

# Newsletter

Business Unit: Pharma, Healthcare and Life Sciences

## THE ITALIAN TAX AUTHORITIES CLARIFY VAT TREATMENT OF PRICE ADJUSTMENTS FOR API SALES

### I. Summary and take-away

In private ruling No. 529 of 6 August 2021 (the “**Ruling**”), the Italian Tax Authorities clarified the VAT treatment of certain price adjustments between two pharmaceutical companies, Alpha and Beta (the “**Companies**”), in relation to the sale of an Active Pharmaceutical Ingredient (“**API**”).

According to the Italian Tax Authorities, the price adjustment of the API, which in the case at stake was connected to the profits of the Companies, constitutes a change in consideration for VAT purposes and requires the issuance of a debit/credit note, in light of the direct link between the original supply and the amount received as price adjustment.

### II. Background and guidance sought by Alpha

Alpha produces and sells the API to Beta, which in turn converts the API into finished pharmaceutical products (“**FPPs**”) and markets the FPPs in Italy and other Countries.

Upon sale of the API, Alpha applies a provisional price (the “**Target Supply Price**”), which, on a quarterly basis, is adjusted based upon the difference between the profits made by each of the Companies from the API/FPPs sales (“**Profit True Up**”).

The Profit True Up mechanism may give rise to a receivable or a debt of Alfa towards Beta.

Against this background, Alpha sought guidance from the Italian Tax Authorities on whether the Profit True Up is relevant for VAT purposes and requires Alpha to issue a debit/credit note.

### III. The VAT treatment of the Profit True Up

At the outset, the Italian Tax Authorities recalled the founding principle of the VAT system under which the taxable amount shall include everything constituting consideration obtained or to be obtained by the supplier, in return for the supply.

On the other hand, the Court of Justice of the EU clarified that the VAT taxable amount for the supply of goods or services for consideration is the consideration actually received for them by the

taxable person (CJEU decision 26 April 2012, C-621/10 and C-129/11, *Balkan and Sea Properties and Provadinvest*; ECJ decision 23 November 1988, C-230/87, *Naturally Yours*).

Further, the Italian Tax Authorities put forward that, in order for a price adjustment to be relevant for VAT purposes and thus qualify as a change in consideration, there must be a direct link between such adjustment and the original supplies. In this context, the Ruling made reference to the EU Commission Working Paper No. 923 of 28 February 2017, which stresses that such direct link must be assessed on a case-by-case basis.

In the case at stake, the Italian Tax Authorities pointed out that the Companies agreed to set the price through a two-stage mechanism, encompassing a provisional price upon sale (*i.e.*, the Target Supply Price), to be adjusted afterwards in relation to the profits made by the Companies. The Tax Authorities further noted that the Profit True Up is calculated quarterly and on an analytical basis.

Therefore, the Tax Authorities deemed the Profit True Up directly connected with the API supplies, thus qualifying as a change in consideration for VAT purposes and requiring Alpha to issue a debit/credit note in relation to the increase/decrease of the price.

On a separate note, it is worth noting that the Ruling is coherent with the approach taken in private ruling No. 60 of 2 November 2018, where the Italian Tax Authorities had stated that the adjustments made as a result of transfer pricing policies may have VAT implications only if the adjustments amount to a change in consideration for previous supplies and a direct link exists between the original supply and the adjusted consideration.

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