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Tax Controversy

Italy: Law & Practice
and
Italy: 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 for 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 issue in terms of both frequency and value. Withholding taxes and value added tax (VAT) are often 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 controversy is to manage and control tax risks responsibly. A useful tool in this respect is the right of the taxpayer to file ruling requests with 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 90-120 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, recent measures (eg, 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 down payment 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 down payment of the whole amount, while the abuse of tax law claims does not require any payment pending a first-instance judgment. The taxpayer can ask the Tax Administration and the Tax Court to suspend the down payment. 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 economic and patrimonial condition of the taxpayer. However, the Tax Courts often consider this requirement as fulfilled if the amounts required are very high, regardless of the condition of the taxpayer (periculum in re ipsa).

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.

1.6 Possible Impact of COVID-19 on Tax Controversies

The Italian legislature reacted to the COVID-19 crisis with a series of (partially unco-ordinated) decrees. Due to the impossibility of the Tax Administration and taxpayers progressing

with their work as usual, the terms related to pending and new tax controversies have been suspended. This includes both the preliminary activities carried out by tax authorities and the ones carried on in the Tax Courts. Further postponements are currently under discussion and it is likely that a general suspension will be granted until the end of September.

More precisely, the main postponements are the following.

The deadline for the liquidation of taxes, tax audits, patent box agreements and co-operative procedures with the Tax Authorities have been suspended for the period between March 9th and May 31st.

As far as the litigation phase is concerned, the deadlines for serving and lodging appeals are suspended between March 9th and May 11th. The actual terms are calculated with the exclusion of this period. The suspension, however, does not apply to interim or urgent measures.

The same regime applies to hearings before the Tax Courts which have been postponed to after May 31st, with the exclusion of those hearings related to interim procedures or procedures necessary to avoid any damage to the parts. The introduction of a special procedure aimed at ruling the attendance at hearings by videoconference is currently under discussion.

One of the main points of controversy surrounding the decrees is whether the deadline for challenging the tax assessment before the tax court can be calculated cumulatively using two suspensions: the one ordinarily granted if a tax settlement procedure is initiated and the COVID-19 one. The tax Administration has interpreted the law in favour of the taxpayer (in its Circular Letter 6/2020). However, doubts on this interpretation remain since the Supreme Court has already faced a similar issue. In 2015, the Court (Cass. 11632/2015) stated that the suspension period of one month granted to all court activities for the summer holidays and the suspension granted for the settlement procedures could not be added together. The fear is that courts could apply the same principle to the COVID-19 suspensions. The legislator is now considering including an explicit solution to the issue – favourable to the taxpayer – in an upcoming decree.

Nonetheless, the delay in handling this issue and the uncertainty on the correct interpretation of the decree led many taxpayers to start litigation without benefitting from the COVID suspension.

It should also be considered that, while litigation is pending, taxpayers are required to pay upfront one third of the tax object of the controversy (see **1.5 Additional Tax Assessments**). Notwithstanding the COVID general suspension, the legislature has not modified this rule; therefore taxpayers who have already challenged an appeal (adopting a conservative approach) are required to execute this down payment. In this regard, the COVID suspension will cause a significant delay to the end of trials and to the opportunity for taxpayers to benefit from the restitution of the upfront payments.

In conclusion, it is likely that the overall duration of trials will be longer because of the increased pressure on courts, causing higher litigation costs. In a system where taxpayers are already burdened with relatively long procedures, this will likely affect negatively their activity.

2. Tax Audits

2.1 Main Rules Determining Tax Audits

The frequency of tax audits is established by law and internal regulations 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;
- 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 assessments. 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; this statute of limitation was doubled if the alleged tax violations could imply a criminal violation. As from fiscal year 2016 and those following, 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).

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. This limit has to be calculated taking into account each day of physical presence of the tax auditors in the premises and not the overall number of 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 on the number of days.

2.3 Location and Procedure of Tax Audits

As mentioned, 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 actually be performed.

Auditors analyse both printed documents and digital data as long as that documentation is helpful in investigating the taxpayer's behaviour.

One very effective tool is the forensic back-up of the taxpayers' computers and/or server, taken by the auditors for investigating all the available documentation as well as 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 these 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, which have increased the chances of the Tax Administration challenging potential tax issues.

The Italian Tax Administration has carried out some joint tax audits with the Bavarian tax authority; the activity started in 2012 with a pilot project with the Italian Veneto region and it has been extended to other Italian regions, such as Lombardy, Piedmont and Emilia-Romagna. An increase in joint tax audits is expected in 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). This prohibition applies only if the taxpayer refuses, of its own volition, 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 this 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 with 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. This 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 any 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 litigation (assessed taxes less than EUR50,000). Once the taxpayer challenges the tax assessment and serves the appeal to the tax office, he or she is 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 this 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

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.

Tax litigation is a "documentary" process: it is based exclusively on the documents and pieces of evidence provided by the parties. No witnesses are allowed to give evidence. A public hearing to discuss the case in front of a 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 documentary 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 makes 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 with 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 immediately preceding it.

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 step the taxpayer can take on to prove the correctness of his or her 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 tax litigation or during the litigation, up to 20 "free days" before the hearing of the 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 just 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 to 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 litigation changes depending on the specific case. It is not possible to set out 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 down payment (normally corresponding to one third of the assessed taxes). As said (see **1.5 Additional Tax Assessments**), the taxpayer can request that the Tax Court 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 merits 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 on the merits; 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 evidence 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 on the court to satisfy such request.

Even during the litigation phase, the taxpayer and the 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-instance judgments and 50% in second-instance 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 jurisprudence of the European Court of Justice, 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-instance 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 have already been presented during the first stage of litigation are lost if they are not repeated in the second stage.

5.2 Stages in the Tax Appeal Procedure

The stages of the tax appeal procedure are almost identical to those provided for the first-instance 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 with 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 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*), the highest level of jurisdiction, whose purpose 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 a full re-examination of the merits of the case by the Supreme Court.

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 within 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 instances (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 an honorary, not a professional, one). 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, whose members are elected every four years between the tax court judges (11) and the Members of Parliament (four).

The third and last instance 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 alternative dispute resolution (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 (*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:

- the reduction to one third of the minimum penalties calculated based on the settled taxes;
- 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

- 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 that settlement may not be appealed against by the parties.

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 (*conciliazione giudiziale*) pending both the first and second-instance 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 **1.4 Avoidance of Tax Controversies**) is an opinion issued by the Tax Administration; if the taxpayer acts in conformity with the ruling, the Tax Administration cannot challenge its behaviour. An advance ruling is therefore an effective tool for reducing tax litigation.

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 this were 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 and timely drafted the specific documentation and applied for penalty protection (which requires a specific flagging in the income tax return).

The criminal proceeding is independent of 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 criminal violations, they are required to report the case to the Public Prosecutor's Office, which has a 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

As said, the 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 of criminal tax cases are different from the ones 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 interest 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 undue compensation of a non-existent tax credit.

In such cases, the taxpayer is required to make the payment before the declaration of the opening of the first-instance hearing of the trial (*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 unfaithful or omitted tax declarations, 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-instance 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; this can be 15, 30 or 45 days from the date on which the decision is issued and varies according to the complexity of the judgment.

The second-instance decision issued by the second-instance court (*Corte d'Appello*) can be appealed before the Supreme Court. 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 a re-examination of the merits of the case by the Supreme Court.

7.8 Rules Challenging Transactions and Operations in this Jurisdiction

The application of the general anti-avoidance rules (GAAR) and specific anti-avoidance rules (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 claims.

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).

Please note that the transposition of the EU Tax Dispute Resolution Directive (Council Directive (EU) 2017/1852 of 10 October 2017) has not been completed yet.

8.2 Application of GAAR/SAAR to Cross-Border Situations

There are no general rules for the application of GAAR and SAAR in cases where there is a bilateral tax treaty. There have been cases in which 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).

8.3 Challenges to International Transfer Pricing Adjustments

There is no 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, this Convention guarantees the solution of the case in a relatively short period.

Taxpayers are obliged to pursue tax litigation in all other cases when it is not possible to open an international dispute resolution mechanism, as in cases where the counterparty is not resident in an EU member state. It is, thus, not possible to achieve a positive outcome to a mutual agreement procedure in a reasonable period.

8.4 Unilateral/Bilateral Advance Pricing Agreements

Advance pricing agreements (APAs) are an effective mechanism 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 outline 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 transfer pricing purposes. Once the investigation is over, 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 proved that the taxpayer has acted in different ways from those 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. Costs/Fees

9.1 Costs/Fees Relating to Administrative Litigation

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

9.2 Judicial Court Fees

The mandatory unified contributions for first and second-instance 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). This contribution is paid by the party introducing the judgment: in the first-instance litigation it is paid by the taxpayer; 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 for the Tax Court to condemn the losing party to refund the expenses incurred by the other party; however, the judges often rule that each party bear its own cost.

9.3 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.

9.4 Costs of Alternative Dispute Resolution

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

10. Statistics

10.1 Pending Tax Court Cases

The average number of cases attributed to a judge of first instance in 2018 was 128.2.

The number of pending cases in first-instance courts as of 31 December 2018 was 225,317, with a total value of approximately EUR19.7 billion. The number of pending cases in second-instance courts as of 31 December 2018 was 148,368, with a total value of approximately EUR23 billion.

10.2 Cases Relating to Different Taxes

The number of cases initiated in recent years was as follows:

- Individual income tax: 62,280 in 2015; 55,741 in 2016; 46,088 in 2017; 44,054 in 2018.
- Regional tax on productive activities (Irap): 24,376; 17,143; 13,390; 11,868.
- VAT: 23,187; 22,137; 18,833; 18,613.
- Registration fee: 15,924; 14,846; 13,445; 13,000.
- Mortgage and cadastral taxes: 14,123; 8,630; 10,392; 8,010.
- Tax on corporate income: 15,614; 15,074; 13,834; 14,476.

- Custom duties: 2,337; 2,105; 2,116; 2,013.
- Others: 21,032; 23,189; 20,549; 21,399.
- Taxes on real estate: 27,071; 22,643; 21,671; 26,900.
- Waste taxes: 19,031; 23,192; 22,289; 22,384.
- Road tax: 19,159; 13,510; 15,347; 16,115.
- Advertisement tax: 2,416; 1,672; 1,883; 1,854.
- Other local taxes: 10,486; 11,933; 11,678; 9,636.
- Total cases: 259,051; 233,831; 213,532; 210,322.
- Total value 2018: approximately EUR24.2 billion.

The number of cases terminated in 2018 was as follows:

- Individual income tax: 53,530.
- Regional tax on productive activities (Irap): 17,054.
- VAT: 22,281.
- Registration fee: 15,960.
- Mortgage and cadastral taxes: 12,780.
- Tax on corporate income: 14,908.
- Custom duties: 2,277.
- Others: 26,078.
- Taxes on real estate: 27,308.
- Waste taxes: 26,840.
- Road tax: 20,677.
- Advertisement tax: 2,208.
- Other local taxes: 11,538.
- Total cases: 253,439.
- Total value 2018: EUR31.3 billion.

10.3 Parties Succeeding in Litigation

For 2018 the trend in first-instance judgments shows a 46.05% success rate for tax authorities, a 30.84% success rate for taxpayers, 11.34% as a partial success, 0.54% for judicial conciliation and 11.23% for other outcomes.

The trend in second-instance judgments shows a 45.40% success rate for tax authorities, a 36.79% success rate for taxpayers, 7.97% as a partial success, 0.40% for judicial conciliation and 9.45% for other outcomes.

11. Strategies

11.1 Strategic Guidelines in Tax Controversies

In order to define the most effective strategy in handling potential tax litigation, the first crucial phase has to be a rigorous checking of the facts; it is indeed paramount to understand if the case revolves around a mere point of law and the 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 as in 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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Trend of the Tax Litigation Cases

As a preliminary remark, it should be highlighted that in recent years there has been a decrease in the number of tax litigation cases and an increase in value of the overall cases. Such evolution is mainly linked to the following reasons.

New statute

A specific statute on the abuse of law has been adopted, entailing a higher legal certainty for both the Tax Administration and the taxpayers. In fact, before such reform, the legal framework was uncertain, focusing primarily on specific tax avoidance cases related to specific situations, characterised by a significant tax risk, such as business combinations, and had been progressively superseded by the Supreme Court case-law (with reference both to harmonised taxes, in light of the EU anti-abuse doctrine, and to non-harmonised taxes).

The Supreme Court, in a revival of its own previous position which dated back to the end of the '90s, gradually adopted another view, denying legitimacy of transactions aimed at obtaining undue tax benefits and lacking sound business reasons, irrespective of the fact that they were not specifically included in the anti-avoidance provisions. As from 2008, the Plenary Session of the Supreme Court has stated, in light of the ability to pay principle provided by the Constitution, the principle according to which the taxpayer "cannot derive undue tax advantages from the distorted use of legal instruments, albeit such use is not conflicting with any specific provision".

Application of new principles

The application of this very broad and undetermined principle led to significant uncertainty and resulted in a significant increase of challenges by the Tax Administration based on "anti-tax abuse" concept, in absence of codified rules, which ended up targeting also perfectly legitimate behaviours.

The current legislation provides that, in order for the abuse of law principle to apply, the Tax Administration must identify and prove the existence of three conditions.

First, an "undue" tax advantage, consisting of "benefits, also to be realised in the future, obtained in contrast with the tax laws' purposes or with the tax system's principles".

Second, the lack of "economic reasons" of the transaction carried out, consisting of "facts, deeds and contracts, even related to each other, unsuitable to produce significant effects other than tax advantages".

And third, the essential nature of the "tax advantage", ie, an advantage without which the transaction would not have been carried out. At the same time, the full legitimacy of the choice between alternative tax regimes has been affirmed as well as the non-abusiveness of transactions where sound business reasons can be found.

The new law provisions also stipulated that the abuse of law cases do not constitute criminal offenses.

Further Changes in Tax Law

Furthermore, the legislator extended the right of taxpayers to request rulings to the Tax Administration. Indeed, originally the ruling request could refer only to the application of the abuse of law principle or the interpretation and application of tax provisions when there was an objective uncertainty on their correct interpretation. Conversely, as of today, it is possible to request a 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.

From a different point of view, in 2015, a deep revision of the VAT penalty system was enacted in order to graduate the penalties proportionally to the materiality of the offence, linking them to the actual risk of tax losses for the financial administration. In this sense, for the majority of cases, when the violations do not affect the correct liquidation and payment of the tax or in any case are not part of a tax fraud mechanism, a fixed sanction is now envisaged, thus aligning domestic legislation with the principles enshrined in the EU Court of Justice case law.

Litigation

The legislator also intervened with regard to litigation deflationary tools, expanding their scope. In particular, the possibility of settling disputes was introduced also during the second-tier

judgment and the threshold of the compulsory mediation before serving the appeal was raised from EUR20,000 to EUR50,000.

A further contribution to the litigation decrease is expected by the increase in the application of the cooperative compliance program between the financial administration and the taxpayer, which allows to identify, to monitor and to jointly manage 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 Tax Administration and the taxpayer.

The current situation

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 of the aforementioned tool. In fact, only companies with revenues of not less than EUR10 billion (EUR1 billion for those who have joined the so-called "pilot project" of the regime in question) can access it.

Moreover, such access is granted, regardless the amount of revenues, for those companies wishing to implement the indications of the financial administration following a ruling request for the applicable tax regime to new investments in Italy, a provision which represents a legislative choice in the framework of those rules implemented with the aim to attract (also foreign) investments in our territory.

The dimensional limits for the access to the co-operative compliance should be subject to a progressive reduction and, starting from the 1 January 2020, the reduction of the limit to EUR100 million was expected, thus allowing all "large taxpayers" (approximately 3,200 subjects) to access the scheme. However, as of today, the relevant Decree has not yet been approved. When the accessing threshold to the regime is to be lowered, there will be an increase in the preventive confrontation and, therefore, a further reduction of the tax litigation is expected.

From an empirical point of view, all the above-mentioned changes reduced the overall number of cases in litigation, but not their value which increased by about 15% compared to the previous year (according to 2018 data, most recent year for which official statistics have been published). This increase is due to the fact that the assessments against the so-called "large taxpayers" have not undergone a contraction at all but, on the contrary, have increased as a consequence of the guidelines that provide for frequent (if not continuous) tax audits on such taxpayers. At the same time, it is not yet possible to assess the actual impact on tax litigation of the co-operative compliance regime, to which most taxpayers have applied from 2019.

Trend of the 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 (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 when Directive (EU) 2017/1852 on tax dispute resolution mechanisms in the European Union will be transposed into law, ensuring the implementation of a mechanism to resolve all disputes within the EU related to the application of bilateral conventions against double taxation on income and capital. This Directive is expected to provide specific rules to solve the case while giving the taxpayer initiative powers in case of inertia of the competent authorities (the Decree is currently under discussion in Parliament and should be approved shortly).

Further, the *Multilateral Convention to Implement Tax Treaty Related Measures To Prevent Base Erosion And Profit Shifting* will be ratified, given that Italy has opted for the introduction of a mandatory and binding arbitration mechanism for 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, on the one hand, 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), on the other hand, there is a "bottleneck" effect at the Supreme Court level where a judgment can be issued even after six/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 (degree in economics or law) 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 lack of a professional tax judiciary reverberates its effects 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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