities in favor of the applicant through a place of business in Italy and (b) the combination of the activities carried out by the applicant and by any other Italian company belonging to the Group (i.e., even if other than an Auxiliary Entity).

The CEC application

The applicant is required to file the approved form³ by including all its relevant data (as well as those of the Auxiliary Entities), declaring fulfillment of all the requirements mentioned under (i), (ii), (iii) above, appointing an Italian representative for the procedure and (possibly) requesting access to the CCR. A set of documents must be submitted along with the CEC form.⁴

After the filing of the form, the ITA are prevented from starting any tax inspections on the existence of the (potential) Italian PE for which the CEC form was submitted.

Timing

Within 30 days from the filing of the said set of documents, the ITA are to notify the applicant of the admission to the CEC. In the following 180 days, the ITA are entitled to access the premises of all the Italian entities of the Group. After the 180-day term, the ITA are to inform the applicant on the outcome of the procedure and specifically if an Italian PE has been deemed to exist.

The mentioned terms may be suspended if the ITA require further information or documents.

Effects of the CEC agreement

The final agreement is binding on both parties. Thus, if a PE has been excluded, the ITA may no longer assess its existence to the extent that the factual circumstances and the law provisions according to which the agreement has been reached, remain unchanged. However, in the case that the existence of a PE is denied, the ITA may start a deeper investigation on the transfer pricing policy adopted by the Italian entities pertaining to the Group.

Conversely, should a PE be deemed to exist, the ITA will compute, in discussion with the applicant, the amount of income and VAT turnover to be allocated to the PE for all the FYs for which the deadline to file the relevant tax returns has expired. If, based on the above computation, the applicant pays in full the taxes (including any related interest), the mentioned penalty reductions apply. Otherwise, the ITA will issue any relevant tax assessments by applying ordinary penalties.

Implications

The continued focus of Italian tax audits on hidden PEs and the lack of instruments allowing foreign entities to disclose any hidden PE in Italy makes the CEC an interesting opportunity for eligible entities to limit tax penalties and avoid criminal liabilities.

The above is more actual than ever considering that the ratification of the Organisation for Economic Co-operation and Development (OECD) *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the MLI) will most likely increase the focus of the ITA in PE assessments, also in the light of the latest development of the Italian PE definition with reference to digital PE, anti-fragmentation and commissionaire clauses.

The short timeline provided for the procedure should make the CEC even more appealing.

Endnotes

1. The CECF was introduced by Law Decree n. 50/2017 (converted into Law 96/2017). See EY Global Tax Alert, [*Italy issues draft law to encourage foreign companies engaged in digital economy to disclose or agree to existence of a permanent establishment*](#), dated 12 June 2017.
2. The CCR was introduced with Law Decree 128/2015 and allows qualifying large businesses (either Italian or foreign residents) to manage their tax risk (e.g., via discussions with the ITA before the filing of the relevant tax returns, quicker rulings and reduced penalties) by adopting a tax control framework in agreement with the ITA.
3. The approved form has been made available at the ITA website www.agenziaentrate.gov.it.
4. The applicant may complete the submission of the documents by 30 days from the filing of the form. Such documentation includes an explanation of the business carried out by the Group and the activity and the role of the Italian entities, by clarifying the alleged reasons for an Italian PE to exist or not. For these purposes, the applicant is required to submit the Group's consolidated financial statements plus its stand-alone ones (including those of any Group company operating in Italy) referred to the previous three FYs as well as transfer pricing documentation concerning the Auxiliary Entities and other data.

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