Questionnaire 'The Burden of Proof in Tax Matters', EATLP Conference, May 2011, Athens, Greece

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How the burden of proof is allocated is an important issue in legal disputes concerning tax matters. Courts often hear tax cases in which the allocation of the burden of proof is an essential element for deciding the case. But national tax legislators also take a special interest in how the burden of proof is allocated. In abusive situations the burden of proof is often shifted to the taxpayer. This thereby strengthens the position of the tax administration.
In European tax cases the European Court of Justice (ECJ) has held that when a taxpayer provides proof in a tax case, this may only take place on the assumption that the taxpayer is able to do so without encountering undue administrative constraints.
And in international tax matters such as transfer pricing arrangements, the burden of proof is also very important. In such cases the burden of proof lies primarily with the taxpayer and he generally has to comply with severe documentation requirements.

The questionnaire, as a starting point for the coming EATLP Conference, looks at various aspects of the burden of proof at four different levels:

1. National concepts
2. The burden of proof in anti-abuse provisions
3. The burden of proof and European tax law
4. The burden of proof in cross-border situations (international tax law)

Part A: National concepts

1. General rule on the burden of proof

In Sweden like many other countries, the general rule concerning the division of the burden of proof is that the tax administration has to prove the income-side and that the taxpayer has to prove the cost-side. This rule has been established in tax practice and is based on the idea that each party must provide the evidence that is easiest for it to gather. Usually, it is easier for the tax administration to prove that income has been received and for the taxpayer to prove that costs have been made than the other way around.

Question: Does such a general rule exist in your legal system? Is it based on the law or on tax practice? If such a general rule does not exist, how is the burden of proof allocated? Do different rules apply for proceedings in the tax administration, the tax courts or the criminal courts?

2. Variations on the general rule depending on time period or if it is claimed that the taxpayer has submitted false/incorrect information

In Sweden, the general rule is the one mentioned above. This rule is applicable only in the ordinary tax procedure. The ordinary tax procedure lasts for a period of one year after the tax year (in other words, two years after the income year). After that period the tax administration has to make its decision according to the special rules of additional taxation. In case of an additional tax assessment the tax administration has to prove that the taxpayer has provided incorrect/false information (or omitted or failed to provide information that he is obliged to provide). Accordingly, during the tax procedure with regard to the additional tax assessment the tax administration bears the burden of proof for both the income- and the cost-side. The purpose of this rule is to provide legal certainty/security when a tax decision is made after the ordinary period of time has lapsed.

Question: In your country, do different rules of burden of proof apply depending on the period of time in which the decision on the tax dispute is being made? Where does the burden of proof lie where a tax penalty is being imposed?

3. Burden of proof regarding discretionary decisions on tax issues or regarding estimated assessments

In Sweden, tax assessments may be made by discretionary decisions or by estimates, in situations where the taxpayer has failed to fulfil his bookkeeping obligations. In such cases the tax administration has to show that its estimate was "probable". If the estimated assessment is probable, then the burden of proof shifts to the taxpayer and he has to provide evidence that the estimate is incorrect.

Question: How is the burden of proof allocated in discretionary decisions on tax assessments or for estimates in your country? Is the burden of proof different if a tax penalty within such a tax assessment is being imposed?

4. Variations in burden of proof with respect to tax havens, etc.

As follows from the general rule in Sweden, each party must prove whatever is easiest for that party. In practice, when it is difficult for the tax administration to obtain the relevant information, for example with respect to tax havens, etc., the burden of proof is shifted to the taxpayer. In such cases, the burden of proof lies on the taxpayer for both income and costs.

Question: How is the burden of proof allocated where a tax case contains information that is difficult or impossible for the tax administration to investigate (e.g. where a tax haven is involved)?

5. Level of the burden of proof

In Sweden, as mentioned above, the general rule within the ordinary time period for taxation is that the tax administration bears the burden of proof for income and the taxpayer for costs. The general rule regarding evidentiary requirements is that each party has to demonstrate that the income/cost is "probable"/"plausible".

Question: Does your country have a general rule regarding evidentiary requirements? If so, what are the requirements (level of proof)? Is it based on the law or on practice? Do different rules apply to the tax administration, the tax courts and the criminal courts? And are there situations in which the burden of proof is aggravated, for instance when the taxpayer has not fulfilled his bookkeeping obligations?

6. Evidentiary requirements in discretionary/estimated tax assessments

See question no. 4 above on the burden of proof in discretionary/estimated tax assessments. The tax administration has to show that its estimate is "probable". If the discretionary tax assessment is combined with a tax penalty, which is often the case, the tax administration also has to show that the tax penalty is "probable". The tax penalty in such cases so to speak follows automatically upon the discretionary tax assessment.

If the tax assessment is made according to the rules on additional taxation (two years after the tax year) the tax administration has to "prove" that the information is false/incorrect.

Question: What are the evidentiary requirements (level of proof) for discretionary/estimated tax assessments? Are the evidentiary requirements the same for tax penalties in such cases? Are the evidentiary requirements different if the tax assessments are being made according to the rules for additional tax assessments (i.e. do such rules exist in your country)?

7. Evidentiary requirements depending on exchange of information, tax havens, etc.

From question no. 4 above it follows that if it is difficult or impossible for the tax administration to investigate situations having to do with tax havens, the burden of proof may shift. More and more countries have entered into information exchange agreements with tax havens which could affect the burden and level of proof.

Question: Are the evidentiary requirements affected by the possibility for the tax administration to investigate circumstances in a case e.g. by means of exchange of information with a country involved?

8. Different evidentiary requirements for different types of taxes

In Sweden, in certain cases, the evidentiary requirements seem to differ for different types of taxes in the same case. For example, for false invoices of subcontractors, different types of taxes are involved: income tax, VAT and social security fees. In Sweden, it seems as though different evidentiary requirements are applicable for these different types of taxes.

Question: Are different evidentiary requirements applicable in your country for different types of taxes?

9. General rule on evaluation of evidence and the limitations to such a rule

In Sweden there exists the principle of a free assessment of evidence. A consequence of this is that the evidence in a case is also freely evaluated by the tax administration and ultimately by the tax court. The principle of the free assessment and evaluation of evidence in tax matters is statutory.

Question: Is the evaluation of evidence free or is it in any way limited? Is it statutory or is it based on practice?

Part B: Burden of Proof in Anti-Abuse Provisions

10. General anti-abuse provision

Question: Is there a general anti-abuse provision in your (procedural) tax law and which party bears the burden of proof under this provision?

Please illustrate the actual way this provision is given form: what does it provide for and to what extent is the term "anti-abuse" specified? In case there is no such provision in your national tax law, is reference made to anti-abuse provisions in other fields of law? An example of an anti-abuse provision or principle that originates from civil law is the principle of good faith (principle of abuse of law). Please explain as well the actual way the burden of proof is given form. Some jurisdictions have established a two-step mechanism, e.g. Germany in Sec. 42 General Tax Code: It is up to the tax authority to provide probable cause - it has to be substantiated that the taxpayer's legal arrangement is inappropriate. The taxpayer has then subsequently to give proof to the contrary, i.e. to substantiate that the rationale for his arrangement is not tax related but e.g. based on economic reasons.

11. Alternative or supplementary approaches

Question: Are there any other (alternative or supplementary) approaches established in practice or by case-law in this regard and do these comply with the general principle of the division of burden of proof in your country?

Examples of such other ways may be the economic approach, the look-through approach or substance over form approach, all of which deal with the relation between legal form and economic substance. E.g. in Sweden, an anti-abuse provision is part of Swedish tax law, but a look-through approach established in practice is applied in this regard as well. If your jurisdiction recognizes both anti-abuse provisions and other approaches, is there a priority in application? With regard to the division of burden of proof, are there any deviations from the general principle recognized in many jurisdictions that each party has to prove the facts that are advantageous for them?

12. Special anti-abuse provisions

Question: Are there special anti-abuse provisions dealing with the burden of proof in particular tax law areas and what exact requirements does the taxpayer have to fulfill? Is the required level of proof higher compared to the general provision or principle?

Typically, special anti-abuse provisions can be found in the context of cross-border situations/international transactions. If such provisions exist in your jurisdiction, have there been any reasons given by the legislator for dealing differently with these situations, e.g. that the ex officio discovery of the facts is particularly difficult for the tax authorities and so the burden may be shifted due to the fact that the disclosure of facts is more within the sphere of the taxpayer than within the sphere of the tax authority? Please elaborate on whether there are, according to that reasoning, some provisions in which a situation is deemed to be abusive unless proven otherwise by the taxpayer.

Usually, special anti-abuse provisions also set special requirements which may include the disclosure of certain documents, proof of the appropriateness of certain legal arrangements, the compatibility of intra-group transfer prices with the arm's length principle, etc. Are there any provisions that set the requirements or the level of proof so high that producing proof to the contrary is virtually impossible?

13. Competent authority

Question: Which body (tax authority, independent institution or tax court) may decide if the required level of proof is met? Are there different levels of proof that e.g. the tax authority or the taxpayer have to fulfill?

In some jurisdictions, the decision whether the required level of proof is met will be - at first instance - up to the tax authority. In France, however, an independent institution (consultative committee, comité consultative pour le repression des abus de droit) decides whether certain arrangements have to be considered abusive. In other jurisdictions, for instance in Sweden, it is only up to the court to decide whether the required level of proof is met. With regard to the level of proof imposed on the tax authority, there might be deviations from the requirements set on taxpayers. Different levels of the burden of proof may be imposed, for instance, on the parties by means of the economic substance test (proof that a legal arrangement was made not only for tax-related reasons): while the tax authorities may only be required to show probable cause, the taxpayer may be required to prove both economic profit potential and a subjective business purpose.

14. Judicial review

Question: Is the decision of the above authority or body subject to a full (or a partial) judicial review and are there different levels of burden of proof in the different stages of the judicial proceedings?

Please explain the extent to which the decision of the body that is in charge of deciding whether the required level of proof has been met is binding. In case the decision is subject to a judicial review, is the court bound to a certain extent by the prior decision (e.g. that the decision will only undergo a plausibility check)? With regard to the different stages of judicial proceedings, it should be elaborated on, for instance, whether the tax authority may impose a different level of burden of proof on the taxpayer than a tax court does. May the taxpayer be obliged to present clear and convincing evidence in tax authority proceedings, while a preponderance of the evidence is a sufficient standard before tax courts?

15. Case law

Question: Are there any court judgments in your jurisdiction concerning the burden of proof with regard to:

a) the situations in which (special) anti-abuse provisions may be applied to the taxpayer?

b) the requirements that may be imposed on the taxpayer?

c) the compatibility of burden-of-proof provisions in anti-abuse matters with your country's Constitution or EU law?

In the answer to these questions, the focus should be in particular on the limits set by the courts, e.g. that the application of certain provisions is within the discretion of the tax authority, but that tax officers, however, have to comply with the principles of proportionality and reasonableness. A special point at issue may be the challenge of anti-abuse provisions (especially for general anti-abuse rules) on grounds of not complying with the principle of legal certainty or, on the other hand, the justification as the fulfilment of the constitutional duty to safeguard the principle of equality of tax burdens.

Part C: The burden of proof and European tax law

16. EC law and the reversal of the burden of proof

In the famous Leur-Bloem case (ECJ 17 July 1997, case C-28/95) the ECJ ruled as follows: "Article 11 of the Directive is to be interpreted as meaning that in determining whether the planned operation has as its principal objective or as one of its principal objectives tax evasion or tax avoidance, the competent national authorities must carry out a general examination of the operation in each particular case. Such an examination must be open to judicial review. Under Article 11(1)(a) of the Directive, the Member States may stipulate that the fact that the planned operation is not carried out for valid commercial reasons constitutes a presumption of tax evasion or tax avoidance. It is for the Member States, observing the principle of proportionality, to determine the internal procedures necessary for this purpose. However, the laying down of a general rule automatically excluding certain categories of operations from the tax advantage, on the basis of criteria such as those mentioned in the second answer under (a), whether or not there is actually tax evasion or tax avoidance, would go further than is necessary for preventing such tax evasion or such tax avoidance and would undermine the aim pursued by the Directive."

In general the outcome of this ruling can be described as follows:

1. Member States are not allowed to have provisions in their national tax laws that deem certain situations to have occurred primarily as the result of tax evasion or tax avoidance, while at the same time allowing the taxpayer to provide proof to the contrary. This reversal of the burden of proof to the detriment of the taxpayer violates EC law.
2. The tax administration must prove that the motive of a transaction is tax avoidance or tax evasion on a case-by-case basis.

Questions

1. Could you give an impression how the Leur-Bloem judgment was viewed in your country by lawyers, the judiciary and the government?
2. Did the decision lead to any significant changes in legislation?
3. Are there provisions in the national tax legislation that do not yet meet the standards in the Leur-Bloem judgment?

17. Reversal of the burden of proof and time limits

Article 14, paragraph 4 of the Netherlands Corporate Income Tax Act 1969 contains a specific provision concerning the possible abuse of merger facilities with regard to an asset merger. It provides that if the shares in the receiving company that were received on the occasion of the transfer of the assets to the receiving company are being sold within three years after the merger, the merger facilities are retroactively withdrawn unless the taxpayer proves that the transaction was carried out for sound business reasons.

Question: Does the tax legislation of your country contain similar provisions and how do you assess such a provision in the light of EU (tax) law?

18. Reversal of the burden of proof and transactions with non-domestic entities

Article 13b, paragraph 4 of the Netherlands Income Tax Act 1969 contains a specific provision to combat abuse of tax law where an intra-group loan is written down. It provides that if the loan that was written down for Netherlands tax purposes is sold to a company established outside the Netherlands or to a natural person resident outside the Netherlands, it is deemed to be a transaction with a foreign company belonging to the group or with a natural person having a substantial interest in the group, unless the taxpayer proves the contrary.
The background of this provision is the situation that the written-down loan leaves the Netherlands tax jurisdiction even though it is not clear whether or not the loan was sold to an affiliated group company or a natural person. If the loan is sold to a third party, the writing down of the loan definitely ends up as a final tax loss that stays in the Netherlands. But if the loan stays ‘within the group’ the writing down of the loan is recaptured.

Question: Does your national tax legislation contain a more or less similar provision and what is your opinion of the provision in the light of EU law requirements?

19. Donations to foreign charitable institutions and the burden of proof

In the Persche case (ECJ 27 January 2009, case C-318/07) the ECJ ruled as follows: “Article 56 EC precludes legislation of a Member State by virtue of which, as regards gifts made to bodies recognised as having charitable status, the benefit of a deduction for tax purposes is allowed only in respect of gifts made to bodies established in that Member State, without any possibility for the taxpayer to show that a gift made to a body established in another Member State satisfies the requirements imposed by that legislation for the grant of such a benefit.”

The deductibility of donations (in money or in kind) to foreign charitable institutions is a highly debated topic in the light of EU developments (Community law). In this respect the issue of the burden of proof is very relevant as taxpayers often have limited possibilities to prove that the foreign institution is involved in charitable activities while the Member State is far better equipped to investigate the contested activities.

Question: How do you view the taxpayer's obligation to provide the requested proof (as held by the ECJ) and when does a reasonable division of the burden proof evolve into a situation in which, after the taxpayer provides the initial proof, the burden shifts to the tax administration to prove the nature of the activities of the foreign charitable institution?

20. The burden of proof and proportionality

In the recent SGI-case (ECJ 21 January 2010, case C-311/08) the ECJ ruled on profit corrections regarding transactions between related companies in a cross-border situation. The contested transactions implied the provision of a loan without taking any interest into consideration and the payment of excessive management remunerations.
The Court held that it was proportional that the initial burden of proof, to demonstrate, on the basis of objective and verifiable elements, that the transaction, or elements of the transaction, represent an artificial arrangement lies with the tax administration.
The taxpayer is then to be given the opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that may have existed for that transaction. See also, paragraph 82 Thin Cap GLO (C-524/04) and paragraph 84 CFC and Dividend GLO (C-201/05). In the case at hand the taxpayer had a period of one month, which could be extended, within which to establish that no unusual or gratuitous advantage is involved. This seems to be reasonable.
This approach seems to be in line with Commission Paper COM(2007) 785 final concerning anti-abuse regulations in the field of direct taxes – application in the EU and with regard to third countries, page 5.

Question:
To what extent is the direct tax legislation and case law in your country in line with the above-mentioned standards set by the ECJ?

Part D: Burden of Proof in Cross-Border Situations (International Tax Law)

Transfer Pricing Aspects

21. The burden of proof between tax authorities and taxpayers

In some countries, the burden of proof may be reversed if the taxpayer is found not to have acted in good faith, for example, by not cooperating or complying with reasonable documentation requests or by filing false or misleading returns. In other countries, the burden of proof lies only with the taxpayer.
In **Italy** tax assessments must be properly motivated and the burden of proof is with the tax authorities (Art. 2967 Civil Code, which also regulates the burden of proof in the case of tax assessments).
The application of this principle to <u>transfer pricing means that the burden of proof that the intercompany pricing is not at arm's length lies with the tax administration</u>. However - upon the notification of a tax assessment providing evidence that costs have not been incurred by the taxpayer - the burden of proof shifts to the taxpayer, while the tax administration must provide reasons supporting the assessment of an increase in taxable income.

Local tax offices tend to be very aggressive in challenging the deductibility of costs for centralized services charged by non-resident companies to their Italian permanent establishment or to their resident associated company. Tax assessments are usually based on the view that such expenses are not inherent to the business activity carried on in Italy, which implies the lack of any benefit to the taxpayer.

Question: Who bears the burden, the tax administration or the taxpayer, of proving that transfer pricing operations are at arm's length?

22. Set of documents

In recent years, OECD member countries and EU Member States have been adopting transfer pricing documentation rules.
The OECD Guidelines are based on the prudent business management principle, which means that the need for information should be balanced against the costs and the burden that the taxpayer will bear in preparing or obtaining such documentation. The OECD Guidelines stress that the tax authorities should take great care that the imposition of documentation requirements will not impose disproportionately high costs and administrative burdens on MNEs (multinational enterprises), which will have to obtain documentation from foreign associated enterprises. The tax authorities should also refrain from requiring taxpayers to engage in an exhaustive search for comparable data from uncontrolled transactions if the taxpayer reasonably believes that no comparable data can be found or the efforts to find these data would be disproportionately high in relation to the amounts at issue.
The main goal of the European Union Transfer Pricing Documentation (EU TDP) is to maintain a balance between, on the one hand, the right of the tax authorities to obtain the necessary information from taxpayers in order to assess whether transfer pricing is at arm's length and, on the other hand, the compliance costs MNEs incur from complying with the rules. The key reason for implementing the EU TPD was to significantly reduce the tax compliance burden and complications that companies have to face when doing business with associated enterprises in other EU Member States.
Italian tax law does not include any formal provisions regarding transfer pricing documentation. There is no rule that requires Italian companies to prepare contemporaneous documentation describing and supporting the transfer pricing policies that have been adopted by the corporate group and the group's intercompany transactions. Nevertheless, under Article 32 of Presidential Decree 600 of 20 September 1973, the Italian tax authorities may require taxpayers to produce documents concerning the assessment to which they are subject. This means that Italian companies must compile documents such as:

- the group's legal structure;
- a description of any existing transfer pricing guidelines or policies within the group;
- a benchmarking analysis possibly used by the parties to determine the fair market price, rate or consideration;
- intercompany agreements signed by parties; and
- all documents proving that any inter-company services have been actually rendered to the Italian company and the benefit derived by the Italian company from such services.

Question: Is there a statutory requirement in the national tax legislation to prepare documentation proving the arm's length value in the determination of transfer pricing? Is the breach of the rule accompanied by an administrative or criminal penalty? Are "*statutory requirements*" provided or is the "*documentation just recommended to avoid shifting the burden of proof concerning a reasonable price to the taxpayer*"?

23. Imposition of penalties and burden of proof

The EU Code of Conduct recommends that Member States not impose documentation- related penalties on taxpayers, at least not when they have complied in good faith with the EU TDP or with domestic documentation requirements in a reasonable manner and within a reasonable time (Communication from the Commission to the Council, the European Parliament and Economic and Social Committee", note 3, at 7).
Italy: There are no specific transfer pricing penalties.

Question: If there is a statutory requirement to prepare documents, what is the nature (administrative or criminal) of the related penalty?

24. Type of documents to be provided

Italy: The taxpayer is obliged to provide documents within its legal sphere, e.g. the original documents which, assessed overall, lead to a functional analysis; in contrast, the taxpayer is not required to provide the summary of the functional analysis. The taxpayer, when specifically requested, has to provide (given it might be unable to produce them later) documents of its business, and therefore the auditors could well require the production of the documents that establish the capital employed and risks assumed in the intercompany transaction. For example, a contract between the assessed enterprise and an associated company (or correspondence proving covenants between the companies themselves) has to be provided to the tax authorities, without any possibility of being used afterwards; instead, the summary functional analysis, which also includes an evaluation of the functions performed by the taxpayer, may also be produced by the same taxpayer later.

Question: Is the taxpayer required to provide only "original documents" or must it provide even a functional analysis with an evaluation? In particular, are there implicit limitations in the request for information by domestic tax authorities to foreign companies within the same group of the audited company? (For example: during the tax audit, does the taxpayer have to provide the price that its foreign affiliates paid to independent enterprise or should the tax administration consult the competent foreign tax authorities by means of information exchange?)

25. Choice of transfer pricing method

The TP Guidelines establish a hierarchy among the three traditional transaction methods (comparable uncontrolled price, cost plus and resale minus) and the transactional profit methods (transactional net margin method and transactional profit split methods). According to the TP Guidelines, the transactional profit methods are last-resort methods, e.g. they should be used only in the exceptional situations where there are no data available or the available data are not of sufficient quality to rely solely or at all on the traditional transaction methods (Paragraph 2.49 of the TP Guidelines). The CUP method is always preferable where it can be applied in a sufficiently reliable manner.
Italy: The tax treatment of transfer pricing is currently governed by Article 110, Paragraph 7 of the Income Tax Consolidated Act (ITCA). The arm's length definition contained in this provision refers to the concept of "normal value", which is defined by Article 9 (2) of the ITCA. Therefore, Article 9 of the ITCA represents the statutory basis for the determination of the arm's length value of an intra-group transaction. In order to provide guidance on the concept of "normal value" arising from Article 9 of the ICTA, the Ministry of Finance issued a Circular Letter (32/9/2267 of 22 September 1980) [and Circular letter 42/12/1587 of 12 December 1981] in which it analytically indicated the methods to be used for each type of

transaction (e.g. transfer of movable goods, transfer of technology, loans and intra- group services) based on the arm's length principle. Although not legally binding, the Circular is generally accepted by the tax authorities and taxpayers, and is considered to be the main reference for the interpretation of transfer pricing issues. Such Circular Letters refer to a body of rules which have in part been modified but are still extensively applicable and extremely important, especially with regard to the methods for determining the normal value, since they represent the only instructions of a general nature supplied by the Ministry on the matter.

<u>Basic Methods</u>: A reading of the above-mentioned Article 9(2) ITCA seems to indicate that the comparable price method is the only method the Italian legislator allows to be used for the actual application of the transfer pricing system. The Italian Ministry of Finance, the prevailing opinion and the case law all concur in the necessity of having recourse to the transfer pricing system even when the comparable price method proves not to be applicable. In its 1980 Circular Letter the Ministry of Finance affirmed, in harmony with the indications set forth under OECD Reports, that where a comparison between the transaction being verified and the sample one is not possible, recourse must be made to the resale price method or to cost-plus method.

<u>Alternative Methods</u> (*The Overall Profit Allocation Method; Profit Comparison Method, Invested Capital Profitability Method, Economic Sector Gross Margin Method*): The use of alternative methods, in other words transfer pricing methods other than the basic ones, is not provided for by the current legislation as it envisages only the comparable price method. In its 1980 Circular Letter the Ministry of Finance has, however, allowed that "the application of the basic methods (price comparison, resale price, cost-plus) may not, in some particular cases, satisfy the application of the regulations governing Transfer Pricing since frequently there are no comparable transactions and just as frequently a reliable comparison between independent enterprise is not possible". Consequently, it was considered advisable that other methods suitable for a practical use be taken into consideration in the event that basic methods prove inadequate. It is pointed out in the said Circular Letter that in practice the use of such methods tends to determine the normal profit rather than the congruity of the transfer price and it is specified that alternative methods may be considered useful: i) supplementary, when upon verifying the correct application of the three basic methods uncertainties, arise; ii) alternatively, when it is absolutely impossible to apply the three basic methods.

Question: Is there a regulatory hierarchy in choosing these methods? Are the *transactional methods* preferred over the *profit-based methods*? Is the choice based on the nature of the goods or service sold?

26. Burden of proof and bilateral conventions

Potential conflicts may result from a different allocation of the burden of proof in the jurisdictions involved in transfer pricing matters: see *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2009 Para. 4.14 ("*When transfer pricing issues are present, the divergent rules on burden of proof among OECD Member countries will present serious problems if the strict legal rights implied by those rules are used as a guide for appropriate behaviour. For example, consider the case where the controlled transaction under examination involves one jurisdiction in which the burden of proof is on the taxpayer and a second jurisdiction in which the burden of proof is on the tax administration. If the burden of proof is guiding behaviour, the tax administration in the first jurisdiction might make an unsubstantiated assertion about the transfer pricing, which the taxpayer might accept, and the tax administration in the second jurisdiction would have the burden of disproving the pricing. It could be that neither the taxpayer in the second jurisdiction not the tax administration in the first jurisdiction would be making efforts to establish an acceptable*

arm's length price. This type of behaviour would set the stage for significant conflict as well as double taxation") and Para. 4.15 ("*Consider the same facts as in the example in the preceding paragraph. If the burden of proof is again guiding behaviour, a taxpayer in the first jurisdiction being a subsidiary of a taxpayer in the second jurisdiction (notwithstanding the burden of proof and these Guidelines), may be unable or unwilling to show that its transfer prices are arm's length. The tax administration in the first jurisdiction after examination makes an adjustment in good faith based on the information available to it. The parent company in the second jurisdiction is not obliged to provide to its tax administration any information to show that the transfer pricing was arm's length as the burden of proof rests with the tax administration. This will make it difficult for the two tax administrations to reach agreement in competent authority proceedings*").
Italy: there are no bilateral conventions containing provisions in this sense.

Question: Given that Article 9 of the OECD Model is silent on the subject of the burden of proof, are there bilateral conventions to avoid double taxation that instead contain express provisions on the burden of proof in transfer pricing matters? Is this a matter of domestic law?

27. Burden of proof and information exchange procedures

The tax authorities tend to perform all auditing activities in **Italy** without reverting to bilateral or multilateral procedures available in order to verify and prove their conclusions. For example, the lack of comparable data in Italy often leads the tax authorities to abandon the CUP method in favour of the cost-plus methods or the other alternative methods which do not require investigations outside of Italy. Indeed, practice shows that there are few exceptions to this attitude and few situations in which audits are commenced based on information spontaneously made available by foreign authorities.
For example, an assessment which justifies the application of the cost-plus method because of the impossibility of finding comparable data may be considered void for lack of proof if it can be shown that the tax authorities did not try to find the comparable data through an exchange of information with the jurisdiction in the market of destination of the goods. When the tax authorities have failed to undertake an exchange of information procedure, tax courts may void tax assessments for lack of proof. However it is interesting to note that the Italian tax authorities are aware of the risk that a passive approach in carrying out audits of international transactions may be considered by a judge as a failure to meet the burden of proof. In Circular letter of 21 October 1997 271/E, paragraph 2.3., the Ministry of Finance stressed that finalization of assessments concerning the deductibility of head office expenses is appropriate only after having taken recourse to the exchange of information procedures aimed at verifying whether the costs recharged to the Italian taxpayer were actually borne by the head office and if the costs were connected to the business of Italian taxpayer.

Question: Does the national law in your country require prior recourse to an exchange of information procedure in order to finalize a tax assessment regarding transfer pricing or a tax assessment involving international tax issues in general?
- In particular, are the tax authorities free to issue assessments based on alleged violations of the arm's length principle without the necessity of previously verifying abroad the information and the data which could confirm or void such assessments?
- What kind of obligations does the taxpayer have to fulfil if the tax authorities request further information during this procedure?

28. Burden of proof in the mutual agreement procedure

Tax treaties do not provide for the avoidance of double taxation in specific situations. Consequently, there is a need for an effective tool to solve disputes among the tax authorities of different jurisdictions. Therefore, income tax treaties include a special kind of procedure known as the mutual agreement procedure (MAP), which is generally modelled on Article 25 of the OECD Model Treaty. The great advantage of the MAP for both tax authorities and taxpayers is its flexibility and relatively non-bureaucratic nature.

The taxpayer should be given the right to approach the tax authorities of the two countries involved to obtain advance clearance, on the basis of mutual agreement, on the basic elements of the transfer pricing system to be followed such as the method to be applied, the selection of the data to be used and, if required, adjustments thereto.

Question: What is the taxpayer’s legal position in a mutual agreement procedure?