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A Comparative Study of International Transfer Pricing: Italy and Japan

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ABSTRACT

(EN)

This study attempted to analyze the regulatory framework of the two countries, Italy, and Japan by first covering and understanding key economic approaches to transfer pricing. Following their profiles which are meant to accurately reflect the current status of the country's legislation and illustrate the extent to which their policies adhere to the OECD Transfer Pricing Guidelines.

Furthermore, we analyze the actions relevant to TP that would improve cross-border tax rule coherence, tighten substance requirements, and promote transparency in order to resolve BEPS offered by the OECD/G20.

Finally, we reviewed Italy and Japan's implementation of the OECD/G20 BEPS Project and determine that Italy's competent authority is struggling more than Japan's, as a consequence of having more new MAP cases submitted yearly and being under-resourced. As a result, after taking into consideration all the aspects evaluated in this study, we are able to say that even though there is one Transfer Pricing Guideline that governs all the OECD members including Italy and Japan, the result of its implementation is different in each country.

ABSTRACT

(IT)

Il presente lavoro ha avuto lo scopo di comprendere il quadro normativo di due Paesi, Italia e Giappone. Lo studio ha analizzato in un primo momento gli approcci economici chiave ai prezzi di trasferimento per arrivare in un secondo momento ai profili che illustrano accuratamente lo stato attuale della legislazione del Paese e la misura in cui le loro politiche aderiscono alle Linee guida dell'OCSE sui prezzi di trasferimento.

Inoltre, si è indagato su quali potrebbero essere le azioni rilevanti per TP offerte dall'OCSE/G20 che andrebbero a migliorare la coerenza delle norme fiscali transfrontaliere, inasprirebbero i requisiti sulle sostanze e promuoverebbero la trasparenza al fine di risolvere il BEPS.

Infine, è stato esaminata l'implementazione da parte dei due Paesi del progetto OCSE/G20 BEPS e stabilito che l'autorità competente italiana mostra una maggiore difficoltà rispetto a quella giapponese, gap dovuto alla carenza di risorse e al numero di nuovi casi MAP presentati ogni anno.

Pertanto, dopo aver preso in considerazione tutti gli aspetti oggetto di studio si può affermare che, nonostante esista una Transfer Pricing Guideline che disciplina tutti i membri dell'OCSE compresi Italia e Giappone, il risultato del livello di implementazione è diverso in ciascun Paese.

LIST OF ABBREVIATIONS

ALP	Arm's Length Principle
AOA	Authorized OECD Approach
APA	Advanced Pricing Agreement
ASMT	Act on Special Measures concerning Taxation
ATAD	Anti Tax Avoidance Detective
BEPS	Base Erosion Profit Shifting
CbCR	Country by Country Report
CCA	Cost Contribution Agreements
CDOTP	Commissioner's Directive on the Operation of Transfer Pricing
CPSM	Comparable Profit Split Method
CUP	Comparable Uncontrolled Price
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HTVI	Hard to Value Intangibles
ICAP	International Compliance Assurance Programme Pilot
IRS	Italian Revenue Agency
MAP	Mutual Agreement Procedure
MNE	Multinational Enterprise
MTC	Model Tax Convention
OECD.	Organization for Economic Cooperation and Development

RPSM	Residual Profit Split Method
SME	Small Medium Enterprise
TFEU	Treaty on the Functioning of the EU
TIEA	Tax Information Exchange Agreements
TNMM	Transactional Net Margin Method
TP	Transfer Pricing
TPG	Transfer Pricing Guidelines

INTRODUCTION

Economically speaking, globalization led to the emergence of multinational enterprises (MNEs), which has been one of the most significant global economic phenomena of recent decades. (BalTett, 1992) (Ernst, 1999)

MNEs are more likely to integrate their activities across national borders than inside individual countries. As a result, they transfer vast quantities of products and services between operating subsidiaries in various countries.

Consequently, MNEs can significantly lower their tax payments thanks to globalization.

The use of legal arrangements that make profits disappear for tax purposes or allow profits to be artificially shifted to low or no-tax countries is referred to as Base Erosion and Profit Shifting (BEPS). (OECD, 2015)

The overarching goal of the BEPS measures is to address loopholes in international tax regulations that allow MNEs to shift profits to low- or no-tax jurisdictions legally but artificially.

Although there is evidence that numerous environmental factors influence ITP decisions in the existing literature, most studies focus on a single country or, in contrast, two or more developed national jurisdictions.

The aim of this study is to understand how two countries, Italy and Japan are interpreting and following the Transfer Pricing Guidelines. Additionally, evaluate

whether they are successfully facing current problems by implementing the solutions offered by the OECD.

Firstly, we cover the basics by following a quick overview of the major economic approaches to transfer pricing presented in the first chapter.

Next, the core of this study consists of analyzing the regulatory framework in Italy and Japan. It aims to examine how each of these two countries interprets the OECD Guidelines and adapt their own domestic legislation around it.

In the last chapter, we will see the current problems that transfer pricing is facing and what are the possible solutions offered by the OECD to resolve them. Furthermore, we analyze how Italy and Japan are implementing and resolving their current situation.

CHAPTER 1:

GENERAL BACKGROUND TO THE STUDY

1.1 THEORIES OF INTERNATIONAL TRANSFER PRICING

The subjects mentioned in this thesis will be introduced in this chapter. It will begin with a brief overview of transfer pricing and why it is important.

Following the illustration of the OECD Guidelines, in order to examine the regulations of transfer pricing, which includes an overview of the Guidelines, the Arm's length principle, and the transfer pricing methods used by MNEs.

1.1.1 TRANSFER PRICING

Transfer pricing is a term used to describe inter-company pricing arrangements relating to transactions between related business entities. These can include transfers of intellectual property, tangible goods, services, and loans or other financing transactions. (Holtzman & Nagel, 2014)

However, economists noted as early as 1979 that the term "transfer pricing" had taken on negative connotations, implying that large multinational corporations have the ability to manipulate the prices of intra-firm trade and service flows for business advantage. (Plasschaert, 1979)

TP is necessary for a variety of reasons, including economic (e.g., resource allocation efficiency), functional (e.g., divisionalization of the organization into profit centers

responsible for both revenues and costs), organizational (e.g., enhancing integration and differentiation within divisionalized organizations), and strategic (e.g., influence by and on accounting mechanisms).

Nevertheless, TP can be exploited unethically and illegally, for example, to reduce global tax, in which revenue and costs are manipulated to show maximum and minimum profits in low- and high-tax countries, respectively. According to research, TP has enabled many organizations to shift their profits from high-tax countries to low-tax countries. (Davies et al., 2018; Grubert & Mutti, 1991; Klassen, Lisowsky, & Mescall, 2017; Yao, 2013)

For instance, when unrelated businesses transact with one another, the circumstances of their commercial and financial relationships are generally determined by market forces. When related companies transact with each other, their commercial and financial relationships may not be as directly affected by external market forces. As a result, the prices charged for intra-firm transfers of goods, such as those between a multinational's foreign subsidiary and its US-based parent, may differ from those charged to independent companies for comparable goods transfers. (Urquidi, 2008)

1.1.2 OECD GUIDELINES

1.1.2.1 The OECD

In order to have a clear view of where the Guidelines derive from, I will first describe the organization that is behind them, which is the OECD.

The OECD is a unique organization where governments collaborate to address globalization's economic, social, and environmental challenges. The OECD is also at the top of the agenda to comprehend and assist governments in responding to new developments and concerns, such as corporate governance, the information economy, and so on. The organization provides a platform for governments to share policy experiences, seek solutions to common problems, identify best practices, and work to coordinate domestic and international policies.

The transfer pricing Guidelines, published by the OECD in 1995, are of particular interest. These Guidelines serve as a model for allocating profits from multinational enterprises to countries. The previous version, from July 2017, incorporates the approved action developed under the G20's Base Erosion and Profit Shifting (BEPS) project.

The number of members of the OECD amounts to 38 countries, including Italy since 1960 and Japan since 1964. (*OECD Welcomes Costa Rica as Its 38th Member*, 2021)

1.1.2.2 Highlights of the OECD Guidelines

The 2010 Guidelines are a revision and compilation of previous OECD Committee on Fiscal Affairs transfer pricing reports. They do not depart from the OECD's long-held position that the arm's length principle is the foundation for international agreement on transfer pricing. They are not meant to be comprehensive. Instead, the emphasis is on the key issues raised by the arm's length principle. Additional revisions are likely to

address issues such as applying the arm's length principle to intangibles, services, cost contribution arrangements, permanent establishment, and thin capitalization.

The Guidelines are intended to assist "tax administrations (both OECD member and non-member countries) and MNEs by indicating ways to find mutually satisfactory solutions to transfer pricing cases, thereby minimizing conflict among tax administrations and between tax administrations and MNEs and avoiding costly litigation." (para. 15) The goals of this endeavor are to allocate the international tax base and to avoid double taxation. (para. 7) The Guidelines' primary goal is not to prevent tax evasion or artificial income shifting through transfer pricing. (Li, 2012)

In addition, given the nature of the transfer pricing problem, these guidelines have become a focal point and have had a significant influence not only on international law but also directly on the national legal systems of many countries.

1.1.3 THE ARM'S LENGTH PRINCIPLE

The principle is outlined in Article 9 of the OECD Model Tax Convention and governs the taxation of transfers within a multinational company. This principle can be defined as a transaction in which the buyer and seller of a product act independently and have no connection to one another. In other words, the arm's length principle is connected with a transaction in which the affiliates are bargaining on equal ground, neither party is subject to the other's control or dominant influence, and the transaction is treated fairly and legally. If the transfer price is determined to be significantly different from

the arm's length price, the transfer price will be corrected accordingly by national tax authorities.

Therefore, it avoids the formation of tax advantages or disadvantages, which would otherwise alter either type of entity's relative competitive position. By removing tax implications from economic decisions, the arm's length concept encourages international trade and investment growth.

To protect their tax base, tax authorities have made arm's length pricing (ALP) the central principle of multinational company taxation. Nevertheless, there is no single method that is always correct; it is not that simple. The arm's length price is frequently stated as a range rather than a single price.

In many cases, identifying a price for the same product transferred between two independent agents is difficult in practice. The principle appears to be based on the implicit assumption that arm's length prices observed in trade between independent firms are the "correct" ones when determining the value of multinational firms' intracompany trade.

An arm's length transaction can be calculated in a variety of ways. The taxation authorities will analyze the forms submitted and compare them to the prior year's tax returns to see if a consistent approach was followed. Before being attached to tax returns, these forms should be prepared by qualified tax professionals. An Analytical review is a frequent method used in auditing, and another tool recognized in financial statement analysis is trend analysis, or horizontal analysis, which can be used to analyze consistency in reporting.

1.1.4 TRANSFER PRICING METHODS

Transfer pricing methods or methodologies are used to calculate or test the arm's length nature of prices or profits. Transfer pricing methods are methods for determining the profit margins of transactions or a whole organization, or for computing an arm's length transfer price. Transfer pricing mechanisms must be used to ensure that transactions between connected firms are conducted at arm's length. However, transfer pricing methods are not determinative on their own.

Hence, if an associated enterprise reports an arm's length amount of income without explicitly employing one of the transfer pricing methods recognized in the OECD Transfer Pricing Guidelines, this does not automatically imply that its pricing is not at arm's length, and there may be no reason to impose adjustments.

Some strategies are more relevant and indicative than others for achieving an arm's length result in specific transactions.

There are five comparability elements that the OECD Transfer Pricing Guidelines specify as important to assess when determining whether or not there are any changes between the transactions being compared that effectively influence the exanimated circumstances:

1. The *functional analysis* is the beginning point for selecting a method, which is required regardless of the transfer pricing method chosen. Each method may necessitate a more in-depth examination of elements associated with the method. It assists in identifying and understanding intra-group transactions for the following reasons: first, to provide a basis for comparison; second, to

determine any necessary adjustments to the comparables; third, to ensure the accuracy of the method chosen; and fourth, there is a need to consider policy adaptation if the functions, risks, or assets have changed. (Holtzman & Nagel, 2014)

2. The difference between specific *characteristics of property or services* frequently accounts, at least in part, for differences in their open market value. As a result, comparisons of these traits may be useful in establishing the comparability of controlled and uncontrolled transactions.

   The following characteristics may be vital to assess:

   - Tangible property (physical features of the property, quality and reliability, and the availability and volume supply)
   - Service (the nature and extent of the services)
   - Intangible property (the form of transaction, the type of property, the duration and degree of protection, and the anticipated benefits from the use of the property)

   Overall, this element must be given more or less weight depending on the transfer pricing method.

3. The *contractual terms* of a transaction often describe openly or implicitly how the parties' responsibilities, risks, and benefits are to be distributed. As a result, an examination of contractual conditions should be included in the functional

analysis outlined above. The terms of a transaction may also be found through correspondence/communications between the parties that are not documented in a written contract. Where no written conditions exist, the parties' contractual obligations must be determined from their actions and the economic principles that govern relationships between independent firms in general.

It is critical to determine if the parties' behavior adheres to the provisions of the contract or whether the parties' behavior suggests that the contractual terms have not been followed or are a sham. In such circumstances, additional investigation is required to ascertain the true conditions of the transaction.

4. *Economic circumstances* are factors that may be useful in determining market comparability. Some of the factors are the following:
    - geographical place
    - the size of the markets
    - the competition in the markets
    - the availability of substitute goods and services
    - the levels of supply and demand in the market and, if relevant, consumer purchasing power
    - the nature and scope of government control of market costs of production

5. Many aspects of a company's operations would be considered in *business strategies*. For instance, innovation and new product development, degree of diversification, risk aversion, political change assessment, the input of existing and planned labor laws, duration of arrangements, and other factors affecting daily business operations.

The previously described comparability considerations are linked to the guidance of most nations with established transfer pricing rules. To emphasize the necessity of accuracy, the most recent version of the OECD Transfer Pricing Guidelines emphasizes the importance of correct transaction delineation in comparability analysis and the data that is taken into consideration.

Moving to the selection of the transfer pricing method, the methodologies listed on the Guideline are composed of "traditional transaction methods" and "transactional profit methods" for determining whether the conditions imposed in commercial or financial relations between associated enterprises are consistent with the arm's length principle.

Traditional transaction methods are the following:

- *The Comparable Uncontrolled Price (CUP) method*

  It is a method based on the taxpayer's estimation of the amount charged in a controlled transaction. This means that, according to the CUP method, the price charged for property or services transferred in a controlled transaction should

be compared to the price charged in an uncontrolled transaction. The quotation media and public exchanges could retrieve data from uncontrolled transactions, and the taxpayer should adjust this data.

This method was ideal in a situation where:

- Internal comparable already exist (tangible goods, services, royalty rates)
- Commodities transactions, particularly where information on
- Market prices for homogeneous or standardized commodities exist
- Financial transactions (interest rates on loans)
- Analyzed common intangibles (royalty rates, license fees).

When an exact comparison is not possible, the CUP method can be used, but the analysis's reliability suffers as a result.

- *The Resale Price method*

It is a method based on the distributor's profitability. This means that this method emphasizes determining the gross margin from the distributor's perspective. Then, this method is based on deducting an appropriate gross margin from the uncontrolled resale price, thereby defining the resale price margin. The resale price margin could then be calculated based on the company's uncontrolled purchases and resales in controlled transactions.

The following are three scenarios in which the resale price method could be successful:

- Situation in which a reseller purchases various products for resale from associated and independent parties, but the CUP method cannot be used due to differences.
- Purchases of products from associated parties for resale by a reseller that do not add significant value through physical modification, the contribution of valuable intangible property, or significant marketing activities
- Commissionaires and agents.

- *The Cost Plus method*

The cost plus method begins with the costs incurred by the property (or service) supplier in a regulated transaction for property transferred or services delivered to an associated purchaser. In light of the functions performed and market conditions, an acceptable cost + markup is subsequently added to this cost to create an appropriate profit. What is obtained after adding the cost + mark up to the above costs is an arm's length price of the original regulated transaction. In brief, this method aims for a cost-plus markup that is applied to the cost. In order to generate a reasonable profit, this mark-up cost is added to the costs (costs incurred by the supplier of property or services to a connected purchaser). The Cost Plus approach works wonderfully in the situations listed below:

- Whenever a supplier of goods or services in the controlled transaction provide also similar items to independent parties, but due to the

differences in the products or services the CUP method can not be applied;

- When the manufacturer does not add valuable intangibles or assumes substantial risk
- Intra-group services
- Contract research and development arrangements

Transactional profit methods are the following:

- *The Transactional Net Margin method*

  This method takes an acceptable financial indicator based on the profit realized by the tasting party in controlled transactions and compares it to the profit realized in equivalent uncontrolled deals.

  The facts, conditions, and choice of the tested party all influence whether a financial indication is suitable or not. Because the condition being examined is at the net margin level, there is a larger pool of potential comparable information available than in the CUP, Resale Price, and Cost Plus techniques. It is also quite adaptable during the application. In reality, depending on the financial indicator used, the net margin can be compared to various other metrics.

  These are some examples of how the method has been successfully applied:

  - Sales of tangible products to distributors where the data is not available to use the resale price method

- Sales of tangible products by manufacturers where data is not available to use the cost plus method
- Where gross margin data is available but is not reliable because of differences in the accounting
- Intra-group services, including contract research and development arrangements

- *The Transactional Profit Split method*

It is a method of dividing a company's profits, and according to the regulations, we have two precise profit split methods. The first is called the Comparable Profit Split Method (CPSM), while the second is called the Residual Profit Split Method (RPSM). The comparable profit split approach then requires the sharing of operating profits among controlled taxpayers in amounts comparable to those derived from uncontrolled activities (OECD, 2017). The residual profit approach allocates the combined operating profit or loss of uncontrolled transactions to controlled taxpayers. The operating income is then transferred to the participant, who earns a market return from its commercial activity. The intangible property's residual profit is allocated.

The profit split approach is applied in the following situations:

- When each party makes a distinct and valuable contribution to the transaction

- When a controlled transaction is heavily interwoven and cannot be considered separately
- Transactions are initiated when the parties to the transaction share economically significant risks

Traditional transaction methods are regarded as the most direct means of determining whether conditions in commercial and financial relations between associated enterprises are at arm's length. This is because any difference in the price of a controlled transaction from the price of a comparable uncontrolled transaction can normally be traced directly to the commercial and financial relations made or imposed between the enterprises, and arm's length conditions can be established by directly substituting the price of the comparable uncontrolled transaction for the price of the controlled transaction.

On the other hand, in some cases, transactional profit methods are more appropriate than traditional transaction methods. For example, where each party makes valuable and unique contributions to the controlled transaction or where the parties engage in highly integrated activities, a transactional profit split may be preferable to a one-sided method. As another example, where there is no or limited publicly available reliable gross margin information on third parties, traditional transaction methods may be difficult to apply in cases other than those with internal comparables, and a transactional profit method may be the most appropriate method given the availability of information.

Nonetheless, applying a transactional profit method simply because data on uncontrolled transactions is difficult to obtain or incomplete in one or more respects is not appropriate. Profit-based methods can be accepted only if they are compatible with Article 9 of the OECD Model Tax Convention, particularly in terms of comparability.

1.1.5 ADVANCED PRICING AGREEMENTS

As the number of multinational companies grows, so does the number of related party transactions, and as a result, transfer pricing has come to be seen as one of the most essential parts of taxation. MNEs apply transfer prices to all transactions that effectively determine the income, and thus the tax base, in a specific place for accounting and tax purposes.

Transfer price determination is difficult because not only does the firm's desire to avoid taxation collide with governments' tax revenue ambitions in high tax areas, but there is also a dispute between governments because an increase in one tax base can reduce that in another.

As a result, enterprises do not know whether their transfer prices will be recognized by tax authorities and, if not, how much they would be altered. From this vantage point, it is not unexpected that one of the most serious issues mentioned in a recent survey of multinational corporations (MNEs) is tax uncertainty. (Ernst & Young, 2011)

Implementing advance pricing agreements is one way to eliminate tax uncertainty (APAs). The firm negotiates an APA with the tax authorities to determine the future

transfer pricing technique. In other words, APA is an administrative approach to prevent transfer pricing conflicts by setting the criteria for applying the arm's length principle to transactions in advance. This method entails a transfer price function that determines the transfer price based on outcome variables such as revenues and costs. There are unilateral APAs, which involve only the firm and one country (typically a high tax location), as well as bilateral and multilateral APAs, which involve additional countries in the negotiations.

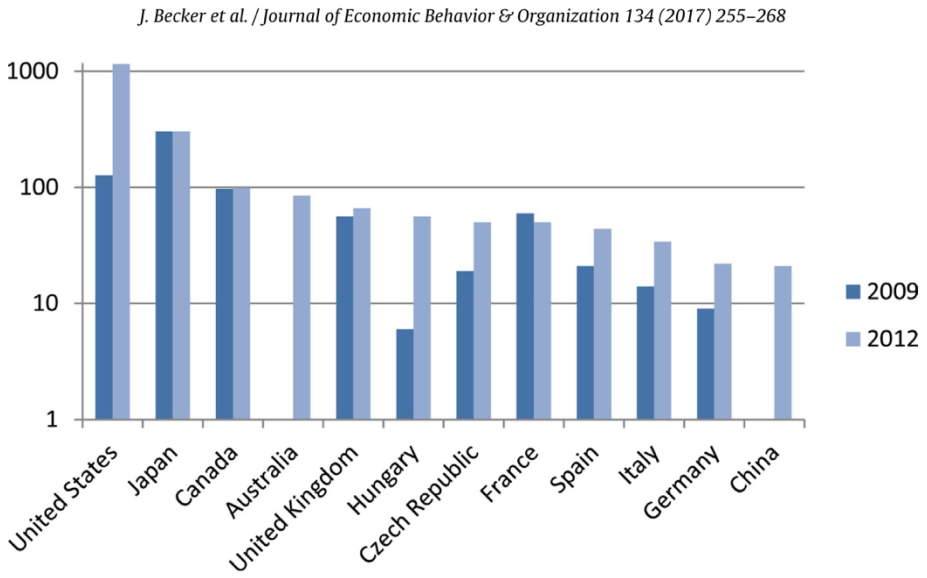

Fig.1.1: Number of APAs in force in 2009 versus 2012.

Sources: IRS(2013), EU Joint Transfer Pricing Forum (2013), Australian Tax Office (2011), Canada Revenue Agency (2013), National Tax Agency Japan (2013), and State Administration of Taxation (China) (2011).

The use of APAs is increasing, with the number of such agreements increasing from 758 in 2009 to 2055 in 2012. (EU Joint Transfer Pricing Forum, 2011, 2013).

Figure 1.1 depicts their use in the dozen nations that account for nearly 95 percent of all APAs. As can be seen, the United States, Japan, and Canada were among the early adopters. In just three years, their use in the United States surged tenfold. Furthermore, other significant FDI suppliers and hosts have begun to use them far more frequently.

There is a significant amount of research that describes and interprets APAs as a type of insurance against future changes in tax treatment (e.g. Vollert et al., 2013). This viewpoint is predicated on the notion that firms are risk averse and hence want to be insured, or that there is some other concavity in the firm's reward function such that it wins in expectation by lowering tax uncertainty.

However, we have to take into consideration the disadvantages of such agreements.

The first aspect is that not every company is eligible for APA. An APA program cannot be used by all taxpayers because the method is expensive and time-consuming, and small taxpayers may not be able to afford it. This is especially true whenever independent experts are involved. As a result, APAs may only be useful in settling large transfer pricing cases.

Furthermore, the resource implications of an APA program may limit the amount of requests that a tax administration can consider. Tax administrations can mitigate these possible issues by ensuring that the level of inquiry is proportionate to the size of the overseas transactions involved when examining APAs.

Another aspect that we have to examine is the effect that APAs have on the market. The reason behind it is that APAs may be a presumptive form of state aid.

As already stated before, an APA's purpose is to clarify an MNE's future tax payments, giving the firm greater clarity and decreasing the likelihood of a tax dispute. As a result, an APA provides an MNE with less tax risk as compared to MNEs that do not have an APA.

In addition, national tax authorities use APA as a policy to improve the business environment for foreign direct investment (FDI) by providing greater tax certainty for MNEs. Therefore, this could lead to distorted competition and impact trade patterns.

In a two-tiered government, state aid is defined as any form of aid granted by a lower-tier government or through the low-tier government's resources that distorts or threatens to distort competition among firms within the upper-tier government's jurisdiction by favoring certain firms or types of activities. A fundamental issue behind a government aid program is that enterprises receiving government help may be enticed to locate in specific sub-jurisdictions (e.g., inward FDI) or may utilize the funds to engage in hostile competitive activity against competing firms. A state policy is intended to keep lower-tier governments from competing for location subsidies, promoting "local champions," or generally distorting competition among enterprises inside national borders.

Since the EEC Treaty of 1957, which barred any aid that distorted or threatened to distort competition insofar as it affected trade between Member States, state aid policy has been a significant pillar of EU competition policy. State aid is an upper-tier (EU) policy, not a lower-tier (Member State) policy, aimed to prevent Member States from

providing assistance to enterprises and activities ("undertakings") that could harm the EU internal market. The EU's official stance on state aid is outlined in Article 107 of the Treaty on the Functioning of the EU (TFEU).

Article 107(1) of the Treaty of the European Union prohibits any aid supplied by an EU Member State if it meets all four of the following conditions.

1. Directly or indirectly funded by a Member State or its resources;
2. Favors certain enterprises or the manufacture of specific goods (i.e., offered selectively or with a selective character, as opposed to broad policies that apply equally to all market participants in comparable conditions);
3. Confers an advantage that could not (or could not be gained on the same terms) from private market actors; and
4. Distorts or threatens to distort competition and impacts trade between Member States.

Article 107(1) encompasses all forms of government aid, including direct grants or subsidies from the state to a firm; loans or guarantees from the state to a firm at below-market interest rates (e.g., capital injections or debt recovery); purchases of goods or services at above-market prices by the state; sale of state assets at below-market value (e.g., privatization) or state purchase of private assets at above-market value.

However, there are exceptions. Five of them can be found in TFEU Articles 107(2,3). They are the following:

- Aid that meets the private market test: If a Member State intervenes on terms that a private sector operator would accept, the intervention does not offer an advantage and is not state aid.
- De Minimus Rule: financial aid supplied by a Member State to a private sector operator that is less than €200,000 over three years is too modest to be considered state aid.
- Compatible Aid: Aid provided by a Member State that is of a social nature, is offered to repair damage caused by natural disasters or under exceptional circumstances, or is in the form of competition for the merger of East and West Germany is not state aid. [Article 107(2) TFEU]
- Aid that Meets the Balancing Test: Aid that is intended to support the development of less developed regions or specific activities (e.g., culture, heritage conservation) where the aid contributes to a common good is not considered state aid. [Article 107(3) TFEU]
- Aid that is not selective: State aid is not granted if no advantage is imparted on a selective basis - either there is no advantage or the advantage applies to all enterprises.

Although Article 107(1) was written with subsidies in mind, the policy has long been recognized to include income taxes as a potential type of state aid. Therefore, to determine if a government policy constitutes state aid, we must first determine whether

an advantage was granted (i.e., whether the subsidy has the ability to distort competition inside the country's borders) and whether the advantage is selective (i.e., whether the advantage is restricted to one or more particular firms or activities).

In the case of APAs, although they are a tax dispute settlement mechanism, they are opaque and flexible. Hence, APAs are almost presumptively state aid, according to the European Commission. Furthermore, any tax benefit that is particular to a single enterprise or activity may be considered state aid by the European Commission if it confers an advantage.

APAs are clearly selective policies. While all MNEs have the right to apply for an APA, the number of MNEs that both seek and receive an APA is quite limited. Furthermore, because APAs are negotiated behind closed doors and are not made public, there is more room for the MNE and the state to engage in negotiating that results in "special arrangements."

In a nutshell, APAs have the potential to be both selective and advantageous. As a result, they are "fair game" for European Commission investigations, and in retrospect, MNEs and EU tax authorities should not have been surprised that APAs had the potential for unintended repercussions in the competition policy arena.

CHAPTER 2:

THEORETICAL FRAMEWORK

The profiles of domestic legislation in Italy and Japan regarding key transfer pricing principles, such as the arm's length principle, transfer pricing methods, comparability analysis, intangible property, intra-group services, cost contribution agreements, transfer pricing documentation, administrative approaches to avoiding and resolving disputes, safe harbors, and other implementation measures, are discussed in the following paragraphs.

The content in these profiles is meant to accurately reflect the current status of countries' legislation and to illustrate the extent to which their policies adhere to the OECD Transfer Pricing Guidelines.

2.1 THE REGULATORY FRAMEWORK FOR TRANSFER PRICING IN ITALY

2.1.1 THE ARM'S LENGTH PRINCIPLE

The arm's length principle is referenced in the domestic legislation. Specifically, in Article 110, para. 7 of the Consolidated Law on Income Taxes and Ministerial Decree of 14 May 2018, Article 1.

The role of the OECD Transfer Pricing Guidelines in Italy is to outline the general guidance for the proper application of the arm's length principle established by law in Article 110, paragraph 7, of the Income Tax Code, the Ministerial Decree dated 14 May 2018 explicitly refers to the OECD Transfer Pricing Guidelines as well as the OECD Final Report on BEPS Actions 8–10.

The OECD TPG is also mentioned in the execution of the law provision requiring TP documentation, as well as the implementation of the law provision endorsing the APA program.

The Italian domestic legislation provides a definition of the related parties. Art. 110 para. 7 of the Income Tax Code, as amended in June 2017, refers to transactions that occur between an Italian enterprise and non-resident companies that: "directly or indirectly control the Italian enterprise, or are controlled by it, or are controlled by the same company controlling the Italian enterprise".

The Decree of the Minister of Economy and Finance dated 14 May 2018 provides for the following details:

(a) "associated enterprises" means an enterprise resident in the Italian territory as well as non-resident companies where:

1. one of them participates directly or indirectly in the management, control, or capital of the other, or
2. the same person participates directly or indirectly in the management, control, or capital of both enterprises;

(b) “participation in the management, control, or capital” means:

1. participation of more than 50% in the capital, voting rights, or profits of another enterprise; or
2. the dominant influence over the management of another enterprise, based on equity or contractual constraints;

2.1.2 TRANSFER PRICING METHODS

Domestic legislation provides transfer pricing methods that are used in transactions. Specifically, the methods recognized by the OECD are described in Article 4 of the Ministerial Decree of May 14, 2018.

According to para. 5, taxpayers may apply a method other than CUP, Resale Price, Cost Plus, TNMM, and Profit Split only if they can demonstrate that:

1. none of those methods could be applied with reliable results to determine the pricing of a controlled transaction on the basis of the arm’s length principle; and
2. such different method produces a result consistent with what independent enterprises would be expected to obtain in carrying out comparable uncontrolled transactions.

Furthermore, the criterion used in the jurisdiction for the application of transfer pricing is the most appropriate method.

Regarding controlled transactions involving commodities, the guidance contained in paragraphs 2.18 - 2.22 of the TPG is followed. However, there is no specific guidance on commodity transactions in Italy's domestic legislation.

2.1.3 COMPARABLE ANALYSIS

The definition of comparability in Article 3 of the Ministerial Decree of May 14, 2018 is the same as in Chapter III of the OECD TPG. There is no preference for domestic comparables over foreign comparables, nor are there secret comparables for transfer pricing assessment purposes by the tax administration.

Regarding the determination of the arm’s length remuneration, it is dealt with in Article 6 of the Ministerial Decree dated 14 May 2018.

The range of figures resulting from the financial indicator chosen to apply the most appropriate method shall be considered at arm's length where the figures reflect a number of uncontrolled transactions, each of which is equally comparable to the controlled transaction. A controlled transaction is regarded to have been carried out in accordance with the arm's length principle if the relevant financial indicator falls within the range stated in paragraph 1 of this Article.

Moreover, there are no comparability adjustments required under the Italian domestic legislation.

2.1.4 INTANGIBLE PROPERTY

Regarding intangible property, in Italy, there is no domestic legislation or regulations containing specific guidance on the pricing of controlled transactions involving intangibles. Neither for the hard to value intangibles (HTVI). The principle of arm's length applies.

However, there are other rules outside transfer pricing rules that are relevant for the tax treatment of transactions involving intangibles, which is The Patent box regime.

In compliance with BEPS Action 5, Italy implemented an IP optional regime ("patent box") in 2015, based on the nexus approach. This regime allows for the exclusion from the tax base of up to 50% of revenue derived from the exploitation of intangibles. To profit from the system, taxpayers must incur costs for research and development activities aimed at the production or maintenance of eligible intellectual property assets. Copyrighted software, industrial patents, drawings and models, methods, equations, and information relating to expertise gained in the industrial, commercial, or scientific fields are all qualifying IP assets. The OECD TPG is explicitly mentioned in the statute. The law states that intangible linked revenue must be calculated using the principles and methodology proposed by the OECD TPG.

2.1.5 INTRA-GROUP SERVICES

Italian transfer pricing domestic legislation does not provide particular guidance on intra-group service transactions. The OECD TPG is being followed.

There is a simplified approach for low value-adding intra-group services, which is Article 7 of the Ministerial Decree of 14 May 2018. It regulates the simplified approach for low value-adding intra-group services, as it is described in BEPS Actions 8-10, without thresholds. This approach is consistent with BEPS Actions 8-10. When applying the simplified approach for low value-adding intra-group services, the companies are required to provide specific information in the Country File (Country specific documentation).

Lastly, there are no rules outside transfer pricing rules that are relevant for the tax treatment of transactions involving services.

2.1.6 FINANCIAL TRANSACTIONS

Domestic legislation in Italy does not provide precise transfer pricing guidance on financial transactions. The OECD TPG is next. The measures in BEPS Action 4 to limit interest deductions and other financial payments have been applied in Italy (see legislative decree 142/2018, which implemented the EU ATAD Directives).

2.1.7 COST CONTRIBUTION AGREEMENT

There is no clear guidance on cost contribution structures in TP domestic legislation. The OECD TPG is being followed.

2.1.8 TRANSFER PRICING DOCUMENTATION

According to the Italian legislation, the taxpayer must prepare transfer pricing documentation for the Country-by-Country report, which corresponds to Annex III to Chapter V of the TPG. Law No. 208, enacted on December 28, 2015, established a Country-by-Country report. The Ministerial Decree dated 23 February 2017 establishes CbCR regulations in accordance with EU Council Directive 2016/881/UE dated 25 May 2016. The Decision of the Commissioner of the Italian Revenue Agency of November 28, 2017, provides thorough guidelines for CbCR implementation. The Italian legislation or regulations do not impose an obligation on the taxpayer to prepare the Master File and Country Specific Documentation (Local File).

For taxpayers, the file and Country Specific Documentation (Local File) are optional. Taxpayers who file adequate TP documentation will benefit from "penalty protection" in the event of upward adjustments. In this situation, Article 26 of Law Decree No. 78 of May 31, 2010, as amended by Law No. 122 of July 30, 2010, established a penalty protection scheme for corporations that filed valid TP documents. The content of the Master File and Country Specific Documentation (Local File), as addressed in the implementation guidelines contained in the Decision of the Commissioner of the Italian

Revenue Agency dated 23 November 2020, is basically equivalent to Annex I and II of Chapter V of the TPG.

Companies that choose to use TP documentation (Master File, Country Specific documentation) must file it at the end of the fiscal year. The Master File and Country Specific Documentation (Local File) must be signed electronically by the legal representation or a delegate representing the taxpayer, with a time stamp set by the date of presentation of the tax return. On request, the taxpayer must send the TP documentation to the tax authorities in electronic form within 20 days. The Master file and Country Specific Documentation must both be written in Italian. The Masterfile, on the other hand, can be submitted in English. CbCR is required for all qualifying taxpayers, as established in the Ministerial Decree of February 23, 2017. It must be filed within 12 months of the end of the reporting fiscal year for each reporting fiscal year.

Penalty protection is guaranteed for companies that choose TP documentation (Master File and Country Specific documentation) if the documentation requirements are met, the TP documentation is proper, meaning that it provides the tax auditors with the data and information necessary to perform an analysis of the transfer pricing applied, with a specific accurate description of the material transactions and comparability analysis, including functional analysis, regardless of the fact that the transfer pricing method or the selection of comparable transactions or enterprises adopted by the taxpayer are different from those identified by the tax authorities).

A simpler solution is provided for small and medium-sized firms (SMEs) choosing for TP documentation (Master File, Country specific documentation - please see also answer to question 21) with reference to the information provided in the Country File (Country specific documentation):

If the comparability analysis is based on publicly available information sources and the comparability factors do not change significantly during the above-mentioned taxable periods, SMEs are not required to update specific information for two fiscal periods following the period to which the documentation relates.

Companies are classified as "small or medium-sized enterprises" if their total turnover or revenue does not surpass the threshold of fifty million euros.

2.1.9 ADMINISTRATIVE APPROACHES TO AVOIDING AND RESOLVING DISPUTES

The mechanisms utilized in Italy to prevent and resolve transfer pricing disputes are the following.

- Advance Pricing Agreements (APA)

  Presidential Decree no.600/1973, Article 31-ter, introduced by art 1 of Legislative Decree 147 dated September 14 2015, and modified by art 2 of Legislative Decree 32 dated March 152015.

  1. Unilateral APAs
  2. Bilateral APAs

3. Multilateral APAs

- Mutual Agreement Procedures

  Circular letter no. 21 released by Italian Revenue on June 5 2012

- Multilateral Controls (e.g. simultaneous audits)

  Presidential Decree no.600/1973, Article 31 bis as modified by the Legislative Decree no. 29 dated 4 March 2014.

- Unilateral corresponding adjustment

Article 31 quarter of Presidential Decree n.600 dated 29 September 1973, introduced by Law Decree no 50 dated 24 April 2017.

In the event of a primary adjustment informed by another country, resident taxpayers may request a unilateral comparable adjustment to the Italian tax administration, resulting in double taxation. In the case of a foreign primary transfer pricing adjustment, the Italian Revenue Agency (IRA) can recognize a downward adjustment not only in the execution of a Mutual Agreement Procedure but also upon formal request by the taxpayer. The newly proposed process permits Italian taxpayers to obtain a unilateral downward adjustment on their taxable income as a result of a transfer pricing adjustment made by foreign tax authorities. The IRA determines whether the principal

adjustment made by the other state is in compliance with the ALP, given that a DTC is in place with the other state, allowing for an acceptable exchange of information.

2.1.10 OTHER LEGISLATIVE ASPECTS

Italy has no safe harbor rules and other simplification measures aside from the streamlined method for low-value-added intra-group services and the simplified approach given for SME-opting for TP documentation, refer to the information supplied in the Country specific documentation.

Regarding the attribution of Profits to Permanent Establishments, Italy follows the authorized OECD approaches. The 2010 OECD Model Tax Convention version of Article 7 has been included in two Tax Treaties that are already in force, as well as a number of treaties that are currently being negotiated and/or ratified. Tax treaties that do not include the AOA may also be construed dynamically as long as it does not indicate a violation of the Treaty and the AOA is also provided for by domestic legislation

2.2 THE REGULATORY FRAMEWORK FOR TRANSFER PRICING IN JAPAN

2.2.1 THE ARM'S LENGTH PRINCIPLE

In Japan, the arm's length principle is referenced in Para 1 Article 66-4 of the Act on Special Measures concerning Taxation ("ASMT"). The Commissioner's Directive on the Operation of Transfer Pricing ("CDOTP") states that the OECD Transfer Pricing Guidelines must be considered during an examination or APA.

Additionally, the Japanese domestic legislation provides a definition of related parties as the following. A "foreign-related party" is a foreign corporation that has an "associated connection" with another corporation. A corporation is considered "connected" with another if it owns 50% or more of the total number of issued stocks or investments of the other corporation. The other cases are to be treated as having an "associated relationship" according to the Order for Enforcement of ASMT.

2.2.2 TRANSFER PRICING METHODS

The transfer pricing methods provided by the Japanese domestic legislation are CUP, Resale Price, Cost Plus, TNMM, Profit Split, and another method in which the valuation technique based on predicted cash flows is specified in the Order for Enforcement of ASMT. The Commissioner's Directive on ASMT Interpretation and

the CDOTP provide guidance on selecting the most appropriate technique, which is essentially compatible with the TPG.

Regarding the criteria of application, the most appropriate method should be chosen based on the facts and circumstances of each controlled transaction, including functions performed and risks assumed.

Finally, the guidance in paragraphs 2.18-2.22 of the TPG is followed for controlled transactions involving commodities.

2.2.3 COMPARABILITY ANALYSIS

The Commissioner's Directive on Interpretation of ASMT 66-4(3)-3 is consistent with the Transfer Pricing Guidelines on comparability analysis contained in Chapter III.

According to the Commissioner's Directive on ASMT Interpretation, market conditions must be considered while undertaking the comparability analysis.

The tax authorities may investigate those involved in comparable enterprises if the local file is not provided or submitted by a specific date based on Para.17 and 18 of Article 66-4 of ASMT. The information gleaned from such examinations may be utilized to calculate the arm's length price.

In relation to the Commissioner's Directive on ASMT 66-4(3)-4 interpretation, no correction shall be made if the arm's length price of the transaction to be verified is within the range of numerous comparable transactions.

As an example of a circumstance where comparability adjustment is required, the CDOTP Chapter 4-4 specifies differences such as trading terms and settlement conditions.

2.2.4 INTANGIBLE PROPERTY

The Commissioner's Directive on Interpretation of ASMT 66-4(8)-2 and 7, as well as CDOTP chapters 3-12 to 3-14, provide guidance on transactions involving intangibles, addressing issues such as activities that contribute to the value of intangibles, ownership of intangible property, and licensing transactions.

Regarding hard to value intangibles (HTVI), the overall approach, which is Para.8 to 10 Article 66-4 of ASMT, 66-4 (9)-1 to 4 of the Commissioner's Directive on Interpretation of ASMT Chapter 3-6 and 4-15, CDOTP, and HTVI Implementation Questionnaire, is based on the TPG guideline.

2.2.5 INTRA-GROUP SERVICES

The Commissioner's Directive on Interpretation of ASMT 66-4(8)-6, as well as chapters 3-9 to 3-11 of the CDOTP, provide guidance on intra-group services, addressing topics such as the links between services and intangibles, benefit tests, and the TPMs to be used.

The CDOTP chapter 3-11 gives guidelines on the streamlined approach for low value-added intra-group services, which is essentially consistent with the TPG.

2.2.6 FINANCIAL TRANSACTION

The Commissioner's Directive on Interpretation of ASMT 66-4(8)-5 and Chapters 3-7 to 3-8 of the CDOTP provide guidance on intra-group loans that is generally compatible with the TPG.

ASMT Articles 66-5 to 66-5-3 contain guidelines to limit interest deductions in accordance with BEPS Action 4.

2.2.7 COST CONTRIBUTION AGREEMENTS

The CDOTP chapter 3-15 to 3-19 gives cost contribution agreements guidance (CCA), addressing problems such as definition, handling of CCA, including the treatment of pre-existing intangibles, and documentation.

2.2.8 TRANSFER PRICING DOCUMENTATION

Due to Japanese legislation, it is required that the taxpayer prepare the transfer pricing documentation. The following are the documents that have to be prepared.

- Mater file (in accordance with Transfer Pricing Guidelines Annex I, Chapter V)

  It must be submitted to the competent District Director in Japanese or English within one year after the conclusion of the Ultimate Parent Entity's fiscal year.

A fine of up to JPY300,000 may be imposed if corporations fail to submit it to the District Director by the deadline for whatever reason.

- Local file (in accordance with Transfer Pricing Guidelines Annex II, Chapter V)

  The deadline for preparation is the due date of the final return filing, which must be kept for seven years, and the deadline for submission is within a specific set period if required during the course of a tax examination. However, there are no specifications regarding the language in which the document should be submitted.

  If the local file is not presented or submitted by a specified set date to ensure the responsibility of transfer pricing documentation, the tax authorities may impose tax by estimation.

- Country-by-country report (in accordance with Transfer Pricing Guidelines Annex III, Chapter V)

  It must be submitted to the competent District Director within one year of the day after the Ultimate Parent Entity's fiscal year ends, and the deadline for notification must be no later than the last day of the Ultimate Parent Entity's fiscal year.

  A fine of up to JPY300,000 may be imposed if corporations fail to submit it to the District Director by the deadline for whatever reason.

Regarding the exemption from transfer pricing documentation obligations for Master file, and CbCR, MNE Groups with less than 100 billion yen in total consolidated revenue for the prior fiscal year of the Ultimate Parent Entity.

On the other hand, for Local file corporations are excluded from the duty of contemporaneous documentation for controlled transactions with one foreign-related party during the current fiscal year if and only if the following conditions are met:

- The amount of transactions (total revenues and payments) with the foreign-related party during the previous business year (or current business year if no prior business year) was less than five billion yen, and

- The amount of intangible transactions (total receipts and payments) with the foreign-related party during the previous business year (or current business year if there was no prior business year) was less than 300 million yen.

2.2.9 ADMINISTRATIVE APPROACHES TO AVOID AND RESOLVE DISPUTES

Japan has a bilateral APA procedure in place that allows taxpayers to request rollbacks. Japan makes explicit rules, standards, and processes for accessing and using the Mutual Agreement Procedures available. The published Japan's Mutual Agreement Procedure

profile, as well as elements B.8-B.10 of Japan's Peer Review report, contain all the necessary information (Stage 2)

2.2.10 OTHER LEGISLATIVE ASPECTS

In terms of the attribution of profits to Permanent Establishments, Japan adheres to the Authorized OECD Approaches. Specifically, starting on May 1, 2021, in ten tax treaties. In circumstances where the existing tax treaties do not contain the new version of Article 7 (OECD MTC 2010 and later), the procedure outlined in OECD MTC 2008 applies.

CHAPTER 3:

CRITICAL ANALYSIS

3.1 PROBLEMS REGARDING THE SOFT LAW IN TRANSFER PRICING

"Soft law" refers to legally non-binding instruments that are developed with the goal of influencing state behavior. Alternatively, the term "soft law" can refer to instruments that are too vague or imprecise, even if they are legally obligatory, or to those that lack formal enforcement mechanisms. It plays a significant role in the international governance of numerous issues since the majority of the OECD's work on international taxes is conducted through soft law, such as the model convention for the avoidance of double taxation, its corresponding commentaries, transfer pricing guidelines, and standards for the effective exchange of information on tax matters.

These Guidelines are not legally binding, but given the complexity of the transfer pricing problem, they have become a focal point and have had a significant influence not only on international law but also directly on the national legal systems of many nations.

It is obvious that soft law facilitates the formation of agreements that would not otherwise be achievable. In other words, it facilitates the coexistence of different legal cultures, perspectives, and values, laying the basis for cooperation among states. (Dean & Kelly, 2009)

Moreover, it is more adjustable than binding agreements, which enable the introduction of amendments. As a result, it would be possible to determine whether the proposed agreement is useful, and if it works properly, it could be the first step toward a binding treaty. Furthermore, the costs associated with soft law agreements are quite often lower than those associated with the negotiation of binding instruments. The reason for this is that the repercussions of breaking them are usually not severe enough, thus states will not engage as much in the negotiation process. (Abbott and Snidal, 2000)

Similarly, since the approval procedure is significantly simpler, the amount of time required to agree on a soft law instrument may be relatively shorter. Ratification of binding instruments, on the other hand, which may necessitate the intervention of national parliaments depending on each state's constitutional laws, might cause significant delays.

The OECD is an international organization with the authority to issue binding norms (referred to as decisions in Art. 5(a) of the OECD Convention) to its member states. In practice, however, the OECD generates nearly entirely soft law, particularly in tax matters. Thus, the OECD's work in this field consists more of disseminating principles and policy solutions, also known as governance through soft law, than of developing exact and obligatory regulations that would limit member nations' sovereignty.

Concerning the legal status of the OECD Transfer Pricing Guidelines, they were approved by the Committee on Fiscal Affairs on 27 June 1995 and are the subject of

OECD Council Recommendation C(95)126/FINAL, dated 13 July 1995. Because it is based on Article 5(b) of the OECD Convention, this proposal is not legally binding, and tax authorities in OECD member countries are simply encouraged to implement the Guidelines.

However, soft law is most often used in a complementary way, particularly as an interpretative tool for treaties in force. The following factors should be considered when interpreting tax treaties in the light of the OECD Transfer Pricing Guidelines.

To begin with, in some situations, the signing governments to a treaty may expressly say in diplomatic notes or a protocol to the treaty that it shall be read in accordance with the Transfer Pricing Guidelines. For example, in the protocols to the treaties between Japan and the United States, in 2003, it was agreed through diplomatic notes that the treaty should be interpreted in accordance with the most recent available version of the Guidelines.

Second, even in the absence of specific references in the treaties or their protocols, the Transfer Pricing Guidelines are closely related to the Commentaries to the OECD and United Nations Model Tax Conventions, which identify the Guidelines with the internationally agreed principles for applying the arm's length standard contained in the Models and, thus, in almost all treaties in force. As a result, the Guidelines can be considered a component of the Commentaries.

Aside from the influence of soft law on formal sources of international law, the OECD Transfer Pricing Guidelines may have a domestic impact. The table that follows outlines the impact of the OECD Transfer Pricing Guidelines on domestic legal systems.

Countries with references to the OECD Guidelines	*With references in legislation*	Hungary, Latvia, Mexico, Norway, Peru, Romania, Spain and the United Kingdom.	
	With references in circulars and other publications of the Tax Administration	Frequent references	Australia, Belgium, Canada, Germany, Namibia, New Zealand, South Africa, Switzerland and the United Kingdom.
		Translation and publication of the Guidelines by the Tax Authorities	Austria, Czech Republic, Italy and Slovak Republic.
		References in particular cases	United States.
	With references in case-law	Canada, Germany, Italy, Kenya, Spain and Switzerland. In very exceptional cases: United States and France. References denying the relevance of the Guidelines: Australia.	

Tab. 3.1: Countries that have made references to the OECD Transfer Pricing Guidelines in their legislation, tax administration circulars, and case law.

In general, it is feasible to see that most nations' transfer pricing practices tend to converge around the OECD Guidelines. The relationship between the Guidelines and domestic legal systems occurs in a variety of ways. Specifically, we have seen it in chapters 2.

In some circumstances, the legislation expressly refers to the OECD Guidelines, usually indicating that they should be considered when interpreting domestic transfer pricing restrictions. However, references to the OECD Guidelines are most frequently found in Tax Administration circulars, which are generally only binding for the Administration but not for taxpayers or courts, even though references to the OECD

Guidelines in case-law are not unusual, particularly in countries where domestic legislation is more imprecise.

Now that we have a clear view of the influential state of the Transfer Pricing Guidelines, we have to identify their current limitations.

Nowadays, MNEs can implement global value chains with business services located wherever they can be carried out most efficiently. This has prompted states to question whether the current norms underlying the international tax structure, such as source, permanent establishment, and residency, or in other words, the governance through "soft law" is keeping up with these changes.

As it becomes more difficult for nations to determine an MNE's genuine location, MNEs will have more opportunities to benefit from mismatches in the international tax system. The apparent propensity of MNEs to move profits across borders to take advantage of low tax rates is of particular concern. In other words, the use of legal arrangements that enable profits to disappear and to be artificially moved to low- or no-tax jurisdictions is referred to as base erosion and profit shifting (BEPS).

Furthermore, global intra-group trade has risen tremendously in recent decades, paralleling economic globalization. Transfer pricing rules, which are utilized for tax purposes, are concerned with defining the conditions, including the price, for transactions within an MNE group that result in the allocation of profits to companies within the group in various countries based on the arm's length principle.

The arm's length principle has proven effective as a practical and balanced standard for tax administrations and taxpayers to analyze transfer prices between linked firms and to avoid double taxation. However, because of its perceived reliance on contractual allocations of functions, assets, and risks, existing guidance on how to apply the principle has proven susceptible to manipulation. This manipulation can result in outcomes that do not correlate to the value provided by the underlying economic activity carried out by MNE group members.

BEPS revenue losses are conservatively projected to be between USD 100 billion and 240 billion per year. This is comparable to 4% to 10% of global corporate income tax. Given the increased reliance of developing countries on such revenues, estimates of the impact on these countries as a percentage of GDP are much higher. Everyone is affected by BEPS. It damages governments by reducing tax revenues and increasing the expense of monitoring compliance. It damages people because when certain multinational corporations pay little or no tax, ordinary taxpayers must bear a bigger share of the tax burden.

3.2 THE POSSIBLE SOLUTION

In the following chapter, we will study the currently utilized and possible solutions established by international entities regarding BEPS, specifically on the transfer pricing issue.

3.2.1 OECD AND G20

Since the London Summit in April 2009, the OECD has been at the forefront of combating tax evasion, ending bank secrecy and tax havens, and addressing multinational corporation tax avoidance. The OECD's tax contributions to the G20 have contributed to the reform, reshaping, and modernization of the international tax architecture.

The OECD and G20 countries agreed on the importance of multilateral efforts to strengthen tax rules, with the goal of ensuring that MNEs report profits where economic activity occurs and value is created. Therefore, they have developed the OECD/G20 BEPS Project to provide nations with domestic and international tools to confront tax evasion.

The OECD launched the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) in 2015 at the request of G20 Leaders, now including 141 members representing a wide range of economic profiles, including a considerable number of developing countries. Every member has an equal chance to take part. They have committed to adopting the BEPS measures, conducting peer reviews of the BEPS minimum standards, and completing the remaining standard-setting work, particularly

in relation to transfer pricing. The BEPS Project's purpose is, therefore, to rebuild trust and promote fair competition among all participants while preserving the potential to remove double taxation.

3.2.2 BEPS PROJECT

As we have already seen in the paragraph above, the OECD/G20 Inclusive Framework on BEPS brings nations and jurisdictions together to collaborate on BEPS implementation.

The BEPS package includes 15 Actions that provide countries with the domestic and international tools they need to combat tax evasion. Countries now have the means to ensure that earnings are taxed where the economic activities that generate the profits take place and value is generated. These solutions also provide better confidence to firms by minimizing disagreements over the implementation of foreign tax legislation and standardizing compliance requirements.

But, in this paragraph, I will only examine the actions that are relevant to this study.

3.2.2.1 Action 8-10

BEPS Actions 8–10 address Transfer Pricing Guidelines to enhance that transfer pricing outcomes are more aligned with the MNE group's value creation. Actions 8-10 clarify and strengthen current standards in this regard, including guidelines on the use of the arm's length principle and an approach for proper pricing of hard intangibles within the arm's length principle. The Actions 8-10 Reports improve guidance on the

arm's length principle to ensure that economic rather than paper reality determines results. In this sense, the activity under Actions 8-10 aims to match transfer pricing outcomes with the MNE group's value creation. In other words, the information offered in Actions 8-10 gives assistance for determining transfer pricing outcomes based on the actual activity of related parties in the context of the transaction's contractual terms. These and other improvements limit the motivation for MNEs to shift money to "cash boxes" - shell companies with few or no workers and little or no economic activity that seek to benefit from low or no-tax jurisdictions.

The revised Transfer Pricing Guidelines specifically address the situation in which a capital-rich member of a group, such as a cash box, simply provides assets such as money for use by an operational firm but undertakes only limited operations. If the capital-rich member does not control the financial risks associated with its funding, it is only entitled to a risk-free return, or less if, for example, the transaction is not commercially rational and therefore the non-recognition guidance applies.

The study includes updates to the OECD Transfer Pricing Guidelines in order to better match transfer pricing outcomes with value creation. The revised guidance focuses on the three key areas listed below.

- Action 8 - Intangibles

  Because intangibles are by definition movable and difficult to value, Action 8 tackles transfer pricing difficulties relating to controlled transactions using intangibles. Profit misallocation from valuable

intangibles has significantly contributed to base erosion and profit shifting.

- Action 9 - Risk and Capital

  Work under Action 9 addresses the contractual allocation of risks, as well as the resultant distribution of profits to these risks, which may or may not correspond to the activities actually performed. Furthermore, Action 9 addresses the level of returns to funding provided by a capital-rich MNE group member when those returns do not correspond to the funding company's level of activity.

- Action 10 - High-risk transactions

  Action 10 focuses on other high-risk areas, such as the scope for addressing profit allocations resulting from controlled transactions that are not commercially rational, the scope for targeting the use of transfer pricing methods in a way that results in diverting profits from the MNE group's most economically important activities, and the use of certain types of payments between MNE group members (such as management fees and head office expenses) to erode profits.

The following are some adaptations made in recent years regarding these action plans:

1. Transfer pricing guidance on financial transactions The OECD issued Transfer Pricing Guidance on Financial Transactions in February 2020, in accordance with BEPS Actions 4 and 8-10. The guidance is significant because it is the first time that the OECD Transfer Pricing Guidelines include guidance on the transfer pricing aspects of financial transactions, which will help to ensure consistency in the interpretation of the arm's length principle and avoid transfer pricing disputes and double taxation.

   A number of examples are provided in the report to demonstrate the principles discussed. Section B explains how to apply the concepts outlined in Section D.1 of Chapter I of the OECD Transfer Pricing Guidelines for financial transactions. Section B.1 of this study, in particular, discusses how the correct delineation analysis discussed in Chapter I applies to the financial structure of an MNE inside an MNE group. It further underlines that the guidance in that part does not preclude nations from pursuing methods of capital structure and interest deductibility under domestic law. Section B.2 presents the economically significant criteria that influence the study of financial transaction terms and conditions. Sections C, D, and E deal with specific difficulties concerning the price of financial transactions (e.g. treasury functions, intra-group loans, cash pooling, hedging, guarantees, and captive insurance). This analysis expands on the precise segmentation as well as the pricing of the restricted financial transactions.

Finally, Section F explains how to calculate a risk-free rate of return and a risk-adjusted rate of return.

Sections A through E of this paper are incorporated as Chapter X of the OECD Transfer Pricing Guidelines. Section F is added to Section D.1.2.1 of the Guidelines, right after paragraph 1.106.

2. Guidance for tax administrations on the application of the approach to hard-to-value intangibles In June 2018, the OECD issued updated guidelines for tax administrations on the implementation of the approach to Hard-to-Value Intangibles under the mandate of BEPS Action 8. (HTVI). The guidance in this paper intends to achieve an uniform understanding and practice among tax administrations regarding how to apply adjustments resulting from the use of the HTVI approach. This recommendation should increase consistency and limit the possibility of economic double taxation. The new recommendations, in particular:

    - Presents the ideas that should underpin tax administrations' use of the HTVI strategy.
    - Provides a variety of examples that clarify how to apply the HTVI method in various contexts; and
    - Addresses the connection between the HTVI approach and access to the mutual agreement procedure under the appropriate tax treaty.

This document's tax administration guidance on the adoption of the HTVI approach has been adopted as an annex to Chapter VI of the Transfer Pricing Guidelines.

3. Revised guidance on the transactional profit split

Under the mandate of BEPS Action 10, the OECD published the final report on revised guidelines on the application of the transactional profit split technique in June 2018. While not prescriptive, this revised guidance clarifies and greatly expands the advise on when a profit split technique may be the most appropriate method. It identifies the presence of one or more of the following indications as significant:

- Each party contributes something unique and important;
- The company's activities are so intertwined that the contributions of the parties cannot be fairly evaluated in isolation from one another;
- The parties may share the assumption of economically significant risks or assume closely comparable risks independently.

The guideline makes it clear that, while a lack of comparables is inadequate to justify using the profit split technique if credible comparables are

available, the method is unlikely to be the most appropriate. Furthermore, the new text expands on how to use the profit split approach, including establishing the relevant profits to be split and acceptable profit splitting variables.

The new guidance includes sixteen examples to explain the principles mentioned in the text and show how the method may be used in practice. These will be included in the Guidelines' Annex II to Chapter II.

3.2.2.2 Action 13

All large multinational enterprises (MNEs) are obliged by BEPS Action 13 to publish a country-by-country (CbC) report containing aggregate data on the global allocation of income, profit, taxes paid, and economic activity among the tax countries in which they operate. This CbC report is provided to these jurisdictions' tax agencies for use in high-level transfer pricing and BEPS risk assessments.

This is due to a lack of quality data on corporate taxation that has been a major impediment to measuring the fiscal and economic effects of tax evasion, making it difficult for authorities to conduct transfer pricing assessments on transactions between linked companies and even more difficult to conduct audits.

The BEPS Action 13 report (Transfer Pricing Documentation and Country-by-Country Reporting) provides a template for MNEs to submit the information set out in the report

annually and for each tax country in which they do business. The Country-by-Country (CbC) Report is the name given to this report.

The CbC Reporting Implementation Package includes: model legislation that countries could use to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence, including backup filing requirements; and three model Competent Authority Agreements that could be used to facilitate implementation of the change, which are:

- Multilateral Convention on Administrative Assistance in Tax Matters
- Bilateral tax conventions
- Tax Information Exchange Agreements (TIEAs).

In addition, the report also contained a demand that the minimum CbC reporting level is revisited starting in 2020. The OECD initiated a public consultation process in February 2020 on issues where its members sought advice from stakeholders in conducting this 2020 review.

So far, in 2016, 58 jurisdictions required or permitted the filing of CbC reports, and more than 100 jurisdictions had legislation establishing a CbC reporting duty. Furthermore, approximately 2900 agreements for the sharing of CbC reports between jurisdictions are in place. This means that nearly every MNE with at least EUR 750 million in consolidated group revenue is already required to publish a CbC report, and the gaps that remain are shrinking.

The first CbC report exchanges occurred in June 2018, and with the OECD's assistance, tax administrations are incorporating CbC reports into their tax risk assessment and assurance processes to better understand the risks posed to their jurisdictions. CbC reports are also at the heart of other programs aimed at providing better tax certainty to MNEs, such as the OECD International Compliance Assurance Programme pilot (ICAP).

3.2.2.3 Action 14

The Minimum Standard for BEPS Action 14 aims to improve the resolution of tax-related disputes between jurisdictions. Inclusive Framework jurisdictions have agreed to have their compliance with the minimal requirement assessed and monitored by their peers as part of a thorough peer review procedure aimed at increasing efficiency and improving the timeliness of the resolution of double taxation issues.

The need for action 14 has arisen, as cross-border business and international labor mobility become more frequent in the global economy. Disputes over which jurisdictions can tax certain sorts of income eventually arise.

Many tax treaties between jurisdictions have a MAP provision that outlines a method for resolving such issues. Article 25 of the OECD Model Tax Convention establishes a mechanism, separate from ordinary legal remedies available under domestic law, for the competent authorities of the Contracting States to resolve differences or difficulties regarding the interpretation or application of the Convention on a mutually agreed-upon basis. This mechanism - the mutual agreement method - is critical to the effective

application and interpretation of tax treaties, particularly to ensure that taxpayers entitled to treaty benefits are not subject to taxes by any of the Contracting States that are contrary to the terms of the treaty.

Despite the prevalence of this provision in tax treaties, more effort is required to guarantee that access to MAP is available and that MAP cases are handled and implemented in a timely manner.

According to recent statistics, tax authorities are closing more cases than ever before. However, new MAP cases have increased dramatically since 2016, putting upward pressure on countries' MAP stocks. As a result, the overall inventory of MAP cases grows year after year because the number of cases closed cannot keep up with the number of new instances.

While anecdotal information suggests that the growth in new cases is related to a variety of circumstances, it is obvious that improving the effectiveness and efficiency of MAP between countries is required to settle such matters in a timely manner.

To address this issue, the final report on Action 14 includes a BEPS minimum standard, which was adopted in October 2015. It is made up of 21 elements and 12 best practices that evaluate a jurisdiction's legislative and administrative framework in four major areas:

- preventing disputes
- availability and access to MAP

- resolution of MAP cases
- implementation of MAP agreements

In addition, members also agreed on a peer review process to evaluate the implementation of this standard and to report MAP statistics under a newly developed reporting framework ("MAP Statistics Reporting Framework").

The Action 14 peer review process began at the end of 2016, with 82 jurisdictions to be assessed beginning in 2017. The procedure is divided into two stages. Stage 1 evaluates jurisdictions' implementation of the Action 14 Minimum Standard and makes recommendations on where jurisdictions should improve in order to be fully compliant with the requirements of this standard. Stage 2 of the process assesses the implementation of the recommendations.

Since the final batch of Action 14 stage 1 mutual agreement procedures (MAP) peer review reports was published in February 2021, more than 1750 recommendations were provided, with approximately 66% (+/- 1150) relating to shortcomings in tax treaties in relation to the MAP item. Approximately 34% (+/- 600) of the recommendations are for MAP practices and policies that do not meet the minimal standard. Furthermore, nearly 400 recommendations are made for jurisdictions to continue actions that were already in compliance with the minimum standard.

There is still to be accomplished in order to bring the reviewed jurisdictions' tax treaties up to the Action 14 minimum standard. However, many of the assessed jurisdictions have made significant progress in upgrading existing treaty networks,

particularly by prioritizing tax treaty talks where treaties are not projected to be affected by the MLI. Future stage 2 monitoring reports that follow up on any stage 1 suggestions will provide additional insight into progress.

3.3 IMPLEMENTATION OF THE BEPS PROJECT

In the next paragraph, we will see how Italy and Japan have implemented the BEPS Project. Because a better understanding of how the BEPS recommendations are implemented in practice could help to avoid misconceptions and disagreements among governments. Greater emphasis on implementation and tax administration could so benefit both governments and businesses. The proposed data and analytical upgrades will aid in the ongoing study of the quantitative impact of BEPS, as well as the evaluation of the impact of the countermeasures developed under the BEPS Project.

3.3.1 ITALY

Italy has a vast network of tax treaties, with over 100 treaties signed and ratified, and has signed and ratified the EU Arbitration Convention. Italy has a well-established MAP program with a lengthy history of settling MAP cases. It has a large MAP inventory, with a significant number of new cases submitted each year and nearly 600 cases pending as of December 31, 2017. 67% of these instances are attribution/allocation cases. The stage 1 peer review process determined that, overall, Italy met the majority of the aspects of the Action14 Minimum Standard, but that changes are needed for certain of them.

Italy attempted to address some of its inadequacies, which were monitored during stage 2 of the process. In this regard, Italy is addressing the highlighted inadequacies and has made steps to rectify some of them. All of Italy's tax treaties feature a MAP provision.

Generally, these treaties adhere to paragraphs 1 through 3 of Article 25 of the OECD Model Tax Convention.

Its treaty network is largely compliant with the requirements of the Action14 Minimum Standard, with the exception of:

- More than three-quarters of its tax treaties do not have the complete equivalent of OECD Model Tax Convention Article 25(1), owing to a protocol clause mandating taxpayers to commence domestic proceedings when making a MAP request.
- More than two-thirds of its tax treaties do not include a provision stating that mutual agreements must be implemented despite any time limits in domestic law (as required by Article25(2), second sentence), nor do they include alternative provisions for Article9(1) and Article7(2) establishing a time limit for making transfer pricing adjustments.
- More than half of its tax treaties lack a provision similar to the second sentence of Article 25(3) of the OECD Model Tax Convention, which allows responsible authorities to discuss jointly to avoid double taxation in instances not covered by the convention.

Italy signed the Multilateral Instrument in order to be completely compliant with all four key areas of an effective dispute resolution mechanism under the Action14 Minimum Standard, through which a number of its tax treaties may be changed to meet the standards of the Action14 Minimum Standard. Furthermore, Italy chose part VI of the Multilateral Instrument, which calls for the inclusion of a mandatory and binding

arbitration provision in tax treaties. Where treaties will not be modified, Italy reported that it has put in place a plan for bilateral renegotiations of these treaties following the entry into force of this Multilateral Instrument for the treaties concerned, which for a relevant number of treaties only concerns the protocol provision requiring taxpayers to initiate domestic proceedings when submitting a MAP request. It has just been concluded negotiations with one treaty partner and is currently negotiating with five more. The strategy distinguishes between treaties that just require an amendment to the protocol clause and those that require additional or different amendments. Regarding the first group, Italy recommended that all treaty parties involved sign a memorandum of understanding, and it intends to embark into bilateral negotiations to change the treaty in formal terms once all other negotiations are concluded. Italy distinguished between treaty partners who signed the Multilateral Instrument and/or are members of the BEPS Inclusive Framework and other treaty partners in the second group. Depending on which treaty partner falls into which category, they will be invited to renegotiate the tax treaty in question. Italy fails to achieve the Minimum Standard for Dispute Prevention established by Action14.

Despite having an established bilateral APA scheme, Italy does not currently allow taxpayers to request roll-backs of bilateral APAs, and such roll-backs are likewise not allowed in reality; nevertheless, legislation to allow roll-backs is under the process.

Furthermore, Italy meets the majority of the Action14 Minimum Standard standards for MAP availability and access. It provides access to MAP in all eligible cases, though for those tax treaties that do not include a filing period for MAP requests, there is a risk that access to MAP will be denied due to Italy's domestic time limits, even if the taxpayer filed its MAP request within three years of the first notification of the action resulting in taxation not in accordance with the tax treaty. Access to MAP is also denied for requests submitted only under the EU Arbitration Convention when the tax authority and the taxpayer have reached an audit settlement. However, for all aspects, Italy is actively modifying its domestic legislation in accordance with the Action14 Minimum Standard to ensure that access to MAP is available in this case. Furthermore, Italy has a notification and consultation process in place for circumstances in which its competent authority deems the objection presented by taxpayers in a MAP request to be unjustified. Italy also offers clear and thorough guidance, both under tax treaties and the EU Arbitration Convention, on the availability of MAP and how the MAP function is construed and utilized in reality. However, this MAP guidance should be updated properly, including the contact details of Italy's competent authority and the fact that access to MAP is accessible under the EU Arbitration Convention when the tax authority and the taxpayer have reached an audit settlement.

In terms of the average time required to settle MAP cases, the MAP figures for 2016-17 are as follows:

2016-17	Opening inventory	Cases started	Cases closed	End inventory	Average time to resolve cases (in months)*
Attribution/allocation cases**	161	288	57	392	31.35
Other cases	147	78	34	191	27.29
Total	308	366	91	583	29.83

Tab. 3.2: The average time taken for resolving MAP cases for post-2015 cases follows the MAP Statistics Reporting Framework.

The number of cases closed in Italy accounts for 25% of all new cases filed in 2016 and 2017. Its MAP inventory as of 31 December 2017 over increased when compared to 1 January 2016. Furthermore, Italy's competent authority failed to process MAP cases on average within 24 months (the desired average for handling MAP cases received on or after January 1, 2016), since the average time necessary was 29.83months in 2016 and 2017. This applies to both attribution/allocation and other circumstances, however attribution/allocation has a somewhat higher average. Furthermore, as compared to 2016, the average in 2017 increased from 27.53months to 30.91months, particularly in attribution/allocation cases, while the average for other cases declined in 2017 to less than 24 months.

These statistics show that Italy's competent authority is under-resourced in terms of resolving MAP cases. Italy reorganized its competent authority role on January 1, 2017, transferring it to the Agenzia delle Entrate, with the goal of enhancing MAP case resolution. This has resulted in stronger connections with its MAP partners and a greater number of MAP cases being handled, albeit the effort to address a number of

old attribution/allocation cases has not allowed for a significant reduction in the average time taken to conclude MAP cases. More staff should be assigned to the competent authority function in order to deal with the increased number of MAP cases and reduce the average completion time, as well as to improve working procedures and avoid delays in communication with other competent authorities, particularly the issuing of and responses to position papers prior to face-to-face meetings.

More staff should be assigned to the competent authority function to deal with the increased number of MAP cases and reduce the average completion time, as well as to improve working procedures and avoid delays in communication with other competent authorities, particularly the issuing and responses to position papers prior to face-to-face meetings.

3.3.2 JAPAN

Japan has a relatively extensive tax treaty network, including over 70 tax treaties. Additionally, has a well-established MAP program and a long history of successfully settling MAP cases. It has a substantial MAP inventory, with only a few new cases presented each year and 90 cases pending as of December 31, 2018. 90% of these situations are about allocation/attribution. According to the results of the stage 1 peer review process, Japan met the majority of the elements of the Action 14 Minimum Standard. Where there are flaws, Japan has attempted to correct them, which has been monitored in stage 2 of the process. In this regard, Japan addressed nearly all of the stated deficiencies.

Furthermore, all of Japan's tax treaties include a MAP provision. These treaties mainly adhere to paragraphs 1–3 of Article 25 of the OECD Model Tax Convention. Its treaty network is mostly consistent with the requirements of the Action 14 Minimum Standard, with the exception that nearly 25% of its tax treaties do not include a provision stating that mutual agreements shall be implemented notwithstanding any time limits in domestic law (as required by Article25(2), second sentence), nor alternative provisions for Article9(1) and Article7(2) to set a time limit for making transfer pricing adjustments.

Japan signed and approved the Multilateral Instrument in order to be fully compliant with all four main elements of an effective dispute resolution mechanism under the Action 14 Minimum Standard. Additionally, Japan chose section VI of the Multilateral Instrument, which calls for the inclusion of a mandatory and binding arbitration

provision in tax treaties. A number of its tax treaties have been or will be updated through this document to meet the standards of the Action 14 Minimum Standard. Japan is in discussion with a few treaty partners in order to add the necessary elements through the Multilateral Instrument.

Despite the fact that treaties will not be updated upon the entrance into force and implementation of the Multilateral Instrument, Japan stated that it aims to update all of its tax treaties to be compatible with the standards of the Action 14 Minimum Standard through bilateral discussions. While Japan's general goal is to initiate negotiations with the relevant treaty partners on those tax treaties, and while some specifications have been provided in respect of two treaty partners, no further details have been shared in respect of the other treaty partners, particularly in terms of the order of prioritization or mode of planned communication. As a result, Japan is regarded as not having put in place a plan or taken any concrete actions to bring, where appropriate, the relevant treaties in accordance with the standards of this standard, other than discussions that are currently pending or are planned to be initiated. Taking this into consideration, Japan is advised to begin talks for a number of treaties as soon as possible in order to achieve compliance with this part of the Action 14 Minimum Standard.

Japan fulfills the Action 14 Minimum Standard for Dispute Prevention. It has a bilateral APA program in place, which is often used by taxpayers and the Japanese tax agency to avoid disagreements. This APA program also allows taxpayers to request rollbacks of bilateral APAs, which are granted in practice.

Japan likewise satisfies the Action 14 Minimum Standard requirements for MAP availability and access. It offers access to MAP in all eligible cases, albeit it has not received any MAP requests addressing the application of anti-abuse provisions since January 1, 2014. It also has a recorded bilateral consultation process in place for circumstances in which its responsible authority believes the objection presented by taxpayers in a MAP request is unjustified, albeit no such examples have surfaced since January 1, 2014. Japan also provides clear and extensive guidance on the availability of MAP and how it implements this approach in practice, including a MAP-specific Q&A.

In terms of the average time required to close MAP cases, the MAP data for Japan for 2016-18 are as follows:

2016-18	Opening inventory 1/1/2016	Cases started	Cases closed	End Inventory 31/12/2018	Average time to close cases (in months)*
Attribution/allocation cases	96	90	105	81	27.95
Other cases	9	10	10	9	17.27
Total	105	100	115	90	27.02

Tab. 3.3: Average time taken for resolving MAP cases for post-15 cases follows the MAP Statistic Reporting Framework.

In Japan, the number of cases closed in 2016-18 was 44% of the total number of cases started in those years. During these years, MAP cases were not resolved within 24 months (the pursued average for resolving MAP cases received on or after January 1, 2016), while the average time necessary was 27.02months. This is especially true for

the settlement of attribution/allocation cases, since the average time to close these cases (27.95 months) is longer than the average time to conclude other cases (17.27months). However, Japan's MAP inventory as of 31 December 2018 declined by 14% compared to 1 January 2016, with attribution/allocation cases (16%) accounting for the majority of the decrease. Furthermore, as more personnel have been assigned to Japan's competent authority function in recent years and successful organizational steps have been taken to increase the number of cases closed and reduce the average completion time, and as Japan has provided comprehensive clarifications explaining the additional time taken to resolve some cases, Japan should continue to closely monitor whether the addition of new staff and the reduction in the average completion time has resulted in an increase in the number of cases closed and a decrease in the average completion time.

Furthermore, Japan meets all of the other standards outlined in the Action 14 Minimum Standard for MAP case settlement. Japan's competent authority functions completely independently of the tax authorities' audit function and takes a realistic approach to resolving MAP issues in an effective and efficient manner. Its organization is adequate, and the performance indicators employed are suitable for carrying out the MAP function. Finally, Japan meets all of the Action 14 Minimum Standards for MAP implementation, and its responsible authority oversees such compliance.

CONCLUSIONS

This study attempted to analyze the regulatory framework of the two countries, Italy and Japan by first covering and understanding key economic approaches to transfer pricing such as the arm's length principles, transfer pricing methods, APA, and the OECD Transfer Pricing Guidelines. Then we analyzed each country's transfer pricing approaches listed above and found that overall, both countries have a coherent relationship between their domestic legislation and the OECD Transfer Pricing Guidelines.

Italy references the TPG through decrees in the majority of the aspects and in case there is no specific domestic legislation the TPG is being followed. Specifically for elements, such as intangible property, intra-group services, financial transactions, and cost contribution agreements.

On the other hand, in Japan, the TPG are referenced in the Act on Special Measures concerning Taxation and the Commissioner's Directive on the Operation of Transfer Pricing and all the elements are covered. Therefore, we may say that Italy's regulatory framework is more imprecise by not covering all the elements by their domestic legislation compare to the Japanese regulatory framework.

Since, global intra-group trade has increased dramatically in recent decades, coinciding with economic globalization. causing the opportunity for MNEs to arrange tax strategies that enable profits to disappear and to be artificially moved to low- or no-tax jurisdictions. TP has a strong correlation to it because of its perceived reliance on

contractual allocations of functions, assets, and risks, existing guidance on how to apply the principle has proven susceptible to manipulation.

In order to face this problem, the OECD/G20 BEPS Project began when the OECD and G20 countries agreed on the need for multilateral measures to strengthen tax rules, with the goal of ensuring that MNEs disclose earnings where economic activities are carried out and value is created. Consequentially, we have analyzed the actions relevant to TP between the 15 Action of the BEPS Project that would improve cross-border tax rule coherence, tighten substance requirements, and promote transparency and clarity.

Finally, we reviewed Italy and Japan's implementation of the OECD/G20 BEPS Project. In light of the peer review procedure established by Action 14, we were able to see that Italy achieved most of the Action14 Minimum Standard, however, adjustments are required for a few of them. Additionally, has a substantial MAP inventory, with approximately 600 cases pending as of December 31, 2017. The result is that Italy has a 47% of increase in MAP inventory compared to January 1, 2016. This is because even though there are a substantial amount of new cases submitted, Italy's competent authority failed to process MAP cases on average within 24 months by being under-resourced and understaffed.

Whereas, Japan met the majority of the Action 14 Minimum Standard requirements and managed to rectify faults, which have been monitored in stage 2 of the process. In this sense, Japan solved nearly all of the flaws mentioned. Regarding MAP inventory, Japan has 90 cases pending as of December 31, 2018. There is a decrease of inventory

by 14% as of December 31, 2018, compared to January 1, 2016. This is due to more personnel being assigned to Japan's competent authority function in recent years, and successful organizational steps have been taken to increase the number of cases closed and reduce the average completion time.

As a result, we have seen that Italy's competent authority is struggling more than Japan's, as a consequence of having more new MAP cases submitted yearly and being under-resourced. An insight would be that increasing resources to the competent authorities in order for them to solve MAP cases more efficiently is a critical component in keeping up with the increasing cases. Even if it appears to be an easy solution, Italy has not yet followed Japan's lead.

Therefore, if you take into consideration all the aspects that we have evaluated in this study we are able to say that even though there is one Transfer Pricing Guideline that governs all the OECD members including Italy and Japan, the result of its implementation is different in each country. This situation has evolved from a much more intricate discussion involving each country's cultural and environmental features. Hence, we may say that the advanced level of implementation is correlated to the advanced state of a country.

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