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Tax Controversy

Italy

Law & Practice
and
Trends & Developments

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ITALY

Law and Practice

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1. TAX CONTROVERSIES

1.1 Tax Controversies in this Jurisdiction

Tax controversies typically arise following tax assessments. Most assessments follow a tax audit, at the end of which the auditors issue a Tax Audit Report. The latter is a report of findings, delivered by the auditors to the taxpayer and to the Tax Agency, and does not qualify as an assessment.

Generally, the Tax Administration cannot issue a tax assessment without a prior audit or formal request of information (some exceptions are provided for registration tax). A request of information may be addressed to the taxpayer and/or to third parties.

If a specific issue arises with respect to a given fiscal year, the Tax Administration always assesses the same finding in all the fiscal years open for assessment.

1.2 Causes of Tax Controversies

With reference to multinational entities (MNEs), corporate income tax and regional tax give rise to most tax controversies, given that transfer pricing claims are the most relevant in terms of amounts and frequency. Withholding taxes and value added tax (VAT) are under the spotlight as well. Moreover, the sale and purchase of going concerns is often challenged with reference to the declared value of the transaction and to its actual nature (ie, recharacterisation of the sale of a going concern as a sale of goods and vice versa).

1.3 Avoidance of Tax Controversies

The best way to mitigate any risk of tax controversies is to manage and control tax risks responsibly. A useful tool in this respect is the right of the taxpayer to file ruling requests to the Tax Administration. The ruling request may concern:

- the interpretation and application of tax provisions when there is an objective uncertainty on their correct interpretation;
- the existence of the conditions and the assessment of the suitability of the evidence required by law for the application of specific tax regimes;
- the application of the abuse of law principle;
- the application of transfer pricing rules and the existence of a permanent establishment; and
- the tax regime of new investments in Italy (if the investment exceeds a certain threshold and determines a significant occupational impact).

The ruling must refer to actual cases and must be filed prior to the execution of the transaction (or to its impact on the tax return of the taxpayer). The Tax Administration has to reply within 90 to 120 days (depending on the kind of ruling; rulings on transfer pricing and international matters have no deadline).

1.4 Efforts to Combat Tax Avoidance

This firm believes that in the short run, tax controversies could increase. Indeed, the recent measures (ie, BEPS recommendations and especially the EU's recent measures to combat tax avoidance) are increasing the Tax Administration's operational field and it is likely that the taxpayer will not be in a position to reshape all the current structures accordingly (eg, permanent establishment). In the long run, controversies should be reduced. All the measures are openly aimed at fighting aggressive tax planning and taxpayers are likely to assume a more conservative approach in carrying out their business activities.

1.5 Additional Tax Assessments

All tax assessments require the payment of additional taxes by the deadline for the appeal before the Tax Court. The deadline is 60 days from the serving date and it is postponed by law by 90 days if the taxpayer lodges an administrative settlement request. If a settlement is not reached and the taxpayer lodges an appeal, it is mandatory to execute a downpayment corresponding to one third of the assessed taxes, plus the related interest for late payment of taxes (but not the penalties).

There are some exceptions: some registration tax assessments require the downpayment of the whole amount, while the abuse of tax law claims does not require any payment pending a first-degree judgment. The taxpayer can ask the Tax Administration and the Tax Court to suspend the downpayment. The above-mentioned suspension is almost never granted, unless extraordinary circumstances are met. The Tax Courts can suspend the payment if:

- after a brief analysis of the reasons for the appeal, the Tax Court holds that the appeal is in principle grounded (fumus boni iuris); and
- at the same time, the payment could cause a serious and irreparable damage to the taxpayer (periculum in mora).

The latter requirement is theoretically subject to an assessment by the Tax Court of the amounts claimed in relation to the economical and patrimonial condition of the taxpayer. However, the Tax Courts often consider such requirement as fulfilled if the amounts required are very high, regardless of the condition of the taxpayer (periculum in re ipsa). If a mutual agreement procedure pursuant to EU Directive 2017/1852 has been opened and the relevant tax litigation has been suspended, the payment is suspended by law.

Under certain circumstances and subject to certain thresholds, both the infringement of tax payment obligations and violations related to income and VAT reporting may trigger a criminal proceeding.

2. TAX AUDITS

2.1 Main Rules Determining Tax Audits

The frequency of tax audits is established by law and internal regulation issued by the Tax Administration. With regard to those identified as “large taxpayers” (ie, annual turnover above EUR100 million), audits are usually carried out within the year following the one in which the tax return has been filed, also taking into consideration the specific risk profile. Theoretically, these taxpayers should be substantially audited on a “continuous basis”.

Other taxpayers are audited based on a selection carried out through specific risk profiles and automatic cross-checks performed by the Tax Administration through dedicated software databases, which monitor discrepancies in the taxpayers’ behaviour.

General risk profiles are identified with:

- the absence of any tax audits in the previous years;
- a loss position or low profitability for multiple subsequent years; and
- the risk of VAT avoidance.

The guidelines also identify high tax-risk areas and positions as potentially leading to aggressive tax planning, certain tax base erosion schemes through tax refund claims and undisclosed permanent establishment of foreign entities.

2.2 Initiation and Duration of a Tax Audit

The tax system provides a set of mandatory deadlines for the tax authorities to issue and serve tax assessment. Indeed, a tax assessment served beyond the expiry of the statute of limitations is null and void. For fiscal years prior to 2016, the statute of limitation expired at the end of December 31st of the fourth year following the one in which the tax return was filed.

In cases in which the tax return had not been filed, the deadline was December 31st of the fifth year from when it should have been filed; such statute of limitation was doubled if the alleged tax violations could imply a criminal violation. The 2015 ordinary deadline expired on 31 December 2020; however, due to the COVID-19 pandemic, the 2015 tax assessments can be served until 28 February 2022.

As from fiscal year 2016, the statute of limitation expires on December 31st of the fifth year following the one in which the tax return was filed (December 31st of the seventh year if no tax return was filed).

Initiating and Completing a Tax Audit

There is no specific moment in time when a tax audit can be initiated, but given that the commencement of a tax audit does not interrupt the statute of limitations, in practice tax audits rarely start by targeting a fiscal year that is about to expire.

If a tax audit is carried out in the taxpayer's business premises, it can last a maximum of 30 working days; the period can be extended by a further 30 working days. Such limit has to be verified taking into account each day of physical presence of the tax auditors in the premises and not the overall calendar days since the beginning of the audit.

There is no final time limit for the completion of the audit activities carried out by the Tax Administration in its own office. This means that a tax audit could theoretically stand for years if the physical presence in the taxpayer's premises is kept under the above-mentioned limit of number of days.

2.3 Location and Procedure of Tax Audits

Tax audits could be carried out at the taxpayer's premises as well as at the Tax Administration's office, depending on the difficulty of the case, the need for evidence and the activity to be actually performed.

Auditors analyse both printed documents and digital data as long as such documentation is helpful to investigate the taxpayer's behaviour.

One very effective tool is the forensic back-up of the taxpayers' computers and/or server that is taken by the auditors for investigating all the available documentation as well as the email conversations.

2.4 Areas of Special Attention in Tax Audits

In any tax audit the formal requirements, the mandatory fiscal books and the general ledger are scrutinised. There are no rules or limitations as to the substantive issues that the audit may address as they might vary depending on the purpose of the specific audit, the industry in which the audited taxpayer operates and the most recent developments in the Tax Administration's audit activities. The Tax Administration usually issues yearly specific guidelines identifying the areas and the transactions to be audited.

2.5 Impact of Rules Concerning Cross-Border Exchanges of Information

and Mutual Assistance Between Tax Authorities on Tax Audits

There has been an increasing prevalence of rules concerning cross-border exchanges of information and mutual assistance between tax authorities is increasing the chances for the Tax Administration to challenge potential tax issues.

The Tax Administration has carried out some joint tax audits with the Bavarian tax authority; the activity started in 2012 with the pilot project with the Italian region Veneto and it has been extended to other Italian regions, like Lombardia, Piemonte and Emilia Romagna. An increase in joint tax audits is expected for the coming years.

2.6 Strategic Points for Consideration During Tax Audits

As a general rule, a co-operative attitude always pays higher dividends than an obstructive one. Nonetheless, it is important to disclose data and to describe activities smoothly, balancing the concepts and, as much as possible, replying in writing. A written answer is normally more accurate and precise, and avoids the risk that a brief oral description may draw a picture that involuntarily leads the tax auditors on a wrong path.

Moreover, it is important to bear in mind that all documents whose exhibition is refused cannot be used in favour of the taxpayer in all the following phases (administrative and litigation). Such prohibition applies only if the taxpayer voluntary refuses to submit the documents and it does not apply if the documents are lodged with the first-tier appeal and the taxpayer declares that it was impossible to produce them; documents (different from the mandatory books) that are not available to the taxpayer when the audit was carried out are not subject to such rule.

3. ADMINISTRATIVE LITIGATION

3.1 Administrative Claim Phase

As a general rule, the administrative claim phase is optional. Once a tax assessment is served, the taxpayer is entitled to lodge a request to open a settlement procedure. Such a request must be lodged to the tax office in charge for the tax assessment and within the deadline provided for commencing litigation before the Tax Court (ie, 60 days from the serving date); the request automatically postpones the deadline by 90 days.

During the settlement procedure, both parties (taxpayer and Tax Administration) are entitled to discuss the case and try to reach a compromise for the solution of the case. Such compromise must follow a legally acceptable rationale and therefore it is not possible to settle based simply on a forfeit amount. Any settlement must be justifiable and grounded on tax rules. If a settlement is achieved, the penalties linked to the confirmed higher taxes are reduced to a third of the minimum, therefore they could range from 30% to 45% (depending on the nature of the claim) of the settled taxes (in most cases, this would result in penalties for tax return violations dropping to 30% of the higher taxes due). Any fiscal year is independent from the other and it is theoretically possible to settle a case that has already been decided by a Tax Court; however, once a favourable decision is issued, it is always hard for the tax authorities to disregard its outcome.

For the sake of completeness, there is a mandatory administrative settlement procedure for minor litigations (assessed taxes less than EUR50,000). Once the taxpayer challenges the tax assessment and serves the appeal to the tax office, they are obliged to indicate in the deed a settlement proposal – which could also be the total voidance of the claim – and wait for 90 days

to allow the Tax Administration to evaluate it. By such deadline, the Tax Administration could confirm the deed of assessment, accept the taxpayer's proposal or suggest an alternative solution. The taxpayer is free to accept the proposal or to continue the litigation.

3.2 Deadline for Administrative Claims

See **3.1 Administrative Claim Phase**.

4. JUDICIAL LITIGATION: FIRST INSTANCE

4.1 Initiation of Judicial Tax Litigation

A judicial tax litigation starts at the initiative of the taxpayer who challenges a tax-assessment notice served by the Tax Administration before the first-instance judge (Provincial Tax Court).

4.2 Procedure of Judicial Tax Litigation

The litigation starts with an appeal served by the taxpayer to the tax office that issued the tax assessment (or refused to grant a refund).

The appeal has to be mandatorily filed within 60 days from the serving date of the challenged deed. If the Tax Administration does not reply to a refund request lodged by the taxpayer within 90 days from the request, it is assumed that the Tax Administration has implicitly denied the refund request. This implicit denial may be challenged within ten years. Clearly, if at any time the Tax Administration adopts and serves a formal denial of the refund request, the ordinary 60-day deadline to file an appeal from the serving of the formal denial should be observed.

Once the appeal is notified to the office, it must be lodged by the taxpayer before the Provincial Tax Court within the following 30 days.

A delay in challenging the appeal or in lodging it before the Tax Court will make the appeal inadmissible.

The Tax Administration has 60 days from the receipt of the appeal to lodge its observations (*controdeduzioni*) before the Provincial Tax Court to defend its position.

Documents and Hearings

Tax litigation is a "documental" process: it is exclusively grounded on the documents and pieces of evidence provided by the parties. No witnesses are allowed as evidence. A public hearing to discuss the case in front of the panel of judges is optional, in the sense that any of the parties may request it. If no such request is made, the case is decided by the Court based on the documental evidence and written arguments presented by the parties.

If one of the parties so requires, the procedure provides for a discussion hearing, during which the parties present the case and the related evidence, and the Tax Court may ask questions. Therefore, aside from under exceptional circumstances, there is only one discussion hearing. After the hearing, the panel of judges casts the decision, which is written and published by the Court after a variable amount of time (from a few days to several months, normally between one and three months). The hearing is usually scheduled after a period ranging from six to 18 months from the day on which the appeal is lodged to the Court.

Both parties have the right to:

- file further documents, until 20 "free days" prior to the hearing; and
- file to the Court further written observations to highlight specific topics or to respond to the other party's observations, until ten "free days" before the hearing.

A "free days" period means a number of days disregarding the first and the last day (ten free days are thus equal to 11 days in standard counting); moreover, if the period ends on a weekend or on a public holiday, the term falls on the first working day before.

COVID-19

During the ongoing COVID-19 pandemic, physical presence in the Tax Courts is not allowed and the Court can decide the case without a hearing of discussion, unless a party insists on it. If this is the case, the hearing is held by videoconference. If such solution is not feasible, a "written" discussion takes place and each party has the right to:

- file a defensive brief within ten days before the hearing; and
- reply to the counterparty's brief, within five days before the hearing.

If such terms cannot be respected, the decision must be postponed.

4.3 Relevance of Evidence in Judicial Tax Litigation

Tax litigation is exclusively based on documents. Witness evidence is not allowed. Consequently, producing the appropriate documentary evidence is the only move the taxpayer can rely on to prove the correctness of his position. Third parties' written statements, appraisal, evaluation, expert opinions as well as other information can be filed to the Court to corroborate the party's position.

Relevant documents can be submitted directly with the appeal at the beginning of the tax litigation or during the litigation, up to 20 "free days" before the hearing of discussion.

4.4 Burden of Proof in Judicial Tax Litigation

In general, the litigation system provides that the burden of proof should be borne by the party claiming its right. Consequently, the Tax Administration should prove its claims as well as taxpayers should prove theirs. However, in determining the taxable income, the burden of proof applies in a variable manner. For example, while the existence of a taxable revenue is a positive fact from which the tax authorities' right to apply the tax derives and hence the burden of proof rests on the Tax Administration, the ability to deduct costs is considered as a taxpayer right and therefore the related burden of proof of cost deductibility is placed on the taxpayer.

In addition, there are some cases in which the law provides for an inversion of the ordinary rules on the burden of proof: for example, Italian citizens that have moved their fiscal residence in blacklisted countries are in any case presumed to be Italian residents unless the opposite is proven.

In a criminal procedure, it is always the State (represented by the public prosecutor) that is required to prove the illegality of the taxpayer behaviour.

4.5 Strategic Options in Judicial Tax Litigation

The way to manage a litigation changes depending on the specific case. It is not possible to set a standard procedure, but experience helps in selecting the best path to follow.

A first strategic decision concerns the opportunity to pay or not the advance downpayment (normally corresponding to one third of the assessed taxes). As stated in **1.5 Additional Tax Assessments**, the taxpayer can request the Tax Court to suspend the advance payment obligation. If both requirements are met (fumus boni

iuris and periculum in mora), asking for a suspension is probably the most appropriate strategy; otherwise, it is probably better to avoid filing a request that will most likely be rejected by the Court. Rejection of a suspension request is not advisable for the following reasons:

- upon rejection of the request, the payment will qualify as a late payment and the taxpayer will face a higher payment, increased by the collecting fees;
- although the decision on the suspension request does not address the merit of the case, it is never advisable to start a litigation judgment with a negative decision, even if on a preliminary issue, as this might influence the Court negatively for the subsequent discussion of the merit; and
- it is possible that the Court will charge the taxpayer the court fees linked to the suspension phase.

The timing for producing documents and evidences depends on their availability and on the complexity of the case. As a general rule, it is better to file all the evidence with the appeal to provide the judge with a more accurate and complete initial statement right from the start. However, if the case is extremely complex (and the appeal is a very long document), it could be helpful to summarise certain arguments and preserve part of the relevant documentation for a defensive brief later on.

If a technical evaluation is needed, the Tax Courts could appoint an expert; the taxpayer can require the Tax Courts to do it, but there is no obligation by the Court to satisfy such request.

Settlement

Even during the litigation phase, the taxpayer and Tax Administration may discuss and reach a settlement. The discount in terms of penalties is lower than that which applies if a settlement is reached prior to the start of the litigation process (a 40% reduction in first-degree judgments and 50% in second-degree judgments).

4.6 Relevance of Jurisprudence and Guidelines to Judicial Tax Litigation

While tax judges usually take into consideration domestic case law, especially when coming from the Supreme Court, and the European Court of Justice jurisprudence, they are often reluctant to rely on international guidelines and jurisprudence.

5. JUDICIAL LITIGATION: APPEALS

5.1 System for Appealing Judicial Tax Litigation

The first-tier decision may be appealed before the competent Regional Tax Court. Both parties (Tax Administration and taxpayer) have to appeal the Provincial Tax Court decision within the mandatory deadline of six months from the issuance date. The deadline may be reduced to 60 days if one party serves the decision to the other.

The appeal can be submitted once; the arguments of the appeal that had been presented during the first degree of litigation are lost if they are not repeated in the second degree.

5.2 Stages in the Tax Appeal Procedure

The stages of the tax appeal procedure are almost identical to those provided for the first-tier judgment.

The appeal must be notified to the other party by the mandatory deadline (see **5.1 System for Appealing Judicial Tax Litigation**) and then lodged before the Regional Tax Court within 30 days. The appealed party can lodge its observations to the Regional Tax Court within 60 days from the receipt of the appeal.

The Regional Tax Court then schedules the date of the hearing of the discussion, normally between one and two years from the submission of the appeal.

Once the date of the hearing is set, both parties can submit further documentation until 20 "free days" before the hearing. Likewise, both parties can deposit further observations to highlight specific topics in their defence or respond to the other party's observations until ten "free days" before the hearing.

The parties have the right to request that the case be discussed in a public hearing before the Tax Court. If such a request is not made, the case is decided by the judges based on the written arguments and evidence presented by the parties. The COVID-19 pandemic procedure applies to the appeal too (see **4.2 Procedure of Judicial Tax Litigation**).

Issuing a Decision

The Tax Court issues the decision after a variable amount of time (from a few days to several months, normally between one and three months).

The Regional Tax Court decisions can be appealed before the Italian Supreme Court (*Corte di Cassazione*), which is the highest level of jurisdiction and its mission is to ensure uniformity of jurisprudence and legal certainty. However, it is possible to file an appeal only if the decision of the Regional Tax Court violates a law or suffers from major inconsistencies and lack of motivation. Conversely, it is not possible to request to the Supreme Court a full re-examination of the merit of the case.

The appeal before the Supreme Court must be filed by the same appeal deadline (see **5.1 System for Appealing Judicial Tax Litigation**) and the other party has the right to file a counter appeal by 40 days from the serving date. It takes a significant period before a decision is issued by the Supreme Court: it ranges from six to eight years.

5.3 Judges and Decisions in Tax Appeals

Tax disputes in the first two degrees (Provincial and Regional Tax Courts) are dealt with by judges who are specialised in tax matters but not professionals (the role of a member of first and second-instance Tax Courts is honorary, not a professional career). Tax Courts of first and second instance are independent bodies deciding in panels of three members.

The Tax Courts are organised in different chambers to which the judges are appointed. Each Tax Court has a president who is in charge of assigning the appeals to individual sections. The control over the general functioning of the Tax Courts (transfer of judges, assessments of incompatibility, disciplinary measures, legislative proposals, professional training) belongs to the High Council for Tax Judiciary, a self-governing body, the members of which are elected every four years between the tax court judges (11) and the Members of Parliament (four).

The third and last degree of judgment is managed by the Supreme Court and is organised into multiple chambers, each chaired by a president and specialised in a specific field of the law; ie, civil, criminal, labour and taxation. Tax cases are heard by the tax chamber, which decides in panels of five members (who are all career judges).

6. ALTERNATIVE DISPUTE RESOLUTION (ADR) MECHANISMS

6.1 Mechanisms for Tax-Related ADR in this Jurisdiction

Many ADR mechanisms are available for the taxpayer to resolve the dispute without resorting to litigation.

- Before any assessment takes place, the taxpayer can opt for the voluntary correction of tax violations (*so-called ravvedimento operoso*), which grants the possibility of rectifying omissions or irregularities made when completing and submitting the income tax return, and when making the payments. A voluntary amendment of tax violations entails a reduction of the minimum applicable penalties (from one tenth to one fifth of the ordinary applicable penalty, depending on the circumstances).
- After an assessment deed is issued, any mistakes may be self-amended by the Tax Administration, possibly upon a specific request filed by the taxpayer.
- Once a tax audit report or a tax assessment is served, the taxpayer may request the opening of a settlement procedure (*accertamento con adesione*) aimed at settling the case. If the discussions have a positive outcome, the procedure ends with the signing of a settlement deed issued by the office and accepted by the taxpayer. The settlement grants the right to enjoy:
  (a) the reduction to one third of the minimum penalties calculated based on the settled taxes;
  (b) the reduction of the penalties envisaged for tax crimes (up to one half) and the non-application of accessory sanctions, if the settlement is signed and the amount paid before the criminal trial starts; and
  (c) the closing of the whole fiscal year for the relevant tax (unless new and material elements emerge).

A negative outcome of the settlement procedure does not limit the taxpayer's right to pursue the tax litigation without any material downside. However, if the parties do reach a settlement, the outcome of the settlement may not be appealed against by the parties.

Tax Mediation

Tax mediation (*mediazione tributaria*) aims at preventing and avoiding disputes that can be settled without going to court, taking into account the guidelines of the law and therefore of the reasonably predictable outcome of the trial. Mediation is enforceable and mandatory on tax claims of a value not exceeding EUR50,000. In the event of a negative outcome, the litigation commences.

Judicial Settlement

Judicial settlement (*conciliazione giudiziale*) pending both the first and second-degree litigation allows the parties to close a tax dispute. With the judicial settlement the taxpayer obtains a reduction of the penalties equal to 40% of the minimum if the litigation is pending before the Provincial Tax Court, or 50% of the minimum if the litigation is pending before the Regional Tax Court. No judicial settlement is possible if the litigation is pending before the Supreme Court.

The judicial settlement leads to a decrease of the penalties envisaged for tax crimes, avoids the application of accessory penalties and compensation of the expenses incurred for the judgment. A particularity of the judicial settlement with respect to the settlement procedure is that it allows the parties to carry out a partial settlement; ie, to settle only part of the claims in litigation and continue to litigate on those that have not been settled.

6.2 Settlement of Tax Disputes by Means of ADR

See **6.1 Mechanisms for Tax-Related ADR in this Jurisdiction**.

6.3 Agreements to Reduce Tax Assessments, Interest or Penalties

See **6.1 Mechanisms for Tax-Related ADR in this Jurisdiction**.

6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests

The ruling (see **1.3 Avoidance of Tax Controversies**) is an opinion issued by the Tax Administration; if the taxpayer acts in conformity to the ruling, the Tax Administration cannot challenge its behaviour. An advance ruling is therefore an effective tool for reducing tax litigations.

However, it is worth underlining that a ruling is just an administrative measure and it could be theoretically revoked at any time by the Tax Administration. However, this occurs very rarely and even if it was the case, no penalties would apply.

6.5 Further Particulars Concerning Tax ADR Mechanisms

It is not possible to apply for an arbitration procedure. The only ADR mechanisms are those described in **6.1 Mechanisms for Tax-Related ADR in this Jurisdiction**.

6.6 Use of ADR in Transfer Pricing and Cases of Indirect Determination of Tax

There is no ADR mechanism specifically for transfer pricing that is different from those described in **6.1 Mechanisms for Tax-Related ADR in this Jurisdiction**.

7. ADMINISTRATIVE AND CRIMINAL TAX OFFENCES

7.1 Interaction of Tax Assessments with Tax Infringements

Any tax claim normally entails the application of an administrative penalty, normally proportionate to the amount of assessed higher taxes. Some exceptions are provided, as for the transfer pricing violations, which are not subject to penalties if the taxpayer has duly drafted the specific documentation in a timely manner and applied for penalty protection (which requires a specific flagging in the income tax return).

The criminal proceeding is independent from the administrative one and may be triggered only if the behaviour of the taxpayer infringes specific criminal statutes, which for certain criminal offences also require that specific thresholds are met. If the tax auditors believe the taxpayer under audit has incurred in criminal violations, they are required to report the case to the Public Prosecutor's Office, which has the duty to analyse the case and possibly start a criminal proceeding and subsequent trial.

7.2 Relationship Between Administrative and Criminal Processes

The litigation process regarding the tax assessment and the possible criminal proceeding run in parallel and in principle do not necessarily affect each other. The criminal proceeding may move forward irrespective of the status of the tax appeal filed by the taxpayer against the assessment deed and vice versa. The outcome of the criminal proceeding may be considered by the tax courts but it is not binding. It is therefore in principle possible that the outcomes of the two proceedings may differ, even though often the settlement of the administrative proceeding entails a reduction of criminal penalties.

7.3 Initiation of Administrative Processes and Criminal Cases

Tax authorities are legally required to report to the Public Prosecutor's Office any potential criminal violation every time they find evidence of such violation. This normally occurs in the context or at the end of a tax audit. Therefore, administrative tax audits often trigger an administrative infringement process and a criminal tax proceeding.

7.4 Stages of Administrative Processes and Criminal Cases

With regard to the stages of a tax administrative infringement process, please refer to **4.1 Initiation of Judicial Tax Litigation**, **4.2 Procedure of Judicial Tax Litigation**, **5.1 System for Appealing Judicial Tax Litigation** and **5.2 Stages in the Tax Appeal Procedure**.

The courts in charge for criminal tax cases are different from the one deciding the corresponding tax adjustment/assessment. In fact, criminal tax cases are handled by specialised criminal courts and tribunals (*Tribunale and Corte d'Appello*) composed of professional judges.

7.5 Possibility of Fine Reductions

The payment of the additional taxes assessed or the settlement of the administrative proceeding determines the reduction of potential criminal penalties.

7.6 Possibility of Agreements to Prevent Trial

The payment of the assessed taxes, plus interests and penalties, allows a criminal tax trial to be prevented or stopped only with reference to the failure of payment of:

- withholding taxes declared or certified by the withholding agent;
- VAT declared by the taxpayer; and
- taxes linked to an undue compensation of a non-existing tax credit.

In such cases, the taxpayer is required to make the payment before the declaration of the opening of the first-degree hearing of the trial (so-called *dichiarazione di apertura del dibattimento di primo grado*).

A criminal tax trial could also be prevented in the case of a fraudulent tax return exploiting invoices for non-existent transactions or other artifices and an unfaithful or omitted tax declaration, if the taxpayer pays all the amounts due within the deadline for filing the tax return relating to the next fiscal year compared to the one in which the violation occurred, provided that any access, inspection or audit has not begun.

7.7 Appeals against Criminal Tax Decisions

The first-tier decision may be appealed before the competent criminal courts (*Corte d'Appello*). Both parties (public prosecutor and taxpayer) must appeal the first decision by the mandatory deadline of 15, 30 or 45 days depending on the time and formality to write the motivation of the decision.

The second-tier decision issued by the second-tier court (*Corte d'Appello*) can be appealed before the Supreme Court, which is the highest level of jurisdiction and its mission is to ensure uniformity of jurisprudence and legal certainty. However, it is possible to file an appeal only if the decision violates a law or suffers major inconsistencies and lack of motivation. Conversely, it is not possible to request to the Supreme Court a re-examination of the merit of the case.

7.8 Rules Challenging Transactions and Operations in this Jurisdiction

The application of the general anti-avoidance rule (GAAR) and specific anti-avoidance rule

(SAAR) does not lead to criminal charges, as well as the transfer pricing claims. It is possible to challenge a criminal violation only if the taxpayer did not book (and declare) revenues or booked (and declared) non-existent costs, which cannot be the case in such claim.

8. CROSS-BORDER TAX DISPUTES

8.1 Mechanisms to Deal with Double Taxation

If a double taxation situation occurs, it is common to challenge the deed of assessment before the Tax Court (a late challenge of the deed will imply its finality).

Once the appeal is lodged, the taxpayer may require the opening of a mutual agreement procedure provided by the double tax treaty or by the European Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC).

As to the new international dispute resolution tools, Italy has not ratified the MLI yet, while the EU Tax Disputes Directive was transposed in the Italian regulatory framework in August 2020 and is applicable to fiscal years from 2018 onwards. It is therefore too soon to assess their effectiveness. However, it is expected that in the future all mutual agreement procedures will be subject to the EU Directive or to the MLI binding arbitration process, as the case may be.

8.2 Application of GAAR/SAAR to Cross-Border Situations

There are no general mandatory guidelines for the application of GAAR and SAAR in cases where there is a bilateral tax treaty. There have been cases in which Tax Courts have acknowledged the treaty protection (non-discrimination clause) against the SAAR concerning the alleged non-deductibility of blacklisted expenses. On the contrary, the GAAR has been invoked for tackling cross-border schemes built on the treaty's provisions and aimed at achieving an undue tax saving (ie, stock lending and dividend washing schemes).

The tax courts have often confirmed claims grounded on the lack of beneficial ownership or, more in general, on treaty shopping, following a substance over form approach and, to some extent, regardless of the strict interpretation of the laws; the authors expect that the PPT and the amendment of the DTT preamble will significantly ease the tax authorities in proving the infringement of the DTT provisions. It will be therefore paramount for taxpayers to adopt a conservative approach in exploiting DTT.

8.3 Challenges to International Transfer Pricing Adjustments

There is no specific rule with reference to transfer pricing adjustments. Taxpayers usually open a mutual agreement procedure in all the cases involving EU member states in which the European Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) is applicable. Indeed, such convention should guarantee the solution of the case in a relatively short timeframe.

Taxpayers are required to pursue tax litigation in all other cases when it is not possible to open an international dispute resolution mechanism, as well as in cases where the counterparty is not resident in an EU member state. In such cases, it might not be possible to achieve a positive outcome to a mutual agreement procedure in a reasonable timeframe.

8.4 Unilateral/Bilateral Advance Pricing Agreements

APAs are an effective means to avoid or mitigate litigation in the transfer pricing field. They are becoming more common, but recently suffered a setback, mainly due to the time required to reach an agreement with the Tax Administration.

The procedure requires the taxpayer to file a specific instance, in which the perimeter of the agreement is outlined. The Tax Administration opens the procedure and verifies, also through interviews with the employees, the correctness of the facts and circumstances described in the taxpayer's instance, the functional and risk profile of the taxpayer, and all other items that are relevant for TP purposes.

Once the analysis is concluded, the parties reach an agreement that is binding for the Tax Administration for the fiscal year in which it is signed and the following four, unless it is proven that the factual circumstances are materially different from what has been agreed in the APA. Moreover, if the factual circumstances are the same in all the fiscal years following the filing (and prior to the signing), the taxpayer is entitled to require a carry back of the APA's effects.

8.5 Litigation Relating to Cross-Border Situations

See **1.2 Causes of Tax Controversies**.

9. INTERNATIONAL TAX ARBITRATION OPTIONS AND PROCEDURES

9.1 Application of Part VI of the MLI to Covered Tax Agreements (CTAs)

Italy opted for the mandatory binding arbitration.

9.2 Types of Matters That Can Be Submitted to Arbitration

Some of the DTTs signed by Italy provide for an arbitration procedure that can be activated only if:

- a proper exchange of notes between the contracting states has been accomplished; and
- both the competent tax authorities are willing to activate the procedure with reference to specific controversy.

This has implied a wide discretion in handling the procedure and the ineffectiveness of this tool in solving tax disputes so far.

Italy has reserved the option to apply Article 19(12) of the MLI to its covered tax agreements, which grants Italy the right to not submit a case to arbitration or to terminate the relevant process if a decision on the same issue has already been issued by a court or administrative tribunal of either of the contracting states.

9.3 Application of the Baseball Arbitration or the Independent Opinion Procedure

Italy opted for the Baseball Arbitration and made the reservation under Article 23(3) of the MLI to not open any mandatory binding arbitration with parties that have not taken the same option. If this is the case, the competent authorities of the contracting states shall endeavour to reach agreement on the type of arbitration process that shall apply with respect to that DTT. Until such an agreement is reached, the mandatory binding arbitration shall not apply.

It is likely that the reason for such a choice is pursuing the easier possible procedure. Indeed, the "baseball" or "final offer" arbitration process requires that each party submits its best offer to the arbitrator, who chooses one of the two, without the possibility of amendments. This process

therefore encourages the parties to propose the fairest solution and at the same time simplifies and speeds up the arbitrator's activity.

9.4 Implementation of the EU Directive on Arbitration

The EU Directive was transposed in the Italian regulatory framework in 2020; it applies to mutual agreement procedures filed since July 2019 and concerning fiscal years 2018 onwards.

9.5 Existing Use of Recent International and EU Legal Instruments

See **8.1. Mechanisms to Deal with Double Taxation**.

9.6 Publication of Decisions

Until the transposition of the EU Directive in the Italian legal framework, the outcome of a mutual agreement procedure was confidential. The new legal framework provides that, for mutual agreement procedures subject to the EU Directive, the competent authorities may agree to publish the decisions in full, with the consent of the taxpayers and of all the stakeholders. If such consent is not granted, a summary of the decision is published with a description of the case, the subject, the date, the fiscal years concerned, the legal basis, the industrial sector, a brief description of the final outcome and of the arbitration method chosen.

9.7 Most Common Legal Instruments to Settle Tax Disputes

See **8.1. Mechanisms to Deal with Double Taxation**.

9.8 Involvements of Lawyers, Barristers and Practitioners in International Tax Arbitration to Settle Tax Disputes

It is common practice for an Italian taxpayer to hire a tax adviser specialised in this topic in order to handle the procedure vis-à-vis the Italian Tax Administration. The latter does not hire independent professionals and relies on its specialised officers.

10. COSTS/FEES

10.1 Costs/Fees Relating to Administrative Litigation

There is no administrative litigation phase, but only some alternative resolution mechanism procedures described above; the taxpayer is free to activate them without paying any charge.

10.2 Judicial Court Fees

The mandatory unified contributions for first and second-tier judgments are identical and based on the value at stake in the proceeding. They range from EUR30 to a maximum of EUR1,500 (when the value exceeds EUR200,000). Such contribution is paid by the party introducing the judgment:

- in the first-tier litigation it is paid by the taxpayer; or
- in the appeal before the Regional Tax Court it can be paid by the Tax Administration or by the taxpayer, depending on who is serving the appeal.

The contribution must be paid at the beginning of the judgment.

It is possible that the Tax Court condemns the losing party to refund the expenses incurred by the other party; however, the judges often rule that each party bears its own cost.

10.3 Indemnities

Without prejudice to the fact that each party can always ask for the reimbursement of the costs incurred, it is possible to ask for an indemnity if it appears that the unsuccessful party has acted or resisted in court with bad faith or gross negligence.

10.4 Costs of Alternative Dispute Resolution

In general, the use of an ADR mechanism after the commencement of a tax litigation entails that each party bears its own costs, in particular with reference to the contribution paid at the beginning of the judgment.

11. STATISTICS

11.1 Pending Tax Court Cases

The average number of cases attributed to a judge of first instance in 2019 was 125.2.

The number of pending cases in first-instance courts as of 31 December 2019 was 197,578, with a total value of approximately EUR14.1 billion. The number of pending cases in second-instance courts as of 31 December 2019 was 137,684, with a total value of approximately EUR10 billion.

11.2 Cases Relating to Different Taxes

The number of cases initiated in 2019 was as follows.

- Individual income tax: 25,227.
- Regional tax on productive activities (Irap): 6,788.
- VAT: 11,081.
- Registration fee: 8,810.
- Mortgage and cadastral taxes: 4,104.
- Tax on corporate income: 7,776.
- Custom duties: 1,230.
- Tax litigation duties: 944.
- Others: 14,121.
- Taxes on real estate: 22,932.
- Waste taxes: 19,844.
- Road tax: 10,431.
- Advertisement tax: 1,590.
- Public soil taxes: 570
- Other local taxes: 6,705.
- Total of cases: 142,153.
- Total value: over EUR13.3 billion.

The number of cases terminated in 2019 (first-instance judgment) was as follows.

- Individual income tax: 30,050.
- Regional tax on productive activities (Irap): 9,390.
- VAT: 12,763.
- Registration fee: 10,728.
- Mortgage and cadastral taxes: 5,393.
- Tax on corporate income: 7,949.
- Custom duties: 1,271.
- Tax litigation duties: 1,007.
- Others: 16,491.
- Taxes on real estate: 25,816.
- Waste taxes: 22,496.
- Road tax: 16,026.
- Advertisement tax: 1,866.
- Public soil taxes: 778.
- Other local taxes: 8,333.
- Total of cases: 170,357.
- Total value: over EUR14.1 billion.

11.3 Parties Succeeding in Litigation

For 2019 the trend in first-instance judgments shows a 46.80% success rate for tax authorities, a 28.67% success rate for taxpayers, 11.46% as a partial success, 0.37% for judicial conciliation and 12.70% for other outcomes.

The trend in second-instance judgments shows a 46.07% success rate for tax authorities, a 34.06% success rate for taxpayers, 8.31% as a partial success, 0.35% for judicial conciliation and 11.20% for other outcomes.

12. STRATEGIES

12.1 Strategic Guidelines in Tax Controversies

In order to define the most effective strategy in handling a potential tax litigation, the first cru-

cial phase has to be a rigorous checking of the facts; it is indeed paramount to understand if the case revolves around a mere issue of legal interpretation of the applicable rules or if it is also necessary to ascertain the facts with respect to the applicable rules (eg, effectiveness and/or economic reasons of a given transaction, or beneficial ownership of a specific payment), or a quantitative issue (eg, evaluation of a going concern or a transfer pricing issue). Only once a rigorous analysis has been performed is it possible to assess the strengths and weaknesses of the taxpayer's position. In carrying out the analysis, it is also important to perform a proper check of the previous case law, which – notwithstanding the fact that precedents in a civil law system such as the Italian one do not have the same strength of common law systems – is often respected by the tax courts, especially if it is a decision of the Supreme Court.

Once the analysis of the strengths and weaknesses of the tax case is completed, it is in any case appropriate, even if the taxpayer's position is perceived as very strong, to attempt a dialogue with the Tax Administration; any tax litigation is long and, to some extent, uncertain, and it is possible that the Tax Administration could be interested in avoiding a dispute and achieving a reasonable settlement. The issues that are litigated are often complex, especially if they involve multinational taxpayers and transnational issues. Such issues are a challenge even for the most experienced judges; and even more so given that, even if in order to resolve complex technical issues it would be theoretically possible for the Tax Court to appoint technical consultants, judges are usually reluctant to lengthen the process and accumulate costs.

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Trends and Developments

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COVID-19 Pandemic Regulatory Framework

The Italian legislator reacted to the COVID-19 crisis with a series of (partially uncoordinated) decrees. During the first months of the emergency, due to the impossibility for the Italian tax authorities and taxpayers to move on with their standard workflows, the statutory terms related to pending and new tax litigations were suspended. This included both the preliminary activities carried on by the Italian Revenue Agency and the ones carried on in the Italian Tax Courts.

Special procedure for hearings

In autumn 2020 a special procedure for handling the hearings of discussions during the ongoing emergency was approved. More precisely, physical presence in Italian Tax Courts is not allowed and the judges can decide the case law without a court hearing of discussion, unless a party insists on it. If this is the case, the hearing is held by videoconference. However, if it is not feasible, a "written" discussion takes place and each party has the right to:

- file a defensive brief within ten days before the hearing; and
- reply to the counterparty's brief, within five days before the hearing.

If such terms cannot be respected, the decision must be postponed. It was impossible for all the Italian Tax Courts to arrange a hearing by videoconference. Hence, court hearings were often postponed indefinitely but sometimes the Italian Tax Courts ignored the parties' requests and decided the case law without any court hearing.

Although both outcomes entailed some issues, the second one was undoubtedly the worst.

Postponement

A postponement implies a longer overall duration of the trial and higher litigation costs. In a system where taxpayers are already burdened with relatively long procedures, this will likely negatively affect their activity. While litigation is pending, taxpayers are required to pay upfront one third of the tax object of the controversy (see the **Italy Law & Practice** chapter, **1.5 Additional Tax Assessment**). Notwithstanding the ongoing emergency, the legislator has not modified such rule; therefore, the taxpayers are required to execute such downpayment, but the postponement will cause a significant delay of the completion of trials and on the taxpayers' opportunity to benefit from the refund of the upfront payments. The legislator set forth an "expedient" for postponing such mandatory collecting activity, allowing the Italian Revenue Agency to serve the 2015 tax assessments by 28 February 2022, that is 14 months later than the deadline of the statute of limitation (ie, 31 December 2020; see the **Italy Law & Practice** chapter, **2.2 Initiation and Duration of a Tax Audit**).

Decisions with no hearings

The issuance of a decision with no hearing of discussion can endanger the outcome of the litigation. The hearing is indeed a crucial waypoint in the tax litigation and it is the only chance taxpayers have for interacting with the Italian Tax Court and explaining any details of the case that might not been easily understood with a simple deed's reading, especially in complex tax litigations regarding international tax matters.

Trend of Tax Litigation Cases

General overview

Up to 2019 (the most recent year for which official statistics have been published) there was a decrease in the number of tax litigation cases and in value of the overall cases.

The tax disputes pending on 31 December 2019 were 335,262, down by 10.45%, compared to what was recorded in 2018 (374,394). In 2019, there was a decrease in disputes received before the Tax Commissions compared to 2018, equal to 10.16%, and a decrease of those defined by 9.82%. The 2010-19 period highlights an inversion of flows in 2012, with a greater number of disputes defined of those received.

However, it is likely that the general slowdown of the tax litigation caused by the ongoing pandemic will imply a significant change in such trend. Once the pandemic is over, all pending tax assessments will have to be served and the postponed hearings scheduled, with an overload of workflows for the Italian Tax Courts and consequent delays.

Although the COVID-19 pandemic will result in a significant delay in handling the tax litigation, a reduction in new litigation is expected.

Co-operative compliance programme

A significant contribution to the litigation decrease is expected due to the increase in the application of the co-operative compliance programme between the financial administration and the taxpayer, which allows for identification, monitoring and joint-management of the tax risk (interpreted as the risk of operating in violation of tax regulations or in contrast with the principles or purposes of the tax system). In particular, the objective of such tool is to provide legal certainty in relation to the company's tax risks, through a relationship and mutual trust between the Italian tax authorities and the taxpayers.

At the moment, only taxpayers equipped with a tax risk detection, measurement, management and control system (ie, a tax control framework) and who possess certain requirements (mainly dimensional) can benefit from the co-operative compliance rules. For fiscal year 2021 only companies with revenues of not less than EUR5 billion can apply for the regime. Moreover, access is granted, regardless of the amount of revenue, for those companies that file a tax ruling request for the so-called new investments regime. This provision represents a legislative choice in the framework of those rules implemented with the aim to attract (also foreign) investments in Italy.

The dimensional limits for access to co-operative compliance should be subject to a progressive reduction and a reduction of the limit to EUR100 million is expected, thus allowing all "large taxpayers" (approximately 3,200 subjects) to access the scheme. However, as of today, the dimensional requirement has been reduced from EUR10 billion to EUR5 billion. When the accessing threshold to the regime is to be lowered, there will be an increase in the preventative confrontation and, therefore, a further reduction of the tax litigation is expected.

Increase in the number of rulings issued by the Italian Revenue Agency

A further contribution to the litigation decrease is expected as a result of the rulings issued on a regular basis by the Revenue Agency.

Indeed, on the one hand, the legislator extended the right of taxpayers to request rulings from the Italian Revenue Agency. In fact, the ruling request could refer exclusively to the application of the abuse of law principle or the interpretation and application of tax provisions where there was an objective uncertainty on their correct interpretation. Conversely, as of today, it is possible to file a tax ruling concerning the existence of the conditions and the assessment of the suitability

of the evidence required by law for the application of specific tax regimes. The ruling may now concern the application of transfer pricing rules and the existence of a permanent establishment, as well as the applicable tax regime to new investments in Italy (if the investment exceeds a certain threshold and determines a significant occupational impact). Such opportunity entails an effective reduction of legal uncertainty.

On the other hand, since 1 September 2018, there has been a significant growth in the number of rulings published by the Italian Revenue Agency on many different matters; such activity should increase the chance for taxpayers to be aware of the official interpretation of the tax law in advance and, therefore, reduce the uncertainty in its application.

Trend of International Tax Disputes Resolution

As regards the resolution of international tax disputes, the well-known difficulties that led to the approval of Action 14 in the context of the BEPS project can also be found in Italy. In fact, to date, almost all of the disputes subject to Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (the so-called arbitration convention) have been resolved, albeit in a significant time span; indeed, it is almost impossible to reach a solution of ordinary mutual agreement procedures within a time horizon compatible with the need of the economic operators.

However, the scenario should undergo a significant transformation in the near future. On the one hand, Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union was transposed into the Italian regulatory framework in 2020 and it is expected that all disputes within the EU related to the application of bilateral conventions against double taxation on income and capital will be solved in a fairly short timeframe; the Directive provides specific rules to solve the case while giving the taxpayer initiative powers in the case of inertia of the competent tax authorities.

On the other hand, it is expected that once the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion And Profit Shifting is ratified by Italy, there will be a further boost in handling international controversies, given that Italy has opted for the introduction of a mandatory and binding arbitration mechanism for the resolution of tax disputes.

The Discussion about a Reform of the Tax Justice Framework

With reference to the overall tax justice framework, a long-standing debate is in place to implement a comprehensive reform.

If the first two levels of judgment (first degree and appeal) guarantee on average a reasonably fast trial (on average two/three years to complete second-tier judgment), there is a “bottleneck” effect at the Supreme Court level, where a judgment can be issued even after six to eight years from the filing of the Supreme Court appeal. At the same time, operators complain about the absence of a professional judiciary specialised in tax matters. In the first two judgment tiers, only the tax commissions’ presidents and the presidents of the individual court chambers are part of the judiciary (on duty or retired).

The remaining components are selected based on a certain length of service (generally ten years) and qualification (a degree in economics or law) from among employees of the public administrations, retired tax police officers, accountants, experts, notaries, lawyers or chartered accountants. For these tax court judges, the appointment does not create a public employment relationship and they are just “honorary” judges.

The main limitation of the current system is the increasing level of uncertainty faced by taxpayers entering litigation, especially in relation to cases characterised by a high complexity for which, even at the Supreme Court level, an adequate analysis from a technical standpoint might not be available. Undoubtedly, the effects of the lack of a professional tax judiciary reverberate at the Supreme Court level.

Although the Supreme Court judges are all career magistrates with decades of experience, they have not all had the opportunity to gain suitably extensive experience in tax matters. Moreover, this might be one of the reasons behind the general reluctance, especially in the first two judgment tiers, to adhere to the law principles enshrined by the Court of Justice and to identify profiles of potential incompatibility of domestic legislation with EU laws, which may justify a reference for a preliminary ruling to the Court of Justice.

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