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"Global international taxation, from national tax systems towards global tax systems"

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Il presente lavoro nasce dallo Eucotax Wintercourse, al quale l'Università Luiss Guido Carli partecipa sin dal 1995.

Si tratta di un progetto di cooperazione nell'attività di ricerca in materia di diritto tributario (*European Universities COoperating on TAXes*), al quale partecipano, oltre all'Università LUISS Guido Carli, prestigiose università europee ed americane, tra cui la *Georgetown University*, la *Uppsala Universitet*, la *Katholieke Universiteit Leuven*, la *Universitat de Barcelona*, la *Universität Osnabrück*, l'*Universiteit van Tilburg*, l'*Université Paris 1 Panthéon–Sorbonne*, la *Queen Mary University of London*, la *Wirtschaftsuniversität Wien*, la *Corvinus University of Budapest*.

Ne forma oggetto, con cadenza annuale, un argomento di studio di carattere generale, che viene suddiviso in sei *sub-topics*, per ciascuno dei quali viene elaborato un questionario. Gli studenti delle singole Università rispondono ai questionari dall'angolo visuale del proprio Stato di appartenenza, per poi confrontarsi nel corso di una settimana di lavori comuni con i colleghi delle altre Università. Si perviene così ad un documento conclusivo unitario, nel quale gli studenti evidenziano per ciascun argomento i profili generali, le risposte normative o giurisprudenziali fornite nei diversi Stati, gli elementi critici emersi a seguito dell'indagine comparata e le relative proposte di soluzione, anche in vista di una possibile armonizzazione della disciplina normativa a livello comunitario.

Ha formato oggetto dell'ultima edizione del Wintercourse – tenutosi presso l'Università di Lodz dal 12 al 19 aprile 2012 – il tema della "Fiscalità internazionale su base mondiale: dai sistemi fiscali nazionali verso sistemi di tassazione su base globale", così articolato:

1. Principi e norme di tassazione internazionale;
2. La concorrenza fiscale dannosa nel contesto di operazioni transnazionali;
3. Ripartizione del reddito tra gli Stati;
4. Normativa sull'abuso del diritto;
5. Tassazione di transazioni transnazionali effettuate dalle istituzioni finanziarie e strumenti finanziari;
6. Calcolo della base imponibile.

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I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti da: Mariagrazia Spadafora (Subtopic 1), dott. Valentino Tamburro (Subtopic 2), dott. Gianpaolo Sbaraglia (Subtopic 3), Tiziana Tursellino (Subtopic 4), dott. Riccardo Carboni (Subtopic 5) e Sarah Supino (Subtopic 6).

Il dott. Alessio Persiani ed il dott. Federico Rasi hanno assistito i dottorandi e gli studenti nella preparazione dei lavori e nella successiva discussione presso l'Università di Lodz.

I lavori sono stati diretti dal Prof. Giuseppe Melis e dal Dott. Eugenio Ruggiero.

Elenco dei contributi

1. Principles and Standards of Transnational Taxation (Direct versus indirect taxation, ability to pay, worldwide income versus territoriality, destination principle versus principle of origin, neutrality, double taxation/double non-taxation, EU/OECD/G20 standards, how to implement international standards in national tax law, relationship with principles of democracy, legitimacy, representation, rule of law);

2. Harmful Tax Competition in the context of transnational transactions (State Aid, Code of Conduct, exchange of information -OECD, tax evasion, money laundering, transnational tax crimes, tax havens, offshore financial centers);

3. Allocation of income between states (Head office-PEs, transfer pricing, formulary apportionment, apportionment of consolidated tax base under CCCTB);

4. Anti-abuse law (Base erosion, CFC, LOB, beneficial ownership, dividend stripping, arbitrage in jurisdictions);

5. Taxation of transnational transactions of financial institutions and financial instruments (Vat, bank taxes, financial transaction taxes, financial activity taxes);

6. Calculation of the tax base (National tax accounting systems, relationship to Is/Ifrs,Us Gaap, Ccctb).

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Principles and Standards of Transnational Taxation

Mariagrazia Spadafora

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1. GENERAL PRINCIPLES AND STANDARDS IN TAXATION

In our system the source of tax law is the Constitution. The legislator obeys to it in order to provide for tax rules. The pillars which represent the principles of tax law are contained in important articles of the Constitution:

Art 3: principle of equality;

Art 23: adoption of tax rules by law;

Art 53: ability to pay , universality of taxation system;

Art 75: prohibition of referendum repealing to tax laws;

Among the ones mentioned above, Article 53 is the most interesting in terms of many principles such as ability to pay , universality tax and progressive tax. There is no doubt that the considerable principle is the ability to pay because expresses the will of legislator to safeguard the taxpayer. His economic and tax ability is the condition used by legislator to commensurate the contribute for public investment. On the other hand there is a contrary orientation that denies the rule of article 53 as the function of guarantee norm for taxpayers; According to this contrary orientation Article 53 is seen as standard of distribution of tax burdens.

The jurisprudence of Constitutional Court has not always taken a strict position regarding ability to pay; it affirms that ability to pay can be found in every economic fact which is indicative of ability to pay.

The principle of equality and the principle of ability to pay are closely linked. The principle of ability to pay is considered the clarification for tax purposes of the principle of equality.

Article 3 of the Constitution regulates the principle of equality and the treatment must be equal for all citizens removing economic and social obstacles. In this way, the equality also remains relatively to the ability to pay[1].

The ability to pay principle[2] is meant to ensure an equitable result between taxpayers. Its application has many consequences when a tax system is set up; most immediate effect for individuals is that taxation takes into account their overall income and personal position.

The interaction of different domestic rules and the bilateral conventions in force between States may give rise to a wide variety of results in taxation, ranging from double taxation to double dip positions. Direct taxation is still only partially harmonized and general guidelines have to be interred by interpreting the Community Treaties, the treaty on European Union and the secondary legislation available. Article 6 of the EU Treaty provides that " The union shall respect fundamental rights, as guaranteed by The European Convention for the Protection of Human Rights and Fundamental Freedoms signed in Rome on 4 november 1950.

Ability to pay is traditionally linked to the taxation of individuals[3], mainly on the grounds that legal entities are not real persons, they have no human needs such as shelter, food or provision for old age. At the level of single Member State, the issue of the applicability of the ability to pay principles to companies and businesses on general may be not relevant if we consider that the principle of equality in taxation is widely recognized. Whenever companies invest or expand across borders through permanent establishments or subsidiaries, equality remains an undefined concept whose application is often in contrast to other well-established principles of national and international taxation.

The recent proliferation of cases before the ECJ demonstrates that in the EU direct taxation is generally not equal since it is not harmonized. Whether ability to pay may be considered a common principle of company taxation in the European Union therefore deserves further analysis. Although it is true that legal

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[1] GALLO F., *Le ragioni del fisco. Etica e giustizia nella tassazione*, Bologna,2007 p. 98

[2] BARDINI C. *The ability to pay in the European Market: An impossible Sudoku for the ECJ,* in Intertax, 2010. p.2.

[3] BARDINI C. The ability to pay in the European Market: An impossible Sudoku for the ECJ, in Intertax, 2010. pp. 3 ss.

entities themselves do not feel and personal sacrifice when paying taxes., it is should be nonetheless considered that the ultimate beneficiaries of a company's performance are individuals. This has been widely discussed with regard to the issue of dividend taxation but it is also relevant for an understanding of why different taxation criteria ought to be used for companies and individuals.

The concept of ability to pay represents a limit[4] to the discretional power of legislator for fiscal legislator. In fact the Constitutional Court had affirmed that the legislator decides the determination of facts that are indicative of ability to pay with the only limit of arbitrariness. It can be deduced by any source of wealth and not only by individual income.

Article 11 of the Constitution is the key for the interpretation of Article 53. This provision has the goal to conquer the leading position of Italy: this article states that the legal system fits oneself to custom international law. In this way internal law automatically complies with international system without the need to implement the duties that result from international general law, excepted incompleteness. Therefore a legislative act that results incompatible with an international general common law has to be declared void by unconstitutional legitimacy of breaking violation of article 11 of Constitution.

In the international contest it is appropriate to mention the norms of the Court of Justice about the subject of international tax law; above all it underlines the importance of non-discrimination principle.

Article 34 TFEU provides that quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States. Article 36 TFEU provides in essence that Article 34 shall not preclude restrictions on imports justified on grounds of the protection of intellectual property, provided that such restrictions do not constitute a means of arbitrary discrimination or disguised restriction on trade between Member States. Quantitative restrictions are the obvious prohibitions of import or export a certain product, in absolute or in certain quantities. As seen, this prohibition is the most important step of the discipline of the common market of goods.

[4] Judgment of Consitutional Court n. 156/2001

Art. 65 (1b) TFEU allows Member States "to take all requisite measures to prevent infringements of national law and regulations", in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down declaration procedures for purposes of administrative or statistical information (e.g. cash controls at the border), or to take measures which are justified on grounds of public policy or public security. However, these measures must not represent a means of arbitrary discrimination or a distinguished restriction in the sense of Art. 65(3) TFEU.

Finally, article 110 TFEU rules: “No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products.

According to principle of proportionality, the measures must be in direct relationship with the public interest that must be protected and not exceed the level required.

Paragraph 2 of Article 90 of the European Community treaty rules:“ Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.”

The Court of Justice has developed other justifications under the “ rule of reason” doctrine [5].

Therefore also the tax interests have value of rule of reason because according to the Court it is necessary to prevent tax avoidance, to intensify the efficacy of tax controls and cohesion principle of national tax system.

Regarding to direct taxes the principle derives by the interpretation in order to guarantee to the taxpayers that undergo the same fiscal treatment.

The Consolidated Income Tax Act (Presidential Decree 917 of 1986) is the very important source of tax law in the internal system. It remains the

[5] TESAURO F, *Istituzioni di diritto tributario*, Milano, 2009, p.93

principal text because, despite the date of his entry into force, is constantly updated.

Among indirect taxes there is also IRAP, governed by Legislative Decree. 446/97. The question is difficult because the competence, in this case, is regional and therefore is necessary to coordinate the text with the modifications of the Regions.

The main indirect taxes are six: the most significative is V.A.T(value added tax) governed by DPR 633/72; it was revised in the last years.

The Court of Justice ruled that the principle of tax neutrality[6] should be interpreted as a difference of treatment for the purposes of VAT services of two identical or similar situations from the viewpoint of the consumer is sufficient to prove a violation of this principle. Such a violation does not require that it is also demonstrated the existence of effective competition between the services in question or a distortion. The principle of tax neutrality should be interpreted as meaning that a taxpayer can not claim a refund of VAT paid in respect of certain services. In this way, it refers to a violation of this principle. Although, according to the relevant national legislation, the benefits were not exempted from value tax authorities of the Member State concerned are treated in practice as a performance similar free services. competition due to the difference in treatment.

The definition of international tax law refers to the legal provisions that establish rules aimed to avoid the double taxation that derives from the fact that the States apply the taxation on a worldwide level on the income produced by its residents and also on the income of internal source perceived by non- resident individual. This form of taxation is defined as international double taxation: a person is taxed twice, in two different Countries for the same income. The goal of international tax law is on one side an equal taxation of economic activities and international investments, on the other side it is the elimination of the fiscal distortions in the taxation of the international investments. Equity on taxation of the economic activities is an objective that is pursued even through the principle

[6] Judgment of EU Court of Justice, Third Section, November 10, 2011, Joined Cases C-259/10 and C-260/10 was expressed regarding the application of the principle of fiscal neutrality.

of the ability to pay that is the principle which intends to obtain an equal distribution of the tax expenses between the taxpayers.

It tries to achieve the aim also trough the principle of equality that is the application of the same fiscal treatment in case of same conditions and circumstances. There are instances in which taxation is not equal, these are cases of fiscal discrimination based on residence and nationality or applications of deductions of taxes on payments made by a non- resident individual.

International double taxation can occur when entrepreneurial activity is practiced abroad, if causes the application of a double taxation that is different in respect to the one used for the individual which are residents in the State.

European legislation on taxation has also been adopted under wider provisions of the Treaty:

Article 352 TFEU requires the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, to take appropriate measures to attain one of the objectives set out in the Treaties if those Treaties have not provided the necessary powers. The European Economic Interest Grouping, a legal entity created in 1985 to facilitate and encourage cross-border cooperation, that was adopted under Article 352 TFEU involves specific tax arrangements. The legislation providing for the European Company which was adopted under the same article does not contain tax elements.

Article 293 TEC (repealed by the Treaty of Lisbon) was requiring Member States to enter into negotiations with each other with a view to the abolition of double taxation within the Community. This was the basis on which Member States adopted the Arbitration Convention. This article has not been reproduced in the EU/FEU Treaties. However the general provisions of Article 4 (3) TEU prescribe that the Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardize the attainment of the Union's objectives. A distinction is made between resident and non-resident taxpayers and also between income of internal and external sources; it’s enforced both on natural and legal persons. With regard to legal persons it is necessary to make reference to the source of the income and also to the legal form assumed by

the taxpayer for the execution of the economic activity. In case of international enterprise the investments abroad can be made assuming different legal forms; in case of a natural person it's important to consider the duration of stay of the individual in a certain State in order to establish the treaty whether the person is resident or not resident in a certain State.

The conventions against double taxation are the treaties between two Countries which aim to remove the double taxation. The industrial countries adopt to the model convention developed by OECD (Organization for Economic Co-operation and Development). Articles 1,2 and 3 require mayor attention regarding general definitions. Elimination of double taxation is governed by Article 23 of the OECD model which provides for the possibility to avoid double taxation of an income liable to tax; in Italy with the with-holding tax and also in the State with which Italy has stipulated a convention.

With regard to Article 23 of the OECD model, methods to avoid double taxation are two:

1) Exemption (art 23 A)
2) Tax credit (art 23 B)

Article 23 provides that where a resident of a Contracting State revenue income that are taxed in the Contracting State, the first state allows as a tax deduction on the income of that resident, an amount equal to the tax paid in that other state, however such deduction shall not exceed the proportion of income tax or capital computed before the reduction method is adopted in Italian domestic tax law.

Therefore Italy can include in the taxable income of income taxes relevant for the Italian goals also the income that is taxable in the other contracting State; the deduction is not limitless because the convention establishes a limit to calculate it correctly it's necessary: a) to establish in which percentage the foreign income contribute in the formation of total income; b) to calculate the relevant Italian tax..

The definition of total income is found in Article 8 of C.I.T.A for natural person and in Article 95 for the corporations and commercial entities.

We experimented[7] a radical change of economic and juridical conditions in the assets of international community. Ideology, political values and many political and institutional structures of States had an important rule in this change. An important effect of globalization is the fiscal and distributive policy. Values to progressivity, personality and solidarity are driving to regressivity.

It's very significative[8] about the development of national tax system Taxpayer Bill of Right. It is a legislative text that safeguards the taxpayer: it can be divided in two blocks: the first one includes the first four articles that regard adoption and interpretation of tax laws, the second one includes articles that go from 5 to 15 and embraces the relation between the income tax inspector and the taxpayer. The most significant Article is the first one because the provisions of his law constitute the general principles of the tax system because they can be changed only expressly and never by special laws. The main goal of the legislator is enclosed in the first article. It introduces in the tax system the general principles of constitutional valency in order to create stability to handle the normative tax production.

A part of the doctrine has attributed in an indirect way a Constitutional efficacy to the dispositions of the Statute and for this reason it represents a sort of pillar for the tax system.

The process of the tax autonomy has underwent a slowdown for different reasons. One of these is represented by the 5th claim title. It has been revised and in particular the field of competence linked to fiscal law, between State and region and local government. The reform of the Article 4 is in the normative framework, the constitutional law of October 18th 2001. It exposes a new system of distribution of the powers between States, region and local government. This revision is extremely innovative because the principle of autonomy, responsibility, coordination, cohesion and solidarity are not general affirmations but include binding dispositions.

[7] PERRONE- BERLIRI, *Diritto tributario e Corte Costituzionale*, Napoli, 2006, pp. 317 ss.
[8] PERRONE- BERLIRI, *Diritto tributario e Corte Costituzionale*, Napoli, 2006, pp. 477 ss.

2. CUSTOMARY INTERNATIONAL TAXATION

2.1 Personal Allegiance

The OECD model contains a specific article dedicated to the notion of residence .It identifies some methods to establish the State in which the taxpayer should be considered resident. This rule is relevant only in relations between states that have concluded a bilateral double taxation convention.

Article 4 of the OECD model rule the residence. The article refers to the domestic laws of the Contracting States : if an individual is considered resident from domestic law, it is also resident for the OECD Model.

However, the OECD Model identifies the tie breaker rules. These relevant criteria(domicile, residence, place of management or other and similar criteria).

Tie breaker rules identify the residence :

- the person is resident[9] in the Contracting State if it has a permanent home. The dwelling must be stable; the person must have it constantly available and not just occasionally. In the case of a permanent home in both states the person is resident in the Contracting State where his personal and economic relationship are more frequent (center of vital interests);
- the person is resident in the Contracting State in which ordinary residence if it is not possible to detect the Contracting State in which the person has their own centers of vital interest. (ordinary residence: if the individual has a permanent home in both states the residence is located in the state where the person stays more frequently);
- the person that has an habitual abode in both Contracting States or has not an habitual abode in each of them is considered resident in that State where has the nationality (citizenship);

[9] MELIS G., *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, Roma 1994 pp 38 ss.

Authorities agree with the mutual agreement procedure (Article 25 OECD) if the person has the nationality of both Contracting States.

Article 4 requires[10] that the resident must have full liability to tax. So according to the Convention are not considered residents, people who are taxed only in the state for income produced there.

The concept [11]of residence for tax purposes is important to identify residents and non- residents.

With regard to the individual residence, Article 2 of the C.I.T.A governs the taxpayers.

As stated in Article 2(2) of CITA, for the purposes of income tax shall be considered resident individuals that for the majority of the fiscal year are recorded in the register of the resident population or have their domicile in the State or residence within the meaning of the Civil Code.

Therefore the elements which determine residence for tax purposes in Italy are either:

- enrolment in municipal registers of the residents;

- The domicile in the State under the Article 43(1) of the Civil Code;

- Residence in the State, under Article 43(2) of the Civil Code.

The Supreme Court[12] has commented on taxation in Italy. In one of the reasons it examines the concept of tax residence. It reaffirms the importance of three elements. The Supreme Court states that the inclusion of citizens in the register of residents is not a decisive element to exclude the tax residence in Italy.

The jurisprudence of the Court of Justice argues that the professional and personal interests are relevant to determinate the place of residence of the individual. (EEC Directive 83/182).

The ministerial circular n. 304/1997 states that the inscription register is sufficient to establish the residence of the individual. This condition is an irrebuttable presumption[13], so it is clear that the above requirements are inter

[10] Official Commentary on article 4, paragraph 8

[11] BORIO G., *La tassazione dei non residenti*, Milano ,1996 pp. 3, 4.

[12] Civil Cassation - tax section , Judgment n. 14434 15-06-2010

[13] MARINO G., *Una nuova frontiera giurisprudenziale: la residenza fiscale obbligata*, in Rass. Trib., 2010..

alternative and non-competitors and there will be sufficient the occurrence of only one of them so that a subject is considered tax resident in Italy.

In the other side, the AIRE registration[14] is a condition necessary but not sufficient to be considered non-resident, unlike in enrolment registers of the resident population, that alone is assumed to be considered resident in Italy[15] .

Article 2 (2bis) of the Consolidated Income Tax Act provides that the Italian citizen, removed from the register of residents to have transferred their residence to a state or territory with a privileged tax regime, is considered resident in Italy, unless otherwise.

With regard to the domicile the concept is different. The significance of tax domicile is contained in Articles 58 and 59 of Presidential Decree 600/1973. Article 58 states that individuals residing in Italy have their tax domicile in the municipality where they reside. Persons not resident in Italy have their tax domicile in the municipality in which the income is produced. Tax domicile is considered in the municipality in which the highest income is produced. Italian citizens residing abroad have resident for tax domicile in the italian municipality of last residence.

Article 1 of Law 1228/1954 regulates[16] the obligation to register the positions of the homeless individuals who have established their domicile in the municipality. In this way, the statutory definition of residence is important to determinate the tax domicile.

It's extremely important to address issues relating to the residence of a person or entity, because it is directly connected to which is subject to taxation. There are special rules for income tax, corporation tax, capital gains tax to which each jurisdiction is free to adapt. These situations occur in tax havens.

2.2 Tax havens and double taxation

A tax haven is a country that has a tax system that attracts capital on favorable terms. The system of taxation in tax havens is very low or even absent.

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[14] AIRE means Italian Abroad resident registry office.

[15] In this sense see: Tax ruling n. 351/2008.

[16] . MELIS G. *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, Roma, 2004 p. 47.

It 's cheaper in these countries to establish the headquarters of a company. There are particularly strict bank secrecy rules, which allow to perform covered transactions. In terms of taxation, tax haven is a territory out of control, away from the international tax rules. During the recent G20 meeting, held in London, the great powers have decided to fight the global anomaly of the so called tax havens, providing a black list (which will be drafted by the OECD) and a range of penalties on those who do not cooperate.

Finance Act 2008 re-establishes the rules of Italian tax law designed to prevent the use of tax havens. The black lists and white lists are simplified. Regarding the blacklists, these affect economic relations between companies resident in countries with tax havens and companies resident in Italy.

The rules of taxation for dividends and capital gains on equity investments in companies, such as domiciliate ,are applicable to the black list indicated by the Legislation CFC (Controlled Foreign Company Legislation). Paragraph 4 of Article 47, and paragraph 4 of Article 68 of Italian Law on Consolidated Income Tax refer to resident individuals; Articles 87 paragraph 1 and Article 89 paragraph 3 refer to non-residents.

Paragraph 2 bis of Article 2 of the Italian consolidated law on income tax governs the case of Italian citizens erased from the registers of the resident population to migrate to a tax haven.

Instead, countries that are part of the White List are different from the Black List: these were covered in the white list and have a favorable tax arrangements are open to the exchange of information with other states through special agreements.

The law of 24 December 2008 reorganizes the classification of tax havens to the appointment of a white list of countries "virtuous." There is a white list based on the exchange of information and level of taxation. The tax benefit will no longer have significant relevance, only the level of collaboration with the Italian authorities will be important. Interest and other income from bonds and similar securities received from residents in countries allowing an adequate exchange of information will not be taxed.

The Italian legislature in Article 168 bis, paragraph 1 of the C.I.T.A designates the Ministry of Economy and Finance to draw up an initial white list with states that allow an adequate exchange of information. The list is important for the deductibility of contributions to pension schemes established in the EU.

2.3 Tax trasnsparency

Pursuant to article 168 bis, paragraph 1, the Italian legislature of the Italian consolidated law on income tax designates the Ministry of Economy and Finance to draw up an initial white list with states that allow an adequate exchange of information. The list is important for the deduction of contributions to pension schemes established in the EU.

Article 168 bis, paragraph 2, provides that the ministerial will find another white list of states or territories that have a level of taxation which is not much inferior to that used in Italy.

The second white list applies the following disciplines:

1) transparency of the income of subsidiaries (167, 168 Italian consolidated law on income tax);
2) tax treatment of dividends from foreign sources (47, 59, 89 Italian consolidated law on income tax);
3) the tax system for capital gains and losses related to the sale of equity investments (Italian consolidated law on income tax);
4) Worldwide group taxation

The Italian tax system defines corporate residence. The concept of tax residence depends by Article 73 of C.I.T.A. The effective tax residence coincides with the base of a legal person; real base represents the place of the actual conduct of administration and management of the entity; meetings are convened here for the centralization of corporate bodies and offices in order to make the business.

However this is not enough to talk about corporate residence; the Italian legislation adds an additional criterion that is' "main purpose[17]". According to this criterion the place of residence is the predominant location of the assets owned by companies or organizations.

The commentary to Article 4 of the OECD Model said that the governing authority is the actual place where the main activity and substantial entity is exercised.

Article 73 is the standard reference to understand the concept of tax residence, in particular paragraphs 4 and 5 explain the meaning of the corporate residence.

Tax rule connects the notion of residence of the company to the criteria of civil law. The "principal object" produces the primary purposes specified by law, articles of incorporation and the Statute. Article 2380 bis[18] of Civil Code regulates that the management of the Company is available only to administrators because they can directly realize the goals contained in the Statute and in Constitutive Act. For this reason it is wrong to argue that the purpose coincides with the place where the company's business takes place physically. It's fair to say that it coincides with the place where administrators realize the goals set in the Company by-laws.

However, Article 73 of C.I.T.A places the first criterion of the registered office, the base of the company that is specified by the statute. The legislature has introduced an additional criterion of effectiveness of the seat; this criterion is relevant in cases in which administrators carry out their activities in another place that is considered the seat of government. According to this criterion, the company must be considered tax resident in Italy if the directors take their decisions in the Italian state even if the registered office specified by the Statute is in another place.

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[17] NANETTI F., *Riflessioni in tema di oggetto principale, ai fini dell'art. 73, comma 3, del Tuir in Corr. Trib pp 1-2.*

[18] NANETTI F., *Riflessioni in tema di oggetto principale, ai fini dell'art. 73, comma 3, del Tuir* in Corr. Trib p. 3.

In conclusion, the main object and the administration are two profiles linked. According to the point of view of Italian tax law the place of effective management is where the social object is pursued.

Some court rulings confirm these observations. In particular, the Court of Cassation[19] ruled on this point. It stated that the real seat of the company is the place where it carries on the prevailing directive and administrative activities for the year of the company. The real seat must be the center where the company is real business.

Article 5, paragraph 3, letter d of Consolidation Income Tax Act rules that corporations and associations are considered residents if for most of the tax year has its registered office or administrative authority or the focus of their activities in the State. The article 5 of the C.I.T.A governs the principle of transparency[20]; This legal institution was present in our system for the partnership, while it was not allowed for corporations.

The Legislative Decree 344/2003 reformed the C.I.T.A allowing the application of the principle of transparency to the corporations that have specific requirements.[21] (Articles 115 - 116)

Now it applies to partnerships residents.

Instead, the principle of transparency does not apply to companies not resident whose income produced in Italy.

Tax transparency is a legal institution in which the legislature seeks to prevent double taxation of that income between the company that produced it and the member who perceives it, the aim is to prevent unlawful double taxation.

The income earned but not perceived by the corporate entity is awarded to members in society and is proportionate to the shares in the capital.

Article 166 of the C.I.T.A governs the transfer of residence or headquarters. The term "exit tax"[22] identifies the tax measures adopted by a State at the time of the transfer of tax residence. These tax measures tax capital gains

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[19] Court of Cassation n. 156/1958

[20] BORIA P., *Il principio di trasparenza nella imposizione delle società di persone,* Milano, 1996 pp. 30-31.

[21] TERZANI E., *La tassazione per trasparenza nel nuovo Tuir: spunti critici*, in Il Fisco, 2004 pp. 7861.

[22] UCKMAR V., *Diritto tributario internazionale,* Padova, 2005 pp 371 ss.

accrued up to that point even if it have not yet been realized. The exit tax was introduced for several reasons: This tax discourages the escape of assets in countries that offer a more favorable tax regime. Indeed, the principle of taxation wordwide can be severely threatened because of the emigration of its residents. The introduction of more favorable tax regimes is also justified by the Article 166 of C.I.TA; this article accrued capital gains tax business assets at the time of transfer. The gains are not taxed if the goods are included, following the transfer, with a permanent establishment in Italy of the subject moved. The European Court of Justice ruled on the compatibility of national legislation with the community law. In particular the European Court of Justice paid attention to the principle of non-discrimination and restrictions on fundamental freedoms.

A rule of law is compatible with Community law if it meets the four tests of the rule of reason:

- the rule mustn't be discriminatory;
- The provision must meet the public interest;
- the rule must be appropriate to pursue the public interest;
- the rule must be proportionate to the goal pursued.

Many jurisdictions provide specific tax provisions for the transfer of tax residence. The provisions relate to the movement of natural persons and legal persons from one country to another country. The change of residence may lead to a loss of tax revenue for the country of origin for both the accrued capital gain that for the losing tax revenue relating future income. For this reason, some jurisdictions contain tax anti-avoidance rules to prevent transfer of residence. The transfers are intended to obtain a tax saving.

The tax of transfer of residence is the so-called exit tax. It is a tax burden that can take several forms[23]:

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[23] ROMANO C., *Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell'Unione Europea,* 2004, in Rass. Trib, 2004, p. 1292.

- exit unlimited tax: capital gains matured are considered realized

- limited exit tax: capital gains matured on certain types of goods at the time of transfer of residence are considered are considered realized;

- Trailing tax personal: the person who changes residence is treated, in tax terms as a resident An example is in Article 2, paragraph 2 bis of the C.I.T.A relating to Italian citizens erased from the register of residents and migrants in countries or territories with preferential tax regime.

- Trailing tax real: the person who transfers his residence is taxed in the country of origin only for the items of income or assets that arise from sources in the country located there.

- recovery of prior tax deductions: it applies to the taxable person who has enjoyed deductions, tax deductions or deferrals. This type of exit tax provides that the taxpayer is taxed in the country of origin only in relation to income for which he had enjoyed the deduction, deduction or deferment.

The exit tax is a legitimate need for each country, it is intended to protect the revenue of the country. However, some types of exit tax may not be compatible with the rules laid down by international treaties against double taxation on the basis of the OECD model.

An unlimited or limited exit tax does not seem to be contrary to the provisions of the treaty against double taxation if it is applied when the taxpayer is still resident in the country of origin.

There is double taxation if the new country of residence of the taxpayer does not recognize the value attributed to property tax payer in the country of origin upon transfer of residence. In this case both the value accumulated before the transfer that the value achieved after the transfer are taxed.

The exit tax can be eliminated or revised by the EU member states because of their incompatibility with fundamental freedoms and the principle of non-discrimination protected under the EC Treaty.

In our tax system there are anti-avoidance rules with reference to tax residence of individuals and legal persons; The C.I.T.A provides shifting of the burden of proof for those transferring to a country included in the so-called black list.

None of the fifteen member states of the European Union is included in the blacklist. In addition, the agreements concluded by Italy does not contain specific provisions regarding exit tax;

The provisions of Article 166 of the Income include to avoid the transfer of residence in foreign countries as a form of avoidance. The subjective sphere of application of the rule represents an important modification of the regulatory provisions contained in Article 166.

The new provisions apply to the persons listed in Articles 2 and 73 paragraph 1, letter a) and b).

Regarding Italian citizens erased from the register of residents and migrants from countries with tax havens, according to Article 166, are considered tax resident in Italy. For example, an entrepreneur[24] Italian citizen moves to a country included in the blacklist after the ministerial-registration of the residents: he remains a resident for the purposes of income tax on individuals.

The problem arises if the entrepreneur moves from one country to tax havens to another country that is not to tax havens. In the absence of specific legislation, legislation on transfer of residence abroad is applied and leads to loss of residence for the purposes of direct taxation.

A citizen of an EU member state is free[25] to establish a company in another EU state which has an internal regulation less stringent and restrictive rule of his State.

The first paragraph of Article 43 states that restrictions on freedom of establishment are prohibited. The prohibition also extends to the opening of

[24] ROMANO C., *Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell'Unione Europea*, 2004, in Rass. Trib, 2004, p. 1298.
[25] Treaty European Comunity.

branches, agencies or subsidiaries by nationals of any Member State established in the territory of a member state. Article 48 extends the benefit of the right of establishment for natural persons possessing the nationality of member states and companies that have their registered office, central administration or principal place of business inside the Community.

Association of Accountants of Milan[26] denounced aspects of illegality in the Community exit tax. According to the Association, the exit tax is contrary to Article 43 of the EC Treaty and would constitute a restriction of freedom of establishment. The Association of Accountants has submitted that Article 166 is an excessive measure to counter the abuse and to promote tax controls. It affects those taxpayers who want to leave Italy and move to another state for business opportunities. According to the association the rule is a disincentive for the transfer of economic activities in another EC State and in this way impact on the sphere of economic interests of the entrepreneur.

2.4 Economic allegiance

Tax system in various types of income are regulated by the Tax Code. They are divided into categories that combine to form in the total income of taxpayers. The categories are ranked in the first paragraph of Article 6 of the C.I.T.A: land income, capital gains, income from employment, self-employment income, business income, other income. The total declared income is the sum of individual incomes. The second paragraph contains the principle of substitution. It adjusts the revenue received in replacement of other income. It also governs the compensation received in the form of insurance as compensation for loss of income. Finally, the third paragraph provides for a rebuttable presumption: partnerships, excluding simple partnership, produces business income regardless of the source and social object. With regard to compensatory revenue, case law[27] holds that only the income allocated by way of profits are significant, and not those assigned to actual damage.

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[26] CARRIROLO F.*, Il trasferimento all'estero della sede della società italiana e in Italia della sede di società estera,* in Il Fisco, p. 7923.

[27] ABRITTA, CACCIAPAGLIA, CARBONE, SIRIANNI, DE FUSCO, in Commentary of C.I.T.A.

The legislature has imposed this presumption[28] in the law enforcement delegation of tax reform 825/1971. Article 2 of this reform provided for the inclusion in the calculation of the total income of gains and losses earned by commercial enterprises and gains and losses realized on the sale of assets related to these companies. Instead, the rules of the pension is part of the decree n. 252/2005 because Article 20 of the C.I.T.A was repealed.

2.4 Income taxation on personal allegiance and economic allegiance versus scheduler or synthetic system of tax.

The premise of taxation on personal income is the existence of a situation relative to the detector of ability to pay direct taxes. They affect an immediate manifestation of wealth.

Direct taxes in fact consider the person and his ability to pay with the participation of the subject to taxation with the presentation of the declaration and the taxation of income with the application of the progressive tax (personal tax) or other systems which the scheduler through taxation of wealth in a fixed amount (real tax).

Therefore, direct taxes in relation to the subject are divided into[29]:

-subjective or personal taxes, if they hit the income equally taking into account the personal circumstances of the subject to better identify the ability to pay;

The debate on creation of personal tax has grown with the introduction of the reform of the years 1971-1973, personal income tax. The reform has provided a legislative response to plans to transform the system. and progressive staff.

- Tax real or objective, if they hit on an ongoing basis directly to net income of each species (dry coupon tax on capital gains, rents, etc..) Regardless of the personal circumstances of the taxpayer.

For the purposes of taxation has no real importance, for example if the stock dividend is owned by A or B, from a rich or poor.

[28] ABRITTA, CACCIAPAGLIA, CARBONE, SIRIANNI, DE FUSCO in Commentary of C.I.T.A.
[29] FEDELE A., in Appunti delle lezioni di diritto tributario, 2005.

Assuming the system of flat rate taxation of scheduler, (rents, subject to the tax) and related non-qualified dividends, are not relevant to the total income and therefore should be excluded from the calculation of Income Tax.

It has the advantage of simplicity, clarity, generality, accuracy, and cost of collection.

In real tax system, each income is taxed separately.

The key feature of the case of assessment of personal taxes is to make possible a rational operation of the toll that has regard for the taxpayer and the person measuring the complex index of taxable capacity of a class refers to him.

Therefore, subjective criteria are used in personal taxes. They are taken in our tax system with the tax on personal income and corporate income tax. The objective criteria are used in real taxes in relation to the taxable nature of the respective case.

For the purposes of direct taxes, the establishment[30] is a prerequisite to allow a State to impose tax on business income produced by a non-resident. Under international conventions, the State in which the subject is resident is classified as a country of origin, the country where the permanent establishment is located is classified as a country a source of income. The OECD model bilateral conventions against double taxation, which constitutes the frame of reference in the conclusion of these agreements, in particular in Europe, provides the exclusive taxation of income of the permanent establishment in the source country. For the State of origin, the rules are alternatives to the exclusion of business income earned through the permanent establishment or assignment of a credit for tax paid in the source country. Internationally, the definition of permanent establishment is not univocal; each State may enter into specific agreements in the negotiation of bilateral agreements. Generally, for the purposes of direct taxation, the case includes the assumption of a fixed structure, or the presence of persons acting on behalf of non-resident.

The activity through the establishment must be productive of income. The presence of an office that handles only the purchase of raw materials can not, therefore, assumed to legitimize the imposition on non-resident. The internal

[30] PICCOLO C., Agenzia delle Entrate, www. Fiscooggi.it, 2005

structure of the organization of a society is not a "permanent establishment". Similarly, the manufacturing plant located in a country with low labor costs, which handles relations with the local market and send the entire finished product non-resident company is not permanent establishment

Moreover, the qualification of permanent establishment present in a bilateral agreement governs the relationship between the Contracting States even in the presence of a different classification adopted in their national legislation. Bilateral agreements take precedence, in fact, over the domestic legislation, placing limitations on the part of each other signatory States to exercise power of taxation.

Each country will therefore have different legal definitions of permanent establishment, each with its own separate area of application.

2.5 Worldwide tax income and territoriality

Article 3 of Presidential Decree 917/1986 Institute of worldwide tax income for non- residents.

The Italian tax system adopts a worldwide tax income and a territoriality system. The principle of taxation on a worldwide basis is applied against the residents.

Based on this principle, the subject, once qualified as a resident, is subject to income tax on all its products anywhere.

Instead, the principle of taxation on a territoriality system (also called the principle of source) occurs when the subject is classified as non-resident and is based on the criterion of subjection to taxation based on the location of income in the State.

Therefore, in application of these principles, for the resident, the income includes not only the income produced in Italy but also those produced abroad, while non-resident companies are taxed on any income earned in Italy through a permanent establishment.

So in the Italian tax system, as in most developed countries, the worldwide tax system prevails on the territoriality system.

The territorial taxation means the exercise of sovereignty tax only on income produced by anyone, resident and non resident in its territory, but the global taxation means the exercise of sovereignty also tax the income outside the territory of the State by residents who have a personal connection with the territory. In other words, the right of taxation shall be exercised in respect of all residents, in respect of income wherever held.

The Italian legal system generally adopts the method of tax credit[31] and in some cases only one exemption. The exemption applies to 95% for dividends on the parent and daughter and to the dividends distributed by subsidiaries in the absence of agreement, in the presence of the requirements of the participation exemption.

Through Article 23 of the OECD model, the Italian legislature adopted the system of tax credits for income earned abroad (so-called foreign tax credit).

The legislation for the tax credit is now contained in Article 165 of the Consolidation Income Tax Act.

The new rule is no longer included among the general provisions on the taxation of individuals. It is located inside the Title devoted to common provisions. It is directed to all the subjects, both individuals and corporate entities. This setting goes beyond the provision of the delegated law.

The exemption method[32] is governed by Article 23 of the OECD model.

According to exemption method, the state exempts the income may be subject to taxation in the state of the source. The exemption may be limited or unlimited: it is limited regarding to income derived from permanent establishment is unlimited regarding to dividends.

The exemption can be applied in two ways:

- full exemption method: no reference is made at the rate that applies to the domestic level, taking into consideration the income produced in the world;

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[31] BITONTI D., *Il credito d'imposta per i redditi prodotti all'estero*, in www.fiscooggi.it , 2007

[32] DRAGONETTI, PIACENTINI, SFONDRINI, *Manuale di fiscalita Internazionale,* 2008, pp 43-44

- exemption method for progression: the taxation on household income not exempt applies at the rate which would apply if the tax had been calculated on the income generated on a worldwide basis.

Some states use the method of deduction[33] to eliminate double taxation. According to the method of exemption the taxes paid in the state are tax deductible from income source produced worldwide as a deductible expense of the activity. This method avoids the double taxation part. Deduction method can be applied only if the methods of tax credits and exemptions do not apply.

The old discipline of controlled foreign companies[34] was contained in Article 127 bis of the C.I.T.A.

The new discipline of controlled foreign companies is contained in Article 167 of C.I.T.A .

Law 102/2009 has introduced important changes; the new regulation provides that the economic life of CFC must necessarily be rooted in the economic market of the blacklist. The root is the economic and social ties with the foreign country of the CFC, it must be firmly and continuously and must take advantage.

The sense of discipline C.F.C [35] is to resolve an international circumvention. Articles 167 and 168 of the New Consolidated reformulate the rules of the CFC. and its extension to related foreign companies.

New Art. 167, which reformulates Article 127 bis of the old C.IT.A, the controlled foreign company rules, while new article 168 extends the application of the regulation of CFCs to cases where the resident of Italy owns, directly or indirectly an holding not less than a certain percentage of the profits of an enterprise resident in states subject to preferential tax regime.

The participation rate must be not less than 20% if it is an unlisted company and it shall be not less than 10% if it is a listed company.

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[33] DRAGONETTI, PIACENTINI, SFONDRINI, Manuale di fiscalita Internazionale,2008 pp 43-44
[34] judgment of the Court of Justice 2006 c-196/04 so-called Cadbury-Schweppes
[35] www.fiscooggi.it , *black list e controllate estere*

The income of the non-resident shall be determined by an amount corresponding to the higher of the profit before taxes resulting from the budget prepared by the foreign subsidiary and income determined inductively based on rates of return to certain categories of goods.

The legislation aims to combat avoidance of those in control of firms located in "tax havens". The regulations contained in Article 167 paragraph 1 of CITA regards foreign companies participated located in states with tax levels significantly lower than that applied in Italy and where there is no adequate exchange of information (CFCs controlled foreign companies).

This list is called in the articles of C.I.T.A governing the taxation of dividends received by individuals (articles 47 and 59) and legal persons (Article 89 of the Income Tax Consolidation Act) as well as the articles that set the rules for taxing capital gains realized by individuals exercise of business (Article 58C.I.T.A) and IRES subjects (Article 89 C.I.T.A).

This legislation known as CFC rule (Controlled Foreign Companies) affects not only companies but any taxpayer resident in Italy with stakes in entities located in tax havens

Income derived from investment in companies resident abroad are not subject to tax when they are received: however according to the "CFC rules" , the income of foreign subsidiaries are charged to persons resident in Italy regardless of the distribution. The phenomenon is called "allocation for transparency" members resident in Italy can not omit the taxation of profits and taxation in Italy can not be postponed.

The CFC rules apply to every resident of Italy who holds a direct or indirect control of a company resident in countries or territories to the preferential tax regime.

There are two cases in which the CFC rules do not apply to:

a. The first situation occurs in cases where the subject is located in the state or territory with privileged system actually exercises a trade or business in the State of residence;

b. The second case occurs when the resident entity that controls the "foreign entity involved," does not achieve the effect of locating income in states or territories in order to take advantage of preferential tax treatments.

As regards the taxation of foreign source royalties Directive "2003/49/EC is relevant. It was implemented through the Legislative Decree 143/2005. The withholding on interest and royalties paid to corporations resident subsidiaries in other states Community has been abolished. This decree has ordered major retrospective effect.

2.6 Transfer pricing

The OECD has stated the principle of free competition for the operation of business restructuring, better said arm's length principle.

The arm's length principle is not a general criteria for transfer pricing, but it is a special criteria. The OECD model governs the arms length principle of Article 9. In the Italian national tax system this principle is set out in Article 9, paragraph 3 and Article 110, paragraph 7 of C.I.T.A.

Indeed, Article 9 of the C.I.T.A determines that the normal value of goods is the amount or the price charged for goods and services of the same or similar conditions of free competition and at the same stage of commercialization. Paragraph 2 of Article 110 of the C.I.T.A refers to Article 9 for the determination of normal value. Paragraph 7 of Article 110 of the C.I.T.A specific components of the income resulting from transactions with non-resident companies in the State are valued at market value of the goods supplied, services rendered and goods and services received as adjusted by paragraph 2 of Article 110 C.I.T.A .

The necessity to adapt the taxation of companies operating in the EU and the need to eliminate tax obstacles to cross-border business in the domestic market introduced the so-called CCCTB (Common Consolidated Corporate Tax Base) through a structured dialogue between all parties involved : Member States, representatives of enterprises and economic operators. In 2004, on these

assumptions, the CCCTB Working Group[36] was established at the Directorate General Taxation and Customs Union. The project to the study of the WG aims to give European companies the possibility to choose for a common consolidated tax base at European level.

3. INTERNATIONAL AGREED STANDARDS

In 2009, the global crisis and the growing pressure[37] on public finances lead to a renewed interest in international cooperation in tax matters. In April of that year, the leaders of the G20 meeting in London, took a clear position in favor of the OECD standards on tax transparency and exchange of information, while condemning the "tax havens" (tax haven) and, in general, non-cooperative jurisdictions. The sentence has an almost immediate effect: in a few days, many of the jurisdictions considered uncooperative by the OECD - and included in the cd "Black list" - formalized its intention to waive bank secrecy and adhering to standards of fiscal transparency developed by the OECD. While the black list is empty, in September the G20 Pittsburgh welcomes the decision of the Global Forum to initiate a process of peer review that verifies the actual level of fiscal transparency of the courts and their true commitment to standards. The timing of the revisions, the evaluation criteria and methodology shall be approved in a few months: the first reviews are officially launched in March 2010.

The increasing international tax competition stimulates high-tax jurisdictions to reinforce anti-avoidance rules to counter the erosion of national tax revenue. Several countries have focused their anti-avoidance rules on international transactions, given that the tax arbitrage and avoidance are more easily pursued by jurisdictions that do not allow an adequate exchange of information for tax purposes.

The implications of the existence of non-cooperative jurisdictions, including "tax havens", were addressed during the G20 summit in London on April 2, 2009, in the discussion on measures to strengthen the financial system:

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[36] SACCONE A., *La base imponibile consolidata comune: una sfida per la fiscalità europea*, in www.unina.it di,2009.

[37] VITALE F., *L'Italia tra le punte del diamante,* in www.fiscooggi.it, 2011

governments have committed themselves to taking actions against tax havens and sanctions to protect their public finances. In the occasion, the OECD published a report on the progress made by individual countries in the implementation of an effective exchange of tax information.

Recently, Italy has issued several "anti-avoidance international provisions," referring to the rules with respect to taxes on income which establish different tax treatment because of a connection between income and taxed subject to taxation a privileged country. Taxation for transparency of foreign subsidiaries ("controlled Foreign Companies" - CFC), the presumption of tax residence in Italy for natural persons residing abroad, the limitation of the deductibility of expenses on foreign supplies, the tax treatment of proceeds of finance paid to non-resident or received from abroad fall under these rules.

An instrument that facilitates tax evasion is banking secrecy. Banking secrecy[38] is an obligation of discretion for the representatives and employees of banking institutions. This requirement covers the economic affairs of their clients or others who know the course of their work. Any person in connection with a bank is also linked to banking secrecy. This is about the customer and not the bank, and the customer is the only one to give it up.

In Italy, by Decree n. 214/2011, bank secrecy has been deleted.

The banking secrecy[39] with the decree fell once and the tax authorities will receive periodic movements of the accounts by financial operators. The abolition of banking secrecy is a weapon which, added to the tax return and the new Redditometro, able to "measure" the spending power of a taxpayer, should help the state to track down tax evaders. Article 11 of the decree is entitled "Emergence of the tax base";

The decree "Monti" is intended to prevent avoidance or illegality in order to recover the tax base removed from taxation. The availability of organs responsible for conflict evasion requires the notice to the industry and gives a strong impetus to the effectiveness of fiscal supervision.

[38] SERVIDIO S. www.fiscooggi.it, 2011
[39] December 22, 2011 Decree.

Article 11 of the Decree provides for controls on bank accounts and any financial relationship with banks, post offices etc.. even in the absence of specific tax investigations have led to the end of banking secrecy.

From 1 January 2012 financial operators, banks, the Italian Post Office, financial intermediaries and investment firms, insurance companies, are obliged to periodically send to the Tax Office, the instrument introduced by the Financial Administration Decree 605/1973 that census of all the Italian taxpayer.

Then the tax office must not only receive data and tax code relating to the nominee, delegates and their relationship as a kind of art. 7 of the decree, but also:

-all amounts in the accounts of the movements

all-out account transactions, exchange checks, requests for transfers of cash, foreign currency exchange, with the sole exception of payments current account post bulletins below 1500 euros.

The abolition of banking secrecy is a weapon which, added to the tax return and the new “Redditometro”, able to "measure" the spending power of a taxpayer, should help the state to track down tax evaders.

For almost two years, the Global Forum on transparency[40] and exchange of information for testing the effectiveness of fiscal rules and procedures for the exchange in the Member States and in major financial centers through a system of peer review. The last meeting of the Leaders of the G20, held in Cannes in early November, has provided an opportunity to take stock of achievements and goals for the coming years.

Italy, however, is among the jurisdictions more "virtuous", including those that comply fully with international standards on tax transparency.

Leaders of the G20 said they were ready, if necessary, to use "countermeasures" against jurisdictions that do not meet standards of fiscal transparency[41] and invited the OECD, FATF and other agencies and international organizations working on coordinated to improve fiscal transparency.

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[40] VITALE F ,in www.fiscooggi.it, 2011

[41] See paragraph 36 of the Final Declarations.

3.1 FAFT recommendations

Financial Action Task Force (FATF) was established in 1989 at the G7 meeting in Paris. It is an intergovernmental body whose purpose is the elaboration and development of strategies for combating money laundering of illicit origin and, since 2001, including the prevention of terrorism financing.

Since[42] July 2001 the President of the group is Giancarlo Del Bufalo. The Italian President will guide the development of strategies for combating money laundering of illicit origin. Strengthen the role and activities undertaken by the International Financial Action Group. The ambitious goal of the Italian presidency, which, on the wake of what has been done by the Mexican one, will continue the work undertaken in recent years. An Italian Presidency of the purposes is to identify those countries that show deficiencies in strategic combat money laundering and financing of terrorism, to work to adapt the systems to operate to international standards, to deepen the analysis of new technologies and methods of use of the financial system for illegal purposes. In this context, the dialogue with regional groups formed on the model of the FATF (for Moneyval countries as members of the Council of Europe) will be essential.

The objectives of the Italian Presidency are also in line with the responsibility to drive the structure into the review of international standards against money laundering and terrorist financing. In particular, in contrast to the financing of proliferation of weapons of mass destruction, combating corruption, greater transparency in the financial sector. Everything in order to launch the fourth "Round of Mutual Evaluations" of the member countries not members of FATF.

Recommendations prepared by the Group are 49. They define the measures to be taken to provide States to fight effectively money laundering and terrorist financing. The recommendations are not binding (soft law), but they have been raised internationally. Since 2008 a new commission that the inconsistency of the financing of proliferation of weapons of mass destruction has been

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[42] Gafi, *un italiano alla presidenza del Gruppo per il 2011-2012*,in www.fiscooggi.it ,2011

attributed to the FATF, already responsible for combating money laundering of illicit origin and prevention of terrorist financing.

The Italian tax system rules in article 167 , paragraph 8-ter of C.I.T.A the business activities with low tax jurisdictions regarding expenses[43], presumption relative which admits proof in contrary.

However, the new paragraph 8-ter assures to resident parent the opportunity to demonstrate, through of questioning the procedure referred to in Article 11 of Law 212/2000, that its foreign subsidiary is not "an artificial construct designed to achieve an unfair tax advantage. "

The circular clarifies that, with this provision has been transposed in national law, the notion of "purely artificial" elaborated by the EU, notably in Cadbury-Schweppes of September 12, 2006 (Case C-196/04) .

Moreover, it appears consistent with the guidelines, the evaluation, in the questioning, "case" of the artifice of the construction according to foreign "objective and ascertainable by third parties.

4. THE COMMON PRINCIPLES OF GLOBAL TAXATION

The Government, through the Legislative Decree 74/2000, reformed the tax offenses.[44] The decree was designed to concentrate power penalty case particularly harmful to the interest tax. Many types of offense have found place in the law 516/82. This law had not solved the problem of the length of criminal prosecutions. Legislative Decree 74/00 has confirmed the principle of autonomy between criminal and tax proceedings. This decree provides for offenses relating to income tax and VAT. The measure contains seven criminal cases, four cases are related to the declaration. The article governs two fraudulent misrepresentation by the use of invoices or other documents for nonexistent transactions, Article 3 governs fraudulent misrepresentation by other artifices, Article 4 governs the misrepresentation, Article 5 regulates the omitted declaration. With regard to the offenses of documents and payment of taxes, Article 8 regulates the issuing of

[43] for example: Leur - Bloem ECJ judgment of 17 July 1997, C-28/95

[44] SECHI B.*, Riforma dei reati tributari: più pregi che difetti*. Il d. lgs 74/00,2001 pp. 1,2,3

invoices or other documents for nonexistent transactions, Article 10 governs the concealment or destruction of accounting documents, the article 11 regulates the fraudulent evasion of taxes to pay.

The Title I provides for offenses relating to declaration constitutes the decisive and concrete realization of tax evasion. All criminal figures enclosed in Title I are characterized by the existence of specific intent[45] required for tax evasion. Among the crimes that the first order regulates there is a statement through the use of fraudulent invoices and other documents for nonexistent transactions. Fraud is the use of false invoices or other documents. Concretely, the annual statement must be supported by corresponding mendacious accountants documentation that induce the tax authorities to make mistakes.

The infringer must have fraudulent conduct to obstruct the administration at the time of the determination of mendacity.

Article 4 governs the misrepresentation that contains false information regarding the fictitious assets and liabilities. The assumption regulated by Article 4 shall not be deemed to indicate the fraudulent intention of the offender. Article 5 provides the classic case of tax evasion made by non-declarations of income, but not the more serious cases.

Finally, Article 11 of Legislative Decree 74/00 regulates the possibility of fraudulent evasion of tax payment which is realized through the performance of other fraudulent acts of assets that make it ineffective, even in part, the procedure for compulsory collection.

Article 26 of the OECD Convention provides for the exchange of information between Member States which joined the Convention. Paragraph number 1 provides that states exchange information[46] to apply the Convention or the domestic laws concerning taxes of any kind. It's important that these taxes are not contrary to the Convention. The exchange of information not only about the application of the Convention but also covers internal taxation in both countries. One of the two countries may expressly request the exchange of information. Paragraph 2 of Article 26 OECD states that the information exchanged between

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[45] SECHIB., *Riforma dei reati tributari: più pregi che difetti*. Il d. lgs 74/00,2001 pp. 5 ss.

[46] Modello OCSE 2010: *sullo scambio informazioni sciolte le riserve*, www.fiscooggi.it

states are protected by the same confidentiality provided for information acquired internally. The information may only be used for tax purposes.

Paragraph 3 states that the information that may disclose any trade, business or profession can not be exchanged with other countries. Paragraph 4 states explicitly that a state is required to provide information even if this does not imply any advantage for tax purposes.

Finally, Paragraph 5, establishes that the exchange of information has no limits if these are held by a bank, financial institution, by an agent or a person who is an agent or a fiduciary. G20 The OECD has pointed out the importance tax transparency and exchange of information forcing countries of black list to sign agreements for exchanging information.

Harmful tax competition[47] increases with the globalization of markets. In this context, the Commission has enacted provisions to the Council which pursue the aim to stop the phenomena of harmful tax competition between states.

First, a code of conduct was adopted by the Council and representatives of the Governments of Member States. It 'a non-binding policy document. It programs the block of new measures of direct taxation.

Moreover, a directive on interest and royalties between associated companies has been introduced to include the principle of taxation in the country of residence of the recipient. This would eliminate the formalities required for refunds of taxes.

Finally, a directive on the taxation of interest for non-resident individuals has been proposed. This Directive shall apply an alternative regime: the obligation of communication, exchange of information between the State in which the interest is paid and the state of residence and non-applicability of the deduction. These provisions are called "Monti package" and suggest guidelines to coordinate actions at Community level of national laws.

4.1 State aids

The notion of "State aid"[48] was prepared by the Commission, the European Court of Justice and the Court to the extent of their competence established by

[47] BORIA P., *Diritto tributario europeo,* Milano, 2010

Article 88 of the EC Treaty. According to these organs, state aid is the measure that gives an economic advantage to the beneficiary, is attributable to the state or to state resources and that it is selective, favoring only certain undertakings or productions. State aids instruments are useful for the development of the Single Market (Article 2 EC Treaty). The notion of State aid is wide and lays down the prohibition to use support for fiscal measures.

As regards the sources of law, Articles 87, 88, 89 of the EC Treaty are relevant. These rules already contained in Articles 92.93 and 94 of the EC Treaty of 1957, have not changed. They are located in Title VI concerning the rules on competition, taxation and approximation of the laws and form the second section of Chapter I of Title VI on rules of competition. The estimates of state aid are distinguished from others according to the recipients. The competition rules consist of the antitrust law, instead the provisions[49] on State aid apply to Member States who can not intervene to support enterprises to distort competition. Article 87, paragraph 2 regulates state aid that are not compatible with the common market. Paragraph 3 of Article 87 rule instead of state aid that may be compatible with the common market. As regards state aid that are incompatible, the Commission has the power only to see concretely the intervention of the Member State in cases sanctioned by legislation. Instead, with regard to state aid that are compatible, the Commission has the power of judgment exclusively. In tax matters, there is a conflict between state aid and tax policy community. The Code of Conduct is part of the "global approach". It is an approach of the European tax policy to achieve the objectives set out in Article 2 of the EC Treaty. The global approach has established at Community level. A first result of this global perspective has been the Commission document SEC presented to the Ecofin Council in Verona in 1996. It is a document that focuses on change in the distribution of tax burdens in different states.

In this context, the Commission mentioned the development of competition[50] between different Member States in tax matters. This competition allowed investors to freely choose the place of investment under the tax variable

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[48] RASI F., *Aiuti di Stato in materia fiscale*, Padova, 2007,pp 57, 58.

[49] PERSIANI A., *Aiuti di Stato in materia fiscale*, Padova, 2007 pp. 13 ss.

[50] PERSIANI A. , *Aiuti di Stato in materia fiscale*, Padova, 2007 pp 12 ss.

and encouraged Member States to take tax advantage. The EU policy has developed on this point and disfavor focused on harmful tax competition.

With regard to unfair tax competition measures identified in the Code of Conduct, the Member States committed themselves not to introduce new ones and to consider modifying its internal rules only to eliminate any harmful measure.

All models of the International Convention against double taxation using the expression "beneficial owner"[51] of dividends, interest, royalties received. The beneficial owner is a principle anti abuse incorporated in international conventions against double taxation. It is intended to counter possible behaviors of the elusive nature of the taxpayers. At the international level this principle is the most general expression of the principle of the prevalence of substance over form principle. The anti-abuse principles contained in international conventions are intended to avoid the phenomenon of so-called treaty shopping interposition of a natural person or legal entity that allows you to create a translation provided improper benefits from an international agreement to avoid double taxation on income and on capital. All agreements contain a specific anti-abuse clause. It is contained in Articles 10, 11 and 12 of the OECD model in which the main international reference models.

The anti-abuse clause is meant to counter the real interposition between the final beneficiary of the income (non-resident) and the subject lender (resident) of a relevant third with the sole order to exploit the more favorable tax regime provided by the various bilateral agreements. The aim is to avoid double taxation on income. The term "beneficial owner" is also contained in several EU directives transposed by the national legislature. The Directive is transposed by the national legislature 2003/49/EC and the taxation applicable to interest and royalty payments between associated companies of different Member States. The EU directive makes it eligible for application of domestic or agreement to eliminate or mitigate the double taxation of interest and royalties in the first head of the person receiving them. Even the national law incorporates the guidance.

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[51] BARGAGLI M., *Il regime fiscale delle royalties tra normative interna e trattati internazionali sulle doppie imposizioni. Riflessioni sul "treaty shopping* ", in Fiscalità Internazionale, 2008, pp299,300,301)

Article 26-quarter, paragraph 4 letter c presidential decree n. 600/73 contains the same definition of beneficial owner required by EU directive. Also, ministerial circular No 47 / E, 2005 stated that the subject is considered beneficial owner if the company receives interest or royalties draw their own economic benefit from the operation performed.

Also Directive 2003/48/EC expresses the concept of beneficial owner of income in the area of interest. Article 2 of this Directive that regulates beneficial owner is any individual who receives an interest payment or any individual in favor of whom an interest payment.

4.2 Money laundering and organized crime

Analyzing the phenomenon of organized crime[52], there are several factors of pollution of the economic system. One of these factors is corruption. Recently, following the crisis that involves the most advanced economies in the world, the fight against corruption has become a priority of international politics. Corruption causes a removal of capital flows. It produces enormous costs if it is fought because destabilizes the free market rules. Moreover, corruption facilitates criminal activities such as drug trafficking and money laundering fueling transnational crime. The G8 countries have placed the need to adopt effective policies to fight to limit the negative effects generated by corruption on economies worldwide. The political statement of the G8 on Combating Corruption confirms that law enforcement efforts against corruption has already shaped national levels to take on international dimensions.

Recently, Italy ratified the United Nations Convention against Corruption (UNCAC), It has a global instrument against corruption and for its broad scope and the number of countries that are part of it. From the mid-nineties other important initiatives have taken a central role in combating bribery of the phenomenon: Conventions against corruption by the OECD, Council of Europe

[52] BONFIGLI S.,*L 'Italia e le politiche internazionali di lotta alla corruzione*, pp 1- ss..

and European Union. As regards the Italian commitment in the GRECO (Group of States against Corruption) and WGB (Working Group) on corruption OECD represent the two most important mechanisms of battle against corruption in place in many international organizations.

A several factors of pollution of the economic system is international terrorism.[53] With regard to money laundering, it consists of pipelines related to movement and concealment of property derived from serious crimes. The contrast with the illicit activities of money laundering should be analyzed in several respects: economic phenomenon, criminal cases, identification of procedural instruments for the assessment of evidence. Money laundering is important because it is a phenomenon currently able to build strong economic structures that control the production sectors. The strategy of money laundering is characterized by the utmost discretion and camouflage and takes place in three phases: the first phase is called internship placement: eliminate the cash obtained from the sale of drugs or other criminal activities. The objective is to transform the cash into scriptural represented by cash balances on the relationships established with financial intermediaries; the second stage is layering stage: complete accountants of the tracks and disguise the origin of dirty money sometimes turning it into cash for non-leave documentary traces; last stage is the integration stage: real money laundering that is realized through various forms through the integration of the money in the legal system. The money laundering activity will make it difficult for investigators to identify and track the money comes from illegal activities with the placement if it passes the first two stages.

5. THE SYSTEMIC TAX

Systemic risk is a term widely used but difficult to define. It represents the risk of changes in the structure of an economic or financial system. It concerns the probability of insolvency or default by a broker is translocated into the banking

[53] LAUDATI A., *terrorismo internazionale, criminalità organizzata e money transfer*, in Amministrazione e Finanza, 2002

system as a whole or the whole economy. In a globalized world, a systemic crisis may of course involve the entire international banking system.

The Italian Government, with law decree n. 214/2011 adopted measures[54] to combat the financial crisis. These measures are new taxes and changes to old taxes. The law n. 214/2011 introduced many property taxes. Ordinary[55] general tax on capital is missing in our framework. In fact, property taxes in force in Italian tax system affect specific categories of assets. Constitutionally the tax asset, introduced by decree by the Prime Minister Monti, concerns the taxpayer's ability to pay and equity in taxation. Authoritative doctrine has been expressed in respect of Article 53 regarding the ability to pay. It raised the question whether the patrimony must be considered as an expression of wealth and whether the taxpayer should be taxed.

The taxation on capital understood as a sign of wealth may be subject to taxation. In this way the principle of ability to pay located space. The Constitutional Court argued that the constitutional heritage can be seen as a sensor of wealth for tax purposes.

The introduction of tax on capital is consistent with the principles of equity and social justice[56] when the legislature reduced the income tax. Currently, according to the recent changes introduced by Law 214/2011 does not detect a reduction in the tax burden on income. The "unified property tax" [57] is a tribute to a patrimonial character introduced by the Prime Minister Monti. This imposition taxes all owners of property, including the main house and its outbuildings.

Formally, Local council property tax has not been changed, but was only incorporated in "unified property tax". It includes - in addition to Local council property tax - the share personal income tax that relates to residential property not leased and which are not eligible to defined the taxpayer's main home.

Unified property tax will incorporate Local council property tax and personal income tax in respect of landed income from second homes will replace Local council property tax as regards the operating property. For this reason the

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[54] judgment Constitutional Court. No.111/1997

[57] see: Article 13 of Law 214/2011

Italian companies are not very favorable because it will be taxed more. In fact, this greater tax burden does not seem to respect the principle of tax equity and justice. Unified property tax is a heavier taxation of operating property used by businesses for the purposes of production.

The increase in VAT was another consequence of the financial crisis.

Since 1 October 2012, the VAT rates of 10 and 21% increase by 2%

The tax increase is valid through 2013 and grews a further half-point from 1 January 2014. (ART 18)

Another tax was introduced for taxpayers owners of luxury goods. The principle of "the wealthiest taxpayers pay more" is new with Law 214/2011. (Article 16)

Lowering the limit traceability of payments from 2,500 to 1,000 € is a tool to avoid the use of cash.[58] The costs that exceed the 1000 € can not be made in cash The limitation to use of cash payments in the traceability of translates through a common channeling financial flows to the accounting records of banks whose data and information is easily available in case of investigations

By December 31 2011 the bank deposit books exceeding 1,000 € will be extinct

Operations expenditure of public administrations central and local must be through the use of telematic instruments Any cash payments that under no circumstances exceed EUR 500.

A new tax for wastes and services was introduced into the environment (Art. 14).

In the part relating to wastes the new service tax is payable by anyone who owns occupies or holds premises or open areas liable to generate wastes The rate will be annual and will be commensurate with the quality and quantity of waste produced to surface relatively to the uses and types of activities. "In the determination of the reference rates will be related to two items: a share of the cost of service and a share compared to the amount of waste handed to the service provided and to cost of management The statutory auditors will decrease the rate

[58] CERISANO F., in Italia oggi , Quotidiano economico giuridico e politico, 2011

in cases of reduced production of waste and provide for reductions or exemptions for situations of social hardship.

In environmental matters carbon tax is a necessary measure to put a stop environmental pollution. The European Commission's proposal which should come into force in 2013 with a transition period up to 2023 attempts to harmonize the taxation of energy[59] products in Europe.

Among the main tools of environmental taxation in our system a carbon tax has an important role. It was established by the financial law 448/98, Article 8 of the Finance Act regards taxation on carbon emissions. The carbon tax is a provision that imposes a tax on energy products. It makes a revision of excise duties on mineral oils and introduces a consumption tax on carbon. The proposal to introduce a tax on CO_2 emissions has been relaunched with the agreements signed by Italy at the international conference in Kyoto.

With the introduction of these provisions the objectives set by the agreements signed in Kyoto are implemented. The system of excise duties is harmonized at European level by applying the principles of the Commission Communication refers to the principle "the polluter pays": The carbon tax has to reduce carbon emissions and save energy.

In conclusion, the introduction of these rules would allow operators that use energy to better assess their economic choices favoring the use of less polluting products.

The principle "polluter pays" emerges at the international level in the OECD Recommendation 128/1972. In the first phase of the experience of the EU founding treaties have not tackled the protection of the environment in particular. The basis of the Directive was Article 100 of the Treaty of Rome. In the Treaty the Court of Justice stated that, in terms of environmental protection, many companies could be charged with various charges.

[59] VERRIGNI C., *la rilevanza del principio comunitario "chi inquina paga" nei tributi ambientali* in Rass. Trib. N.5 pp 22-23

A change occurs with the revision of the Treaty of Rome by the Single European Act of 1987. This act recognized the principle of "polluter pays" [60] principle as a pillar of the EU environmental policy.

The European Commission adopted an EU directive which proposes the introduction of a tax on financial transactions in all EU Countries. This tribute is a special tax on business or trade. This type of tax is the medium that allows the emergence of previously untaxed wealth when they form income.

The financial transaction tax[61] is an instrument which would tax the assets in place where you really are. This has consequences: to force owners to contribute to public expenditure not for reasons of nationality but for economic interests.

The financial transaction tax would result in benefits also in terms of domestic law. The first advantage is the tax justice and fair distribution of tax loads.

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Harmful Tax Competition in the context of transnational transactions

Dr. Valentino Tamburro

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CHAPTER 1 – POTENTIALLY HARMFUL TAX MEASURES IN ITALIAN TAX LAW

1.1 Introduction

Since 2001, in order to separate political and technical management of taxes, technical matters in relation to taxes are managed by four independent agencies. The assessment of direct and indirect taxes is, in Italy, under the responsibility of the Agenzia delle Entrate (hereinafter called AE or Italian Revenue Agency). The three other agencies are responsible for customs and excise duties, immovable properties registration and management of State properties. The collection of taxes is performed by Equitalia, a subsidiary of both Revenue Agency and INPS[1]. The organisation of the AE is decentralised with a headquarter located in Rome. Regional directorates are mainly in charge of the audits of large sized businesses and provincial directorates of the audit of small and medium-sized businesses. Local offices, under the supervision of provincial directorates, act as front offices for taxpayers (management of taxpayers, delivery of tax identification numbers, assessment of taxes, and processing of tax adjustments).

A particular feature of the Italian system is the existence of the fiscal police. While the assessment of taxes is the exclusive competence of the AE, the investigation and control of taxes is shared between this agency and the Guardia di Finanza (GDF). As a fiscal police, the GDF is also involved in other areas, for example the fight against money laundering. The GDF is headquartered in Rome with an inter-regional level providing services to local units, and a provincial level supervising all local offices. All operational activities are performed by these local units.

The organisation of the Italian revenue authorities has an impact on international exchange of information for tax purposes. As the AE and GDF have the same responsibilities as regards audit of taxpayers and collection of information, they constitute two authorised competent authorities in the field of

[1] INPS is the Italian National Institute of Social Insurance.

EOI, both having exactly the same level of responsibilities[2].

Italy has one of the world's highest tax burdens that weighs mainly on labour income. Since 2012 financial income will be taxed with a rate of 20% for individuals instead of the tax rate of 12.5% in force in the previous year, which shall remain in force for government bonds only. The exchange of information is active through numerous treaties and Italy also exchange information under the EU Directive, either in spontaneous and automatic way, or on demand.

Italy has a large treaty network of 85 DTCs allowing for exchange of information with 91 jurisdictions. Fifteen DTCs and protocols amending DTCs have been signed by Italy but are not yet in force[3]. A number of these new treaties and protocols are currently under examination by the Italian Parliament.

The interpretations of tax laws by the Italian Revenue Agency are published on its website and are called circular letter, while the decision about the most important individual cases are made public, and are called resolutions. The results of actions to tackle tax evasion are published constantly and the amounts recovered are steadily increasing in recent years. Tax measures introduced last year are: obligation by all financial intermediaries to transfer financial data of its customers to the tax Authorities, the lowering of thresholds for the penal importance of tax evasion; lower limits within which it is allowed to pay in cash.

All these factors substantially demonstrate that Italy cannot be considered a tax haven (or even a potentially harmful regime) in accordance with the OECD Harmful Tax Competition Report and Code of Conduct. However, some critical points of the Italian tax system in relation to the principles expressed by the OECD and the EU will be discussed during this work.

1.2 The Italian tonnage based corporation tax

A study undertaken for the OECD's Maritime Transport Committee[4]

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[2] In this sense see: OECD (2011), Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews, OECD Publishing. http://dx.doi.org/10.1787/9789264115026-en, p. 15-16.

[3] Azerbaijan, Belgium, Canada, Congo, Cuba, Gabon, India, Iran, Kenya, Lebanon, Libya, Moldova, Mongolia, Qatar and the Russian Federation.

[4] Analysis of Selected Maritime Support Measures – Econ Centre for Economic Analysis

concluded that “The effective tax rate faced by a shipping company is one of the most important factors determining its competitiveness, as well as determining the location of its operational base in the longer term”.

Already in 1997, the European Commission, in the introduction to its “Community guidelines on State aid to maritime transport”,[5] stated that: “The competitive difference between ships registered in the Community and those registered outside especially those operated under flags of convenience, 40 depends primarily on fiscal costs. This is because the cost of capital is essentially the same world-wide and equally there is no difference in the technology available. The fiscal costs (corporate taxation and wage related liabilities in respect of seafarers), have been shown by different studies to be the critical and distortive factor”. The ECON report to the Maritime Committee on Selected Maritime Support Measures concluded that effective annual tax rates over the life of shipping projects under OECD regular taxation regimes was in some cases lower than that faced by projects operating under tonnage tax regimes.[6] The unweighted average income tax equivalent of tonnage taxes in the countries examined was found to be about 3.7%, though it fell to 1.5% if the two countries with the highest tonnage tax rates (Greece and Norway) were excluded. The corresponding rate in non-OECD countries was around 1%. Moreover, because ship owners operate in conditions where national boundaries are largely irrelevant, it is relatively easy to register abroad thus avoiding onerous domestic system[7].

The tax relief regimes in the shipping sector, into force in most States in the world, are characterized primarily by: a) a very low tax rate, b) a flat rate determination of the tax base in place of the analytical one. The tax relief of such schemes could be a symptom of potentially harmful tax regimes, according with

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[DSTI/DOT/MTC(2001)1].

[5] Published in the Official Journal: OJ C 205, 5.07. 1997

[6] For an analysis on this see: Analysis of Selected Maritime Support Measures DSTI/DOT/MTC(2000)1

[7] The ECON study states that:

"Over the past few decades the OECD shipping industry has faced increasing competitive pressure from shipping in non-OECD countries. In addition to flag competition from open registers, a number of non- OECD countries have developed shipping industries that benefit from low taxes and wage levels. Companies operating under such conditions may be able to accept lower freight rates, placing those that operate under “normal” tax regimes and higher costs at a disadvantage."

the OECD Report on Harmful Competition. From what has emerged so far, it is clear that in order to identify potentially harmful tax regimes in the shipping sector we can not purely and simply use the criteria defined in the 1998 OECD report, but some adjustments are needed.

With reference to corporate tax, the effective rate depends on the tax rate and the amount of profits imputed to each ship based on the set rate per ton or the fee per ton. The ECON report to the Maritime Committee on Selected Maritime Support Measures concluded that effective annual tax rates over the life of shipping projects under OECD regular taxation regimes was in some cases lower than that faced by projects operating under tonnage tax regimes.[8] The anti-avoidance provisions are also very important.[9] With reference to the criteria of lack of transparency, shipping regimes would be considered non-transparent if shipping companies are exempted from book and record keeping obligations.

The tonnage tax regime in the strict sense, which takes the form of a flat-rate tax, was introduced from Greece, while the tonnage-based corporation tax, which refers to the individual ship tonnage for the determination of the taxable lump sum, it's reference to the Dutch model. Italian regime was inspired to this last model, considered to be more innovative than the other one.

In the Italian version, the tonnage-based corporation tax is like a lump sum tax regime linked to the ship tonnage, an alternative to the normal tax regime, with the aim of enabling the reduction of fiscal asymmetries between the Italian and European fleet. Moreover it is useful to outline the differences between the two forms of tax relief mentioned: issue in both cases tax relief systems, but while the Greek model represents a real substitutive tax, the regime adopted by Italy and most European States, takes the form of lump determination of taxable income.

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[8] For an analysis on this see: Analysis of Selected Maritime Support Measures DSTI/DOT/MTC(2000)1

[9] Anti-avoidance is an area where there appear to be some differences between the various schemes. The importance of anti-avoidance provisions has to do with the fact that the incentives given to shipping companies reduce their tax rates to extremely low levels. As a consequence there is an incentive for the company to seek to allocate expenses such as interest expenses or deductions in respect of depreciation to higher rate taxpayers outside of the scheme. This might be done, for example, by allocating group interest expenses to other group companies that are taxed at higher rates. Some of the schemes examined appear to have strict rules in relation to the allocation of funding costs and also impose limits on the availability of depreciation allowances to lessors and even on the kinds of leases that are permitted into the scheme. In other cases a more relaxed approach appears to be taken.

The discipline of the tonnage based corporation tax in the Italian system is contained in Articles 155 and following into the Presidential Decree 917/1986 and its implementing provisions are contained in the Decree of the Ministry of Economy and Finance dated June, 23, 2005. This system has optional nature and binds the taxpayer that exercises the option for a period of ten years. The subjective requirement for this regime includes both residents and non-resident taxpayers but these may be allowed only if they have a permanent establishment in Italy. The rates to be applied to the ship tonnage for determining the taxable lump are listed in Article 156 of Presidential Decree 917/1986 and are reported in Table 1.

The anti-abuse measures provided in relation the special regime in question include primarily the clause "all in - all out". Within the same group of companies linked by a relationship of legal control, do not may be both companies have opted for tonnage tax based corporations regime and companies, however, do not have opted for this regime.

It is in force thus a principle of "attraction" that works also when a company, that is not under tonnage-based corporation tax regime, becomes part of a group of companies that have already opted for the regime in question, and back. This principle is not applicable in the case of sale of the ship. There is also a provision to avoid illegal arbitrage operations that could be made between those which adopt the optional tax regime and other companies that adopt the ordinary regime. This provision is called "internal transfer pricing." With reference to the regime of capital gains and losses, they are already generally included in the taxable lump sum. It is also provided that where a company carries out also other activities that fall in the ordinary system of taxation, the accounting records must be established separately.

The other points that characterize the regime in question are the following:

- It is not compatible with the system of taxation provided by Article 117 of Presidential Decree 917/1986 (National Consolidated) and with the regime provided by Article 130 of the same Presidential Decree (Worldwide Consolidated).

- Inclusion in the lump tax base[10] also all those activities accessory (e.g. supply of container, managing bars and movie theatres inside the boat).

The regime will lapse if the lease of the ship with the formula of "bareboat" is made for more than 50% of ships that have adopted the special regime, and if there is a lack of training of cadets. The rates for the determination of the flat tax base are shown in the table below, which also contains a comparison with the rates applied in some EU Member States:

Table 1: Tax rate to determinate the corporate taxable income base in some Member State

Tonnage	Tax rate in EURO 100 tons of net tonnage (NT) per day										
	NL	D	DK	UK	E	IRL	FIN	F	B	Average	IT
0-1 000 NT	0,91	0,92	0,94	0,97	0,90	1,00	1,38	0,93	0,90	0,98	0,9
Fino a 10 000 NT	0,67	0,69	0,67	0,73	0,70	0,75	1,03	0,71	0,70	0,74	0,70
Fino a 25 000 NT	0,46	0,46	0,40	0,48	0,40	0,50	0,69	0,47	0,40	0,47	0,40
Oltre 25 000 NT	0,23	0,23	0,27	0,24	0,20	0,25	0,57	0,24	0,20	0,27	0,20

Source:European Commission

In January 2004 European Commission has been considerate[11] the Italian system of tonnage-based corporation tax as illegal State Aid in relation to Article 87 TFEU infringement. The paragraph 3, letter c) of those article provide that: "may be compatible with the common market aid to facilitate the development of certain economic activities or of certain economic areas, does not adversely affect trading conditions to an extent contrary to the common interest." The European Commission has requested Italy a series of information in relation to this preferential regime. Following the analysis of the answers provided by Italy, it has been urged to abolish any discrimination in the tax base calculation based on age of the ships and to determine that each firm does not receive, cumulatively, by means of the measures under the this provision or any other scheme, aid in excess of that authorized by section 11 of the Community guidelines on State aid to maritime transport. Following the comparison of the rates for calculating the tax base provided by Italy with those provided by other Member States, already

[10] In the other side, income from the sale of luxury goods, products and services that are not consumed on board, from gambling, from betting and casinos, are not included in the lump taxable base.

[11] In the absence of prior notification of such State Aid to the European Commission.

subject of analysis in the past, [12] the Commission found that tax rates based on tonnage provided by the Italian authorities are sufficiently close to the average of the rates previously approved by the Commission, thus to reject the risks of potential impacts on trade between Member States.

In relation to the effectiveness of anti-abuse measures provided in the Italian system of tonnage-based corporation tax, the European Commission considered that they are very similar to those provided in the corresponding schemes of other Member States and which are sufficient to ensure, to inside a company or a group of companies, a strict distinction between the activities on the accounting plan eligible and ineligible activities, and therefore helps to prevent evasion of tax in favour of inadmissible activities that companies that have opted for lump taxation could exercise. Commission also considered, at the end of the audit of the State Aid in question, that the Italian flat-rate tax regime applicable to shipping companies complies with the provisions of the Guidelines and it is therefore compatible with the common market.

Analyzing the Guidelines issued by OECD[13] to identify a potentially harmful tax regime in the shipping sector there will be demonstrated that the Italian regime of tonnage-based corporation tax is not classifiable as potentially harmful regime. In those report, OECD found that: In addition to the key factors[14], that identifying an harmful tax regime, there are a number of factors which may assist in identifying harmful tax practices in respect of shipping regimes. In essence, these factors do not so much add additional criteria but spell out in more detail some of the key principles and assumptions that are implicit in the key factors themselves. With reference to the low effective tax rate, the first key factor, in according with OECD provision "the application of this factor alone does not determine if a regime is harmful" but it is necessary "a combination of a low or zero effective

[12] The values of which are shown in Table 1.

[13] For an analysis on this see: OECD, Guidance in Applying the 1998 Report to Preferential Tax Regimes (Consolidated Application Note), 2004.

[14] In the Harmful tax competition report, the key factors that identifing harmful prefential tax regime are:

a) No or low effective tax rates.

b) “Ring fencing” of regimes.

c) Lack of transparency.

d) Lack of effective exchange of information.

tax rate and one or more other factors"[15] to configure and harmful tax regime. With reference to the second key factor, the "ring fencing" criteria[16], the Italian regime includes all the taxpayers, with no distinction between residents and non residents. Also Italian regime does not contain explicit or implicit prohibition from operating in the domestic market.

With reference to the third key factor, the "lack of transparency" criteria,[17] shipping regimes would be considered non-transparent if shipping companies are exempted from book and record keeping obligations. The companies which choose the Italian tonnage based corporation tax regime must keep records separate from any activity subject to the ordinary regime. Also Italian tax law applies the principle that taxes are not negotiable.

With reference to the fourth key factor, the "Lack of effective exchange of information" criteria[18], from a legal perspective the Italian registration system is strong and ensures the availability of ownership information regarding all types of domestic companies that can be incorporated in Italy. Regarding the availability of bank information, there is a dedicated section of the Anagrafe Tributaria, where some bank information is directly available to revenue authorities. Pursuant to Article 7, para.6 of DPR 605/73, banks and financial institutions are indeed required to provide to the Anagrafe Tributaria details of the existence and type of financial relationships with their customers.[19] Pursuant to Article 7, paragraph 11 of the same Presidential Decree, this information can be accessed by revenue authorities when gathering information. From Italy's partners' comments, there does not seem to have been any situation where Italy

[15] For an analysis on this see: OECD, Harmful Tax Competition: An Emerging Global Issue, 1998.

[16] Ring fencing may take one of two forms: (i) the explicit or implicit exclusion of resident taxpayers from the regime and (ii) the explicit or implicit prohibition from operating in the domestic market.

[17] Under the 1998 Report, lack of transparency includes among other things, favourable application of laws and regulations, negotiable tax provisions, and a failure to make widely available administrative practices.

[18] A State's unwillingness or inability to exchange information regarding enterprises qualifying for shipping regimes is an important indicator of the existence of harmful tax practices The limited access that certain countries have to bank information for tax purposes (e.g., because of bank secrecy rules) is increasingly inadequate to detect and to prevent the abuse of harmful preferential tax regimes by taxpayers.

[19] Also with the Decree "Salva Italia" (converted in Law 201/2011) the financial institution have to provide the consistency of the financial relationships with their customer.

was not in a position to provide the bank information requested because it was not available.[20]

With regard to the application of transfer pricing rules in the shipping sector,[21] Italian regime provides that the arm's length principle must be applied both national and cross-border operation that interesting shipping company under tonnage based corporation tax regime.

OECD guidance also showed that it would now appear to be common for countries, including OECD countries, to create a low tax or substantially tax-free environment to attract and retain shipping investment. Although many of these regimes, arguably, respond to the lack of competitiveness of countries' shipping sectors, the low tax factor is not concerned with a State's motive for introducing a particular regime. However, the application of this factor alone does not determine if a regime is harmful. Accordingly, a preferential low tax regime for the shipping sector is not of itself problematic under the 1998 Report.[22]

We can conclude that Italian tonnage based corporation tax regime complies with the principles of the OECD-Report on Harmful Tax Competition and with the Guidance in Applying the 1998 Report to preferential tax regimes.

1.3 European commission actions against Italian harmful tax measures

The Council and the Representatives of the Governments of the Member States, meeting within the Council, adopted on 1 December 1997 a Resolution on

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[20] For an analysis on this see OECD (2011), Global Forum on Transparency and Exchange of Information for Tax Purposes PeerReviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchangeof Information for Tax Purposes: Peer Reviews, OECD Publishing. http://dx.doi.org/10.1787/9789264115026-en

[21] The paragraph 334 of the OECD Guidelines says that: "In some circumstances this has the potential to result in a no or low tax rate in associated enterprises or in non-shipping business of the same enterprise. For example, transfer pricing could facilitate the shifting of profit from associated enterprises in the regime country into the shipping entity. Alternatively, profit could be shifted from nonshipping business to shipping business within the same entity. If this is achieved, again most likely through transfer pricing, then there is a potential that there will be a low effective tax rate. These problems can be largely avoided if the arm's length principle is incorporated into tonnage tax or other shipping regimes to the extent that these are not already covered by a country's existing transfer pricing provisions."

[22] For an analysis on this see: OECD, Guidance in Applying the 1998 Report to Preferential Tax Regimes (Consolidated Application Note) (2004);

a Code of Conduct for business taxation in the framework of the ECOFIN Council conclusions of the same date concerning taxation policy. In 1999, the Group charged to assess the tax measures that may fall within the Code has developed a report that was forwarded to the Council for deliberation. That report (also called Primarolo Report) has identified several potentially harmful measures in Italy. One of these measures, the Trieste Financial Services and Insurance Centre[23], has been authorised by the Commission in 1995, in consideration of the common interest of developing the financial markets of the eastern European countries by private capital mobilisation. This appraisal of the compatibility of the scheme has to be reviewed in the light both of the Commission notice on fiscal aid approved in 1998 and of the new different context prevailing in central and eastern European countries. This also taking into account that the scheme as authorised in 1995 had not yet come into force. Under the first profile, on the basis of the 1998 notice, the scheme constitutes an operating aid and, as such, it is in principle incompatible with the single market and therefore prohibited. The State aid which Italy was authorised to grant to the Trieste Financial Services and Insurance Centre, set up under Article 3 of Law No 19 of 9 January 1991, is incompatible with the common market[24].

With reference to the tax deduction for interest on additional capital contributions from foreign head offices to Italian PE, the Primarolo Report underlined that sums paid by foreign head offices to the Italian PE, instead of being considered an increase of the initial endowment capital of the permanent establishment, may be recognised as loaned capital[25] - if effectively connected to the PE - and, as such, being interest-bearing; this applies provided that transfer pricing conditions are

[23] The scheme creates a Centre of financial and insurance services in Trieste area. Financial, insurance and credit companies (both residents and not) established in the Centre and operatingwith central and eastern European countries benefit of tax incentives. The incentives consist of:

- an exemption from the IRPEG income tax, for the profits produced in the Centre which arise from operations with countries of central and eastern Europe or of the former Soviet Union, or destined to such countries;
- a reduction of the indirect taxes on business (registration, mortgage and cadastral taxes are due on a fixed basis).

[24] This is the text of the Commision decision of 11 December 2002.

[25] As indicated in the Italian Department of Finance guideline number 32/9/2267 of 22nd September 1980.

met. The report concludes that the harmful tax benefit[26] is as follows:

"If the capital contribution is held to constitute a loan, the interest paid by the PE is deductible according to the general tax rules. If there is a fund transfer, which is held to constitute a loan from the Italian PE to the foreign head office, the deemed interest paid by the foreign head office will be included in the taxable base of the Italian PE".

The Italian Revenue Agency, in order to clarify what was stated in Circular no. 32 of 1980, relating to transfer pricing rules, with the new Guidance no. 44 of 30/03/2006 considers both necessary to consider first whether and to what extent the resources that the head office provides, directly or indirectly, of its permanent establishment in the territory of another State, may be considered loans include interest expense deductible from the income of the permanent establishment. The first issue arises when the head office gives the permanent establishment of own resources and/or part of its funding from contracts and interest expense for such claims, but also in cases in which the loan is made directly by the permanent establishment. In this respect, it is clear that the interest of the State in which it has permanent establishment to assess the relationship between debt and equity allocated to it. The lack of resources compared to their capital structure and the activities carried out, in fact, may lead to over indebtedness of the permanent establishment and, ultimately, a transfer of income to the benefit of the State of residence of the head office. As stated by the OECD Commentary on Art. 7 of the Model Convention (see paragraph 18.3), it is necessary that the permanent establishment is with "an appropriate capital structure for both the company and for the duties that he carries. For these reasons, the prohibition on deducting expenses related to internal funding - i.e. those that are mere allocation of resources of its parent - should continue to apply in general. " Ultimately, like any independent business, the permanent establishment of a non-resident company must have its own fund provided that, for tax purposes, may also be a "figurative". In other words, if it does not follow from its budget, the endowment fund must be determinate solely for tax purposes to determine whether any interest expenses are deducted correctly determined as is the case with independent firms.

[26] That arising from this interpretation of the transfer pricing rule.

In this perspective, may be considered deductible, as corresponding to interest expense that would have an independent argued, only those arising from loans that were turned on whether the establishment had been able to have an adequate endowment fund. Instance of questioning is said, however, that there is at group level a strategy aimed at "maximizing shareholder value through minimization of the assets invested in commercial and industrial and concentration of capital in financial institutions belonging to the group more appropriate to get into debt ". In other words, within a precise strategy management group at the international level, it promotes the debt operating companies - including the establishment time - compared with other companies who have reserved the finance function. Ultimately, like to mention that the determination of endowment fund of permanent establishment may be considered appropriate by the fiscal point of view is a matter of fact that requires a detailed analysis of individual cases and must be addressed taking into account principles shared at the international level. The endowment fund of stable organization can be determined, taking into account the level of capitalization society as a whole, depending, for example, the activities carried the permanent establishment of tangible and intangible assets at its disposal to their functions and the risks it has assumed. In order to determine correctly and definitively interest deductible from income of the permanent establishment, the taxpayer may submit a request for questioning pursuant to Art. 8 of Decree-Law September 30, 2003, n. 269, ratified with amendments by Law 24 November 2003 no. 326 (SO-CALLED ruling international).

1.4 ITALIAN TAX PROVISIONS WHICH COULD CONSTITUTE POTENTIALLY HARMFUL TAX MEASURES IN THE MEANING OF THE CODE OF CONDUCT

In Italy, one sector where there is still an open debate on the tax relief matter is relates to the potentially damaging concessions to ecclesiastical entities and no-profit institutions in general, with regarding IMU (previously known as ICI) and corporate income tax. The peculiarities of ecclesiastical entities is that they are legally recognized non-commercial entities for tax purposes. This is by

law[27], for under the Concordat. Ecclesiastical entities can never lose this status, but all other non-profit organizations automatically lose this qualify if they exercise mainly commercial activities. Among the major consequences of this tax classification of ecclesiastical entities as non-commercial entities (without the possibility of losing that status), there is a reduction in corporate income tax to 50%, in so far as these entities carry on activities that the legislator wanted to encourage. [28]. With regarding to the type of activities eligible to this tax relief, the Supreme Court [29] has indicated that it is only for the income arising from an instrumental commercial activity that is "immediately and directly" with purposes of religion and worship of the institution. Consequently do not fall into the category of tax relief the commercial activities addressed exclusively of obtaining financial resources to be used in further activities directly aimed at the religion or cult.

The risk for violating the Community rules on competition have been raised by the European Commission, relatively the possibility of an extension of the scope of application of the provision[30] that would contradict the very nature of subsidy to allow institutions to risk at issue the pre constitution of a tax system more convenient as opposed to the principle of effectiveness of the imposition of taxation. And it is precisely such a burden and uncertainty about the tax exemptions granted to the Church that cost to the Italy investigation by the EU for state aid incompatible with competition rules. Ecclesiastical entities also have the right to an additional exemption which pertaining depends on the type of activity

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[27] The Article 149 of DPR 917/1986 establishes the conditions for the loss of status of non-commercial entity, but excludes those provisions ecclesiastic institutions and amateur sports associations, giving their lives to the status of non-commercial entities. This prediction would be the natural corollary of Art. 2, paragraph 2 of Law 222 of 1985, which commits the State, on the basis of the Concordat, to recognize the legal personality constituted ecclesiastical authorities and approved by ecclesiastical authority, stating that even if they were to engage in activities other would not lose their status; in this sense, Article 149, paragraph IV, would be the repercussions in tax terms of this principle. In this sense, see also R. PIANESE, *Esenzioni fiscali concesse alla Chiesa*, in Innovazione e Diritto, 2010, n. 6.

[28] The Article 6, paragraph I, letter c of the DPR 601/1973, provides for the reduction of one half of the IRES in favor of institutions whose purpose is treated by law for the purposes of charity and education, if they have legal personality under the second paragraph of that article.

[29] Cass., 29 March 1990, n. 2573.

[30]Taking into account the subsequent court decisions, certain "other activities", commercial or profit-making, may be considered subject to the preferential regime, as long as those are in relation to "immediate and direct instrumentality" with the purpose of religion or belief, so justifying the tax relief.

carried out within the property (limited to activities undertaken by non-commercial) but that does not depends of the legal status of the building's owner. Article 7, No. 1, letter i) of Legislative Decree 504/1992 exempts from ICI (which since 2012 has been absorbed from IMU) the property used by non-commercial and intended solely for the performance of care activities, social security, health, educational, cultural accommodation, recreation and sports, as well as the activities of worship as identified in Article 16 of the law 222/1985. Following a series of interventions by the European Commission which asked the question of compatibility of such tax relief with the rules on state aid, the Italian Government, with the Decree Law 223/2006, converted with modification into Law 248 of 4 August 2006, introduced an authentic interpretation on the type of business decisions among ICI exemption in the following terms: "The exemption provided for in Article 7, paragraph 1, letter i) of Legislative Decree 30 December 1992, n. 504 , is intended to apply to the activities listed in the same letter that they have not only a commercial nature." Following this legislative amendment the procedures pending against the Italian State were closed by the European Commission. However some members of the Italian Radical Party appealed to the European Court of Justice because it was believed that the Commission failed in its role as of the Treaties guardian. [31] The state aid investigation was reopened, and therefore the Commission's decision should arrive within the month of April 2012. In addition to what is outlined above, the exemption ICI / IMU does not appear in line with the principles of the Italian tax, especially when read in parallel at Article 149 of the DPR 917/1986, which gives the status of permanent non-commercial entities to ecclesiastical, and that, at first glance appears to be discriminatory, because it allows only unnecessarily and to ecclesiastical entities and amateur sports associations, not to pay municipal tax on real estate. Even a judgment of the Supreme Court[32] has highlighted the critical profiles pertaining to the legality of the exemption if a property is exercised within a business, regardless of whether that activity is conducted exclusively or predominantly.
According to the Supreme Court, in fact, could not be excluded that the ICI/IMU

[31] For an analysis on this see: http://www.repubblica.it/esteri/2010/09/24/news/ue_ici_chiesa-7373099/
[32] Cass.,16 July 2010, n. 16728.

exemption granted to companies owned by ecclesiastical allows them only to reduce the costs that normally are borne in the other budgets companies that operate in the same market that offer similar services, giving an advantage capable of affecting competition.

Another measure that is potentially a State Aid in favour of Italian companies, but this time at the expense of permanent establishments of non-resident companies, consists of the transformation into a tax credit of deferred tax assets recorded in the balance sheet.[33] Through this accounting / fiscal operation, taxpayers can convert by Law potential and thus "virtual" asset in a tax credit that is real and spendable immediately, so they are placed in a position of advantage over those who can not do this. In this regard, the resolution of the Italian Revenue Agency no. 94 of 22/09/2011 has confirmed that under the literal reference to "budget approval by the shareholders meeting," the provision in question is only applicable to taxable corporate income tax made in a legal form which provides the budget approval by the shareholders meeting or other body required by law. According to the Italian Civil Code there is no deposit requirement of the budget for the permanent establishments of non-residents which would thus be excluded from the measure of favour.

1.5 METHODS FOR RELIEVING DOUBLE TAXATION ON FOREIGN-SOURCE INCOME

As known, the combination of income flow that complement the principles of connection, from which two or more tax jurisdictions are down its taxing power, generates the so-called international double taxation.

In the absence of corrective measures, international double taxation is a strong disincentive to cross-border investments, therefore, to remove or mitigate this disincentive were drawn remedies array unilateral or conventional.

In general terms these remedies are the credit for taxes paid abroad or the

[33] This provision was inserted with the Article 2, paragraph 55 of the Decree Law of 29 December 2010, n. 225.

exemption of foreign income[34]. These two methods of elimination or reduction of international juridical double taxation are based, respectively, to the principles of "capital export neutrality" (CEN) and the "capital import neutrality" (CIN).

According to the principle of "capital export neutrality," the resident of State A who invests in the foreign State B should not be treated differently than residents of the State in carrying out domestic investment. This is achieved by recognizing the investor a credit for foreign taxes. Thus to the investor will be applied the tax rate in the current state of residence.

According to the principle of "capital import neutrality" a resident of State A who invests in the foreign State B should not be treated differently than residents of State B, which carry out domestic investment. Recognizing the exemption for foreign income, in fact, the final tax burden on foreign source income is determined at the foreign rate.

Italy, in general, adopted the foreign tax credit method (Article 165 Tax Code), both in terms of unilateral remedy, both in terms of remedy used in the agreement against double taxation of which is part. In some cases, it is applied instead of the partial exclusion criterion. In the case of "transnational dividends" the double taxation is eliminated by applying the principles contained in the "Parents-Subsidiary Directive", when necessary assumptions are verified. Also it is applied the principle that the domestic regime governing the case for outgoing dividends unless it is via a conventional arrangement that is more favourable.

In according to paragraph 3-bis of Article 27 of Presidential Decree 600/1973 it is provided an application of a reduced rate[35] of 1,375 per cent in

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[34] With reference to the "double non taxation" achievable through a double deduction of cross-border losses, M. LANG notes that: "*A Member State that has adopted a tax treaty policy that does not leave much room for double non-taxation is more credible when it is concerned with the danger of the double utilization of losses than Member States that have implemented the exemption method in their tax treaty network, without providing for a subject-to-tax clause. As a result, exemption states have an even harder time defending rules that do not allow the deductibility of foreign losses because of the danger of the double utilization of losses"*. In this sense see: M. LANG, *The Marks & Spencer Case - The Open Issues Following the ECJ's Final World,* in European Taxation, 2006, p. 58.

[35] This paragraph was added with Law 244/2007 and it is entered in-force since 01 January 2008. The previous regime didn't comply with EC Treaty rules. In fact, in the judgment (Case C-540/07) relates to dividend withholding taxes levied in fiscal years prior to the Italian Government’s January 1, 2008 adoption of a reduced withholding tax, the ECJ stated that: "*A Member State which subjects dividends distributed to companies established in other Member States to a less favourable tax regime than that applied to dividends distributed to resident companies, by*

dividends paid to certain residents in the European Union and State of the European Economic Area, provided that those State allowing an adequate exchange of information. If the EU dividend recipients possess the requirements for the application of the Parents-Subsidiary Directive,[36] the rule in Article 27-bis prevails over that provided by the paragraph 3-bis: to the dividends paid by subsidiary companies (resident) to the parent company (non-residents), therefore, not apply the withholding tax of 1, 375 percent, but still applies the Directive regime, which provides, an alternative, the total exemption of dividends from withholding or a full refund the same.

Finally, for inbound dividends, if in the State of residence of the foreign company that paying the dividend to the Italian company this kind of financial income is not deductible from income tax base, and if that state of residence is in the "white list", then Italian taxpayers can exclude from the IRES taxable base the 95% of the dividend received.

Returning back to the Article 165 of the DPR 917/1986, which governs the possibility to deduct the credit for foreign taxes, it provides that if at the total income contributing foreign income, the taxes being paid outright to such income shall be allowed in deduction from net tax due to the competition part of the tax corresponding to the ratio of foreign income and total income net of tax losses from prior periods allowed in deduction.

The essential elements to deduct foreign taxes paid are as follows:

1. the foreign source income have to be included in total income of the Italy taxpayer;

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exempting from taxation, in the amount of 95%, dividends distributed to resident companies and subjecting dividends distributed to companies established in other Member States to a withholding at source at the rate of 27%, part of that sum being capable of being subsequently repaid on application, fails to fulfil its obligations under Article 56(1) EC." Also ECJ stated that: "*By making dividends distributed to companies established in other Member States subject to a less favourable tax regime than that applied to dividends distributed to resident companies, the Italian Republic has failed to fulfil its obligations under Article 56(1) EC regime.*" With reference to this case-law, scholars note that: "*Withholding taxes are always levied on the gross amount of the income, without any deduction for the costs incurred in connection with that income. Where under the corresponding domestic regime the income is taxed on its net amount (as normally happens for corporate income), an infringement of fundamental freedoms might take place.*" In this sense see: M. MARTINELLI, A. PERSIANI, *ECJ Ruling on Italian Dividend Withholding Tax: Analysis and Ramifications,* in Euro Watch, Volume 22, Number 6, 2010.

[36] That may not be less than 10 percent of the capital of the company, held continuously for at least one year.

2. the foreign tax paid on that income have to be outright.

Regarding the source of abroad income paragraph 2 of Article 165 provides that "the income has its source abroad on the basis of reciprocal to those under Article 23 to identify those products in the State."

To calculate the tax foreign credit deductible, you must compare the "foreign tax" with the "proportion of Italian tax".

The foreign taxes becomes foreign tax credit for the extent of the proportion of Italian tax. The proportion of Italian tax, in turn, is determined from the relationship between foreign income and total income, as follows.

$$\text{Portion of Italian tax} = \text{Italian tax} * \frac{\text{Foreign income source}}{\text{Overall Income}}$$

1.6 TAX MEASURES TO PROMOTE NEW INVESTMENTS

With the purpose to stimulate investments in new business venture, or in existing activities, the Article 5 of Law Decree 79/2009, converted into Law 102/2009 (also called Tremonti-Ter Law), has provided that the 50% of the investments carried out within 30 June 2010[37] can be offset against taxation of the income of firms. The beneficiaries of this tax relief were only the owners of income firm without any relevance with reference to the legal form.[38] The previous tax relief called Tremonti-bis regarded also the owners of self-employment income.[39]

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[37] And later than the date of entry in force of the mentioned Law Decree.

[38] In fact also the Permanent Establishment of non-resident taxpayer, only if located in Italy, was included among potential beneficiaries. For an analysis on this see also the Italian Revenue Agency Guidance number 44/2009.

[39] An other difference with the Tremonti-bis Law (Law No 383 of 18 October 2001) is that under this Law, only the part of the investments carried out after 1 July 2001 and corresponding to 50 % of the investments exceeding the average level of investment in the preceding five years can be offset against taxation of the income of firms and the self-employed. Calculation of the average level does not include investments made in the year in which investment was highest. With the Tremonti-Ter Law there isn't the limitation of the average level of investment in the previous years.

The Tremonti-Ter Law intended to facilitate the purchase of new assets, which fall in the division 28 of Ateco 2007[40] table, and that will be utilized in the product-process, excluding of those which have to be transformed or assembled to make goods for sale. There were excluded also the goods which are "individually for sale". Another cause of exclusion was constituted from the second hand goods.

The paragraph 3 of Article 5 Law 102/2009 provided the revocation of the tax relief if the taxpayer will sell the assets or if it will use the assets outside the firm before the second tax year after the purchase. The reason of this anti-abuse law is to avoid that a taxpayer use the tax relief regime only for a tax purpose rather than a business purpose[41].

With reference to the country of origin of the goods, on one hand there weren't any restriction but on the other hand the paragraph 3-bis of the Article 5 Law 102/2009 stated the revocation of the tax relief, if the goods will be sold abroad to third party which have a permanent establishment in country not included in the European Economic Space (EES). The Lawmaker intended to exclude from tax relief the investments in assets allocated, even later, in structures located outside the European Economic Area.

The tax relief, as explained, consisted in an reduction of the taxable income of firm. The tax saving obtained is also tax-free and it can be accumulated with other tax relief, except for those measures that establish diversely.

The Tremonti-Ter Law could be considered as a "revival" of the Tremonti-Bis Law and these laws cannot be considered as state aid with reference to the Article 107 TFEU, because they provide a general tax relief, with the purpose to kick-start the Italian economy. The measures in question don't affect competition and they are not liable to affect intra-Community trade.[42]

The tax relief above examined incentives:

- the creation of new wealth through the purchase of new assets that are able to improve the productivity of the firm.

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[40] ATECO 2007 is the Italian version of NACE Rev. 2, which is the Statistical classification of economic activities in the European Community.

[41] In this sense see also: Italian Revenue Agency Guidance n. 90/E of 17 October 2001, paragraph four.

[42] For an analysis on this see the Italian Revenue Agency Guidance number 4/2002.

- a better capitalization of small and medium-sized enterprise thanks a further tax relief provided in paragraph 3-ter of the mentioned Article 5.

The Tremonti-Ter Law also provides[43] that a percentage of 3% of the capital increase[44] carried out within sixth months later than the data of the entry in force of the Decree[45] can be offset against taxation of the income of firms, not only in the fiscal year of the capital increase, but also for the four fiscal years later.

So it is not a case that this tax relief for capitalization is contained in the same Decree that provides, at Article 13-bis, a "revival" of the Tax Amnesty already saw in the Law-Decree 350/2001.

For the taxpayer that comply with the tax amnesty Law provisions[46] it was possible to regularize the financial assets held abroad at a tax rate of 5%.

The employment of the repatriated financial assets as equity capital in the taxpayer's firm, rather than in other risk-free investments[47], was certainly a good opportunity, being tax-free within an annual tax rate of 3% for five years.

1.7 The Italian tax amnesty as a reaction to harmful tax competition

In Italy, as in many other State, one of the most serious social and economic problems is the high rate of tax evasion. The most immediate consequence to this phenomenon which leads, in the most important and sophisticated, is to transfer or holding financial assets abroad. These activities, in most cases, are not subject to taxation in Italy or at the time of creation of income and even less at the time produce new income, (such as interest, dividends) once the sums illegally expatriate will reinvested in offshore countries. The abroad detention of foreign financial assets related to income not subject to taxation mean

[43] In according to the above mentioned paragraph 3-ter.

[44] This tax relief is reserved only to the capital increase realized from shareholders that are individuals and with a limit of 500.000 Euro.

[45] And later than the date of entry in force of the mentioned Law Decree.

[46] The potential beneficiaries of this tax amnesty are: individuals, non-commercial entities, companies and associations simply assimilated the meaning of Article 5 of Presidential Decree 917/1986. Also is required the tax-residence in the territory of the Italian State.

[47] The concept of risk-free investment, at the light of the current international economic situation, may be certainly revised.

in most cases, that the financial asset are held in tax havens. Whereas in tax havens tax evasion is considered only an administrative offense, [48] the Italian Revenue Agency is unlikely to ask the Italian Government tax State called Tax havens, information on taxpayers subject to tax assessment in Italy, even if they exceeded the thresholds for which the criminal tax evasion is relevant in Italy pursuant to Legislative Decree law 74/2000. In the other hand, also the Milan's Provincial Commission has established, in an judgment[49]: "acts resulting from the international criminal legal assistance can not be used for tax assessment, the evidence provided by a foreign state in performance of the system of criminal assistance, not can be used for prosecution of violations of tax to infringe the European Convention on Mutual Assistance in Criminal Matters, signed at Strasbourg on 20 April 1959 ". We report in this regard the provisions of Art. 2 of the said Convention:

"Assistance may be refused:

- if the request concerns an offence which the requested Party considers a political offence, an offence connected with a political offence, or a fiscal offence;

- if the requested Party considers that execution of the request is likely to prejudice the sovereignty, security, order public or other essential interests of its State."

The interpretation of the Milan Tax Commission was based on its reserves allowed the states to do not provide legal assistance for fiscal offenses.

In another case, the relationships concerning Italy Switzerland, the Supreme Court has clarified that [50]:

In terms of assessment of taxes on income, the reservations expressed by the Helvetic Confederation in connection with ratification of the European Convention on Mutual Assistance in Crime Matters signed at Strasbourg on 20 April 1959, and made effective in Italy with Law 215 of February 23, 1961, regarding the use of information and documents of Swiss source, relate to cases in which federal authorities are to provide information and data according to

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[48] In Italy, however, exceeded the thresholds of the D. Decree law 74/2000 tax evasion prosecution in addition to being considered for administrative purposes, is also liable for penal purposes.

[49] Provincial Tax Commission of Milan - Section XVIII - Judgment n. 175 of 30 May 2000.

[50] Cass. 22 Fenruary 2008, n. 4608.

requests from foreign authorities, while not related to the different cases in which authorities are Swiss to ask the cooperation of the Italian ones, and as part of their application also indirectly provide useful elements to carry out tax audits. In applying this standard, the Supreme Court upheld the judgment under appeal, which was considered usable for the purpose of correcting the statements made by the taxpayer, Helvetic data provided to the Italian judicial authorities in a letter of request advanced to the Helvetic judicial authorities in relation to an alleged fraud in billings cheese.

Given the framework described so far is clear that the taxpayer that doesn't comply with the tax obligation, can benefit of the double "shield" provided by international law and the internal law of tax havens, considering how remote the likelihood that the Italian tax authorities succeed in acquiring information on its foreign deposits, and conversely have little incentive to regularize its position, considering both the costs of adjustment and is thus the possibility that it could attract upon himself the attention of Tax Offices for future investigations.

However, recent cases of stealing bank details of Italians customers who held deposits in banks located in Switzerland and Liechtenstein,[51] with the renewed commitment of the G20 and OECD[52] to combat international tax evasion, have made it increasingly attractive tool tax shelter for those who have illegally exported capital as a result of tax evasion.

In Italy, in 2002, the Legislature has provided an opportunity that was definite "unique" (even though that possibility was renewed in 2003 and also in 2009!), to those who intend to repatriate or regularize the financial assets held abroad. The first version of the "Tax shield" provided for the payment of a substitute tax of 2.5% in total assets regularized or alternatively, the subscription, limited to 12% of the amount repatriated, of Italian government bonds with reduced interest rate

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[51] For an analysis on this see: V. TAMBURRO, *"Liechtenstein, il paradiso può attendere"*, in Nuovofiscooggi.it, on-line review of Italian Revenue Agency, 10/06/2008.

[52] After all one of the key points of international tax evasion is precisely to be able to convince the countries on the OECD black list to progressively eliminate if-shore banking and to collaborate with other OECD states for tax purposes.

so as to make equivalent to the sum due (2.5% of total) the spread between the nominal and market value. [53]

This soft regularization of foreign assets emerging had more advantages:

• On the one hand precluded tax assessments on the taxpayer in respect of all charges up to the assets repatriated (except of course tax evasion is not correlated to the transfer of financial assets abroad).

• Exemption the taxpayer to fill the Rw form[54] in case of repatriation of foreign financial assets, maintaining therefore an high confidentiality regime.

• The provisions relating to tax shelter made the account or securities account opened on behalf of the client in Italy following the return completely anonymous, that is not available to the tax by financial intermediaries in the event of a bank placed under financial investigation Article. 32 c. 7 of DPR 600/73. However, this benefit of absolute confidentiality guaranteed to those who have availed themselves of the tax shield has been partly mitigated by the Dl 223/2006, with the final changeover from to the bank investigation to the procedure called "financial investigation" that has seen the real activation of the Registry of the financial reports. Despite the unfavourable opinion Italian Trust Association, of Italian Bank association and any association of financial intermediaries, it was predicted [55] that they were obliged to include, in the communication of existing financial reports to be sent Financial Administration, even the extremes of accounts called "tax shielded", that are the accounts opened after application the tax. However, this statement of existence of bank accounts to the Tax Authority does not impose any obligations on the bank to communicate the contents of bank accounts "tax shielded" in case of request by Tax Authorities. Finally, the data part of the Registry of the financial reports aren't freely available by the officials of the Inland Revenue, but require detailed authorization at Regional Director of

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[53] Art. 12 Law Decree no. of 25/09/2001.

[54] The exemption of filling Rw form does not apply to activities regularized but still held abroad. The RW form should be completed by those who hold foreign investments. Fall within the scope of that system, individuals, non-commercial entities, companies and associations simply assimilated in the meaning of Article 5 of Presidential Decree 917/1986, but only if they have the tax residence in the territory of the Italian State.

[55] The Italian Revenue Agency has established, with the guidance n. 18/2007, that financial report covered by tax shield, fall in the reporting requirement to the Anagrafe Tributaria.

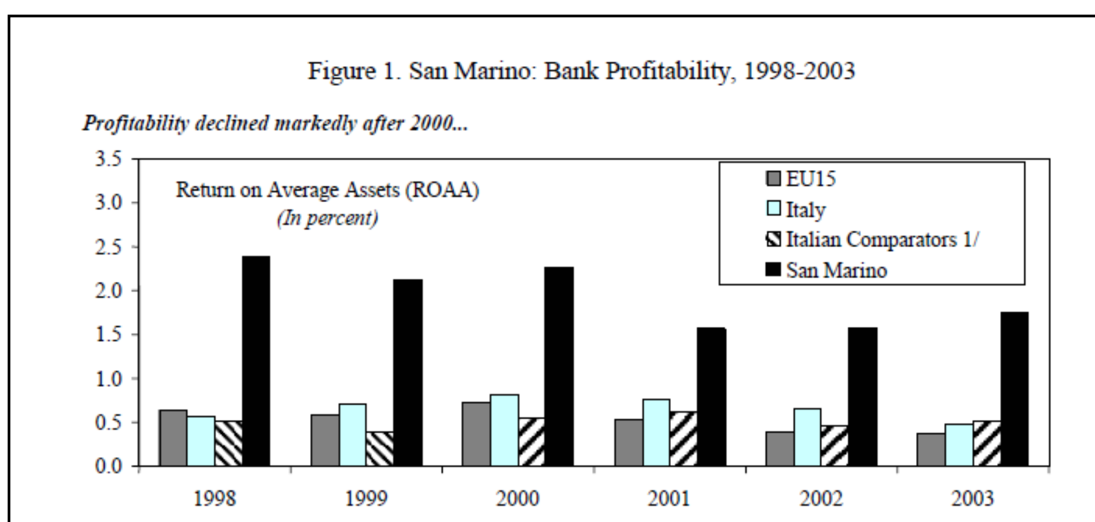
the Administration or at the Regional Commander of the Guardia di Finanza in the case of members of that corp. In 2009 it was introduced the second release of the tax shield[56], with many similarities with respect to the preceding but with the following main differences:

- The rate of tax has increased from 2.5% to 5% (7% with the subsequent extension of the deadline);

- There is no longer given the opportunity to stabilize and hold financial assets held abroad in countries outside the European Union and Iceland and Norway, but you need the return of financial assets in Italy

- It was no longer guaranteed coverage by assessments for VAT[57]

The effects of "international" tax shelter entered into force in 2002, which represented a strong response to harmful tax competition that Italy was forced to suffer from tax havens, have been highlighted by the International Monetary Fund, with a study carried out in 2004 showed that the banking sector of the Republic of San Marino lost its viability in the years covered by the tax amnesty in Italy, following the "capital flight from San Marino."



Fonte: http://www.imf.org/external/pubs/ft/scr/2004/cr04256.pdf

[56] With the Law Decree 78/2009.

[57] In this sense, see L. SALVINI, *Uno scudo bucato?*, In nelMerito.com, 2009, which noted: "*The tax shelter, right to hold a tax amnesty (not so) masked, shows many limits of effective coverage of both tax and criminal violations committed by the taxpayer. Even the anonymity of those repatriates the funds actually seems guaranteed. In addition, there is considerable doubt on his estate community in the light of the rejection of the tax amnesty by the European Court of Justice.*"

Also after 2009 Italian tax amnesty, the IMF found that the growth of the San Marino GDP *is likely to remain negative, at minus 1.8 percent, also in 2010 partly due to the impact of the Italian tax amnesty on financial services.*[58]

It can be affirmed therefore that in practice the tax shield is the best way to assist in the short term entry of large amounts of capital in Italy, with all the positive effects which then arise in the field of tax revenue in subsequent years, but it should be a measure actually "one-off", and not repeated over time, to avoid increasing the propensity tax evasion and the flight of capital abroad, pending further amnesties, which includes the effects would assume so positives generated by the tax shield. Finally the special secrecy regime guaranteed to those that adhere to the tax shield also potentially infringes the right of other states in two ways:

- The funds repatriated to Italy can not be subject to exchange of information for tax purposes;

- Being addressed not only to individuals or entities already resident for tax purposes in Italy but also to those who undertake to acquire residence in Italy during the taxable year of accession to the shield, can be a "safe harbour" for people fleeing from other States who that did not declare their earnings to the Fiscal Authority of their State of residence (based on the principle worldwide income taxation) and who migrate to Italy to legalize their situation with a rate cheaper respect the State of origin.

From a comparative study of rates relating to the tax shield, made by the OECD,[59] it results that in Belgium this rate was equal to a range included between 6% and 9% in the UK as 10%, in Germany equal to a range between 25% and 35%, all more exepnsive if we compare them with the tax rate in Italy that was 2.5% in the first-edition of the shield (2001) and 7% in the second edition.

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[58] For an analysis on this see http://www.imf.org/external/pubs/cat/longres.aspx?sk=23706.0

[59] For an analysis on this see: Improving Access to Bank Information for Tax Purposes, THE 2007 PROGRESS REPORT http://www.oecd.org/dataoecd/24/63/39327984.pdf

CHAPTER 2 –STATE AID

2.1 RELATIONSHIP BETWEEN THE CODE OF CONDUCT AND THE STATE AID RULES FOR THE TFEU

The Ecofin Council[60] concerning taxation policy, that was held on 1 December 1997, noted that the "*code of conduct is a political commitment and does not affect the Member States' rights and obligations of the respective spheres of competence of the Member States and the Community resulting from the Treaty."*

The Code of Conduct was adopted by a Resolution of the Council of the European Union. TFEU have not an explicit mention of the resolution among the measures that legally bind the Member States. We can conclude, from a purely formal point of view, that Code of Conduct falls within the soft law measures also, in this case, so-called "gentlemen's agreement". It is important to note, however, that the Code of Conduct, despite its non-legally binding nature, has an impact that may outweigh legally binding measures, as i.e. State Aid.

With reference to the political binding, it is important to underline that the Primarolo report,[61] was presented as acquis communautaire (sometimes called "the EU acquis") in the negotiations with new Member States. EU acquis means the accumulated legislation, legal acts, court decisions which constitute the body of European Union law. We can conclude, from a substantial point of view, that the EU Code Of Conduct on harmful tax competition has become and hard law measure.[62]

The State Aid rules and the harmful tax measure within the meaning of the Code of Conduct pursue the same general goal of reducing distortions of competition within the internal market, by fighting the harmful tax competition. The criteria provided in the Code of Conduct to identity harmful tax measures are different

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[60] For an analysis of this see: http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998Y0106%2801%29:en:HTML

[61] That is a result of the work made by Code of Conduct group.

[62] In this sense also see: A. PERSIANI, *Le fonti e il sistema istituzionale*, in Aiuti di stato in materia fiscale, L. SALVINI (curated by), Padova, 2007, p. 41.

from the criteria provided in the State Aid rules, but in most cases a tax measure can be harmful both in the sense of Code of Conduct that in State Aid rules.
The Article 107 of the TFEU provides that: "*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.*"
It contains a general definition of State aid conversely to the definition given by the Code of Conduct for identifying potentially harmful measures, that are:

- an effective level of taxation which is significantly lower than the general level of taxation in the country concerned

- tax benefits reserved for non-residents

- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base

- granting of tax advantages even in the absence of any real economic activity

- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD

- lack of transparency.

When those specific criteria are in agreement with the general definition given in the Article 107 of the TFEU then the Commission give priority to tackle this measures. In February 1999, it sent to the Member States a series of requests for information regarding a large number of tax measures. After examining the replies, on 11 July 2001 the Commission initiated the state aid procedure in respect of fifteen tax schemes, thirteen of which had meanwhile been found harmful by the Council's code of conduct group.
The Commission has adopted a number of decisions[63] in which it found measures

[63] See Commission decision of 31 October 2000 on the Spanish scheme of tax deductions for export activities (OJ L 60, 1.3.2011, p. 57) and Commission decision of 11 December 2002 on the French aid scheme for central corporate treasuries.

classed as harmless under the Code of Conduct constituted aid[64].

The Code of Conduct requires Member States to refrain from introducing any new harmful tax measures ("standstill") and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code ("rollback").

2.2 EUROPEAN COMMISSION DECISIONS THAT HAVE HAD AS ISSUE THE STATE AID

In this paragraph we analyze the most important cases where European Commission took initiatives against Italy with reference to state aid[65] under Article 107 TFEU. We will see that the banking reforms was the justification for Italian Government to introduce some tax relief in favour of banking foundation and banks, but all the measures were stopped by European Commission for infringement of the Article 107 TFEU.

Banking foundations state aid

Italian banking foundation[66] were created, almost by chance, more than twenty years ago from the banking reforms better known as the Amato Law (law no. 218 dated 30 July 1990 passed with the relevant implementation decrees) prompted by the 1st and 2nd European Directives on credit, concerning freedom of establishment and banking de-specialisation. These reforms provoked a profound and radical transformation of the original Pledge Banks and the Savings banks - banking institutions having strongly philanthropic leanings - that were born in the early part of the 19th century. The Amato reforms produced a separation of credit business from philanthropic activities. All banking business was spun off and passed to the Savings Banks and to the Pledge Banks, already

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[64] In this sense also see "Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation, Report adopted by the Commission on 09.02.2004":
http://ec.europa.eu/competition/state_aid/studies_reports/rapportaidesfiscales_en.pdf

[65] For the borders of the concept of state aid see: F. RASI, *I confini della nozione*, in Aiuti di stato in materia fiscale, L. SALVINI (curated by), Padova, 2007.

[66] With reference to the fiscal nature of the entity that had conferred his banking company see: F. GALLO, *La natura ai fini fiscali dell'ente che ha conferito ad una s.p.a. la propria azienda creditizia*, in Riv. dir. trib., 1991, I, 537 ss.

established as profit-making societies involved with private commerce and controlled by the Civil Code and banking standards as applied to ordinary banks. The activities concerned with social, cultural, civil and economic development remained with the newly-created Foundations. Initially the Foundations of banking origin were destined, almost exclusively, to be trustees for the capital from the privatized banks and were required to maintain majority ownership of the joint-stock Savings Banks. This was the case until 1994 when law no. 474/94 came into operation and the requirement was eliminated. In 1998, with law no. 461/98 (a.k.a. the "Ciampi" law) and the subsequent application, decree, no. 153/99, the Foundations were required to relinquish any control remaining in their respective banks.[67]

At the same time, Law No 461/98 and Decree No 153/99 introduced, *inter alia*, the following tax advantage for banking foundations:

Foundations that alter their statutes in line with the Decree will be designated as non-commercial bodies.[68] They will then be entitled to the 50 % reduction in corporation tax (IRPEG) provided for in Article 6 of Presidential Decree No 601 of 29 September 1973 for bodies active in the social assistance, health, education or similar sectors.[69]

The European Commission found that those tax advantage(s) granted to banking foundations may constitute State aid within the meaning of Article 87 of the Treaty, *inter alia*, for the following reasons[70]:

1. Law No 461/98 and Decree No 153/99 grant tax advantages specifically to banking foundations. This is a selective measure which confers an economic advantage by forgoing tax revenue, i.e. through State resources,
2. Although banking foundations are non-profit-making bodies bound by corporate objectives laid down by law and cannot pass on tax advantages

[67] For more information see: The foundations of banking origin, edited by ACRI, an association of banking foundation: http://www.acri.it/6_news/6_news_files/Eng/B_Foundations.PDF
[68] See Article 12(1) of Decree No 153/99
[69] See Article 12(2) of Decree No 153/99
[70] See also: COMMISSION DECISION of 22 August 2002 on the tax measures for banking foundations implemented by Italy C 54/2000/EC (ex NN 70/2000)

to their members or to others, they can still be described as economic actors exercising an activity in commercial sectors and may therefore fall within the scope of Article 87 of the Treaty.

In its response to the initiation of the procedure, the Italian Government replied that banking foundations cannot be considered ‘undertakings’ for the purposes of the competition rules because they don't carry out an economic activity, but they are in part "rentier" and in part involved in social activities. In particular, Decree No 356/90 required foundations to treat their holdings in banks as a purely financial investment. Italian Government also was referring to The Court of Justice definition of economic activity.[71]

Accordingly, the Commission[72] considers that the management of own assets and use of the proceeds for making grants to not-for-profit entities operating in the social field is not an economic activity and therefore does not make foundations undertakings within the meaning of Article 87(1) of the Treaty. The infringement procedure was closed with a favourable decision for Italian Government.

Notwithstanding this decision made by European Commission, in the course of proceedings between a banking foundation and the Italian Ministry of Economy and Finance, the Italian Supreme Corte requested to the Court of Justice to clarify the interpretation of Articles 12 EC, 43 EC et seq., 56 EC et seq., 87 EC and 88 EC, as well as the validity of Commission Decision 2003/146/EC of 22 August 2002 on the tax measures for banking foundations implemented by Italy. The referring court states that there was disagreement as to whether or not banking foundations were commercial in nature. In fact, the Italian tax authorities have steadfastly maintained that banking foundations are commercial in nature, so that they are subject to the normal tax regime. The Italian Government, in the course of the procedure which led to Decision 2003/146, maintained for its part that banking foundations cannot be regarded as 'undertakings' for the purposes of the

[71] In Joined Cases C-159/91 and C-160/91 Poucet and Pistre [1993] ECR I-637, (paragraphs 18 and19). the ECJ has ruled that the mere acquisition and holding of shares in a company is not to be regarded as an economic activity.

[72] In this sense, see paragraph 47 of the Commission Decision of 22 August 2002.

competition rules[73]. Differences exist even within the referring court. Certain decisions have accepted the non-commercial nature of banking foundations, on the ground that the management of shareholdings in banking undertakings, as well as of shareholdings in undertakings other than the banking company, is merely instrumental in procuring the financial resources essential to the pursuit of the social and cultural objects assigned to the body. Other decisions have been to the contrary effect, accepting that the social and cultural objects were immaterial for the purposes of the tax relief regime, once the entities in question could operate on the banking market and other markets in competition with other undertakings. The ECJ decided that to see whether a banking foundation is to be classed as an 'undertaking' with reference to the state aid rules, it is for the national court to determine whether it not only held controlling shareholdings in a banking company, but, in addition, actually exercised that control by involving itself directly or indirectly in the management of the latter[74].

After the ECJ decision, the Italian Supreme Court stated[75] that it was necessary to restart the court proceeding by inferior court to decide if the activity exercised from the banking foundation was commercial or non-commercial. Later, the Supreme Court followed the same line with reference to the necessity to analyze case by case the true activity carried out by banking foundation. At the same time, the Court established that it is not necessary to restart the court proceeding, but the issue of the non-commercial activity have to be presented from the taxpayer in the first grade of court proceeding.

Bank state aid

As explained above, the mentioned Amato Law changed the banking sector in Italy and also stated that the non-instrumental assets had to be transferred from banking foundations to the banks. The main consequence of this specific

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[73] For the borders of the concept of "enterprise", with the purpose of state aid see: L. PEVERINI, *La nozione di impresa*, in Aiuti di stato in materia fiscale, L. SALVINI (curated by), Padova, 2007.

[74] See Judgment of the Court in case C-222/04. In this case the Court rules that: *"1. A legal person such as that in question in the main proceedings may, after an examination which it is for the national court to conduct taking account of the regime applicable at the material time, be treated as an 'undertaking' within the meaning of Article 87(1) EC, and, as such, subject at that time to the Community rules relating to State aid".*

[75] Cass., United Sections, 29 December 2006 n. 27619.

rule was that Italian banks had had a Return on Equity (also called ROE) lower than European banks also because of this duty. With the purpose to facilitate the development of banking activity and to guarantee the tax neutrality for transactions in which goods and holdings in ancillary activities transferred to banks pursuant to Law No 218 of 30 July 1990 are returned to the transferring institution, Law 461/98 and Decree 153/99 introduced the following tax advantages for the consolidation of the Italian banking sector:

1. the reduction to 12,5 % of the rate of income tax (IRPEG)[76] for banks which merge or engage in similar restructuring, for five years after the operation, provided that the profits are placed in a special reserve which may not be distributed for a period of three years. The profits which may be placed in the special reserve may not exceed 1,2 % of the difference between the sum of credits and debits of the post-merger bank and the sum of credits and debits of the largest pre-merger bank.
2. tax neutrality[77] for transactions in which goods and holdings in ancillary activities transferred to banks pursuant to Law No 218 of 30 July 1990 are returned to the transferring institution.
3. the imposition of a fixed amount[78] replacing the indirect taxes normally due in connection with the operations cited above in (1) and (2).
4. tax neutrality[79] with respect to the local tax due on the increase in the value of property at the time of change in ownership, in connection with the operations cited above in (1) and (2).
5. exemption[80] from tax for the transfer to banking foundations of banks' holdings in the capital of the Banca d'Italia.

The European Commission analyzed this measures and found that "*Italy has unlawfully implemented Law 461/98 and Decree 153/99 in breach of Article 88(3) of the Treaty. The legislative measures confer an advantage on banks, enabling them to grow in size and benefit from economies of scale at lower cost*

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[76] See Article 22(1) and Article 23(1) of Decree 153/99.
[77] See Article 16(3) of Decree 153/99.
[78] See Article 24(1) and Article 16(5) of Decree 153/99.
[79] See Article 24(1) and Article 16(5) of Decree 153/99.
[80] See Article 27(2) of Decree 153/99.

..... The aid granted to banks is selective. It discriminates within the sector and with respect to other sectors. The measures in question do not represent an adaptation of the general system to the distinctive features of the banking sector but, rather, ad hoc aid having the effect of improving the competitiveness of certain undertakings, i.e. the merging banks. The measure is not justified by the nature and general scheme of the system, with the sole exception of the tax exemption for the transfer to banking foundations of banks' holdings in the capital of the Banca d'Italia (Article 27(2) of Decree 153/99), to the extent that the joint operation of assigning the shares to the bank and transferring them to the foundations has no impact on the bank's balance sheet."

In accordance with this EU Commission Decision, Italian Government suspended the above mentioned tax relief in favour of the banking sector with the Law-Decree 63/2002. The Law-Decree 282/2002 also stated the recovery of this state aid not later than 31 December 2002.

In accordance with Decree No 282/2002, an Italian bank transferred the sum corresponding to the tax and interest due as a result of the tax advantage from which it benefited in 1998, 1999 and 2000 in the form of the tax reduction. Later, the same bank went on to submit three requests for reimbursement of the charges levied in respect of those years. Those requests were rejected by implied decisions of the Italian Revenue Agency. The bank brought an action to challenge those decisions before the Commissione tributaria provinciale di Genova (Provincial Tax Commission, Genoa; hereinafter called 'the national tribunal'), alleging inter alia that the contested decision was unlawful. The national tribunal requested to ECJ for a preliminary ruling concerning the validity of Commission Decision 2002/581/EC of 11 December 2001 on the tax measures for banks and banking foundations implemented by Italy. In parallel with this "preliminary ruling" also the Italian Republic brought an action against the Commission for annulment of the contested decision. With two separate judgments[81] delivered by ECJ on 15

[81] The Case C-148/04 concerns reference for a preliminary ruling under Article 234 EC from the Commissione tributaria provinciale di Genova (Italy).

The Case C-66/02 concerns the action for annulment under Article 230 EC, brought on 21 February 2002 from Italian Republic. Both cases were decided on 15 December 2005 by ECJ with two separate judgments.

December 2005, it stated that: "*Examination of the questions referred has disclosed nothing capable of affecting the validity of Commission Decision 2002/581/EC of 11 December 2001 on the tax measures for banks and banking foundations implemented by Italy.*"

With reference to the effects that the tax reduction has on other Member States, those measures strengthen the position of the beneficiary undertakings in relation to other undertakings active in intra-Community trade.

In addition, as noted by ECJ: "*it is not necessary that the beneficiary undertaking itself be involved in intra-Community trade. Aid granted by a Member State to an undertaking may help to maintain or increase domestic activity, with the result that undertakings established in other Member States have less chance of penetrating the market of the Member State concerned (see, to that effect, in particular, Case C-310/99 Italy v Commission [2002] ECR I-2289, paragraph 84). Furthermore, the strengthening of an undertaking which, until then, was not involved in intra-Community trade may place that undertaking in a position which enables it to penetrate the market of another Member State."*

With reference to the taxpayer legitimate expectation the ECJ also stated that: "*In view of the mandatory nature of the review of State aid by the Commission under Article 88 EC, undertakings to which aid has been granted may not, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in that article and, second, a diligent businessman should normally be able to determine whether that procedure has been followed. In particular, where aid is implemented without prior notification to the Commission, so that it is unlawful under Article 88(3) EC, the recipient of the aid cannot have at that time a legitimate expectation that its grant is lawful*".

Extension of the Tremonti-bis tax relief

In addition to the analysis made in the paragraph 1.6 we will see that the extension of Tremonti-bis tax relief was justified only with reference to individual aid grants to the extent that they do not exceed the net value of the damage actually suffered by each of the recipients as a result of the natural disasters.

The Tremonti-bis was a general measure that doesn't fall in the provision of Article 107 TFEU also because it didn't create a distortion of competition between Member State. When the Italian Government has prolonged[82] those tax benefits solely for firms investing in municipalities seriously affected by natural disasters in 2002, the issue of state aid arose and the European Commission asked the Italian authorities for information on the extension. The Italian authorities explained that the measure was based on a macroeconomic approach, although firms would be asked to present certificates or statements in order to verify the actual damage suffered by each recipient. The tax authorities could subsequently carry out the necessary checks. The certificates would have to contain evidence that the firm was entitled to receive aid on account of its location in an eligible area. The firms would also have to certify that the aid did not exceed the damage suffered and that there was no overcompensation.

European Commission also noted that in particular, such measures distort competition and affect trade between Member States if the recipients export part of their production to other Member States; by analogy, if they do not export, domestic output is favoured because firms in other Member States then have less chance of exporting their products to the Italian market.[83]

European Commission has established[84] that this scheme was unlawfully implemented by Italy in breach of Article 88(3) of the Treaty and it is incompatible with the common market, without prejudice to individual aid grants to the extent that they do not exceed the net value of the damage actually suffered by each of the recipients as a result of the natural disasters referred to in Article 5(e) of Decree-Law No 282 of 24 December 2002, with account being taken of insurance payments or of amounts received under other measures.

Those individual (limited) aids granted under Tremonti-bis extension are thus

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[82] The tax relief for the firms that carried out investments in the municipalities affected by natural disasters in 2002 was provided by Article 5(e) of Decree-Law No 282 of 24 December 2002, which was converted into Law No 27 of 21 February 2003 and prolongs for certain firms the benefits provided for in Article 4(1) of Law No 383 of 18 October 2001.

[83] See also Judgment of the European Court of Justice of 13 July 1988 in Case 102/87 French Republic v Commission of the European Communities (SEB) [1988] ECR 4067, paragraph 19.

[84] Commission decision (2005/315/EC) of 20 October 2004.

compatible with the common market within the meaning of Article 87(2)(b) of the Treaty.

2.3 TAX MEASURES WHICH ARE SUPPOSED TO CONSTITUTE STATE AID

Regional aids

In its notice[85] on the application of the State aid rules to measures relating to direct business taxation, the European Commission notes, *inter alia*, that the regional aid fall in the State Aid discipline but in certain case the can be justified: "*The Commission's decision-making practice so far shows that only measures whose scope extends to the entire territory of the State escape the specificity criterion laid down in Article 92(1)*[86]*. Measures which are regional or local in scope may favour certain undertakings, subject to the principles outlined in paragraph 16*[87]*. The Treaty itself qualifies as aid measures which are intended to promote the economic development of a region. Article 92*[88]*(3)(a) and (c) explicitly provides, in the case of this type of aid, for possible derogations from the general principle of incompatibility laid down in Article 92*[89]*(1)*."

Also Commission notes that: "*A distinction must be made between, on the one hand, the external objectives assigned to a particular tax scheme (in particular, social or regional objectives) and, on the other, the objectives which are inherent in the tax system itself. The whole purpose of the tax system is to collect revenue to finance State expenditure. Each firm is supposed to pay tax once only. It is therefore inherent in the logic of the tax system that taxes paid in the State in which the firm is resident for tax purposes should be taken into account*".

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[85] For more information see: Commission notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03), 10 December 1998.

[86] Now Article 112 TFEU.

[87] Paragraph 16 says: "*The main criterion in applying Article 92(1) to a tax measure is therefore that the measure provides in favour of certain undertakings in the Member State an exception to the application of the tax system. The common system applicable should thus first be determined. It must then be examined whether the exception to the system or differentiations within that system are justified 'by the nature or general scheme` of the tax system, that is to say, whether they derive directly from the basic or guiding principles of the tax system in the Member State concerned. If this is not the case, then State aid is involved.*"

[88] Now Article 112 TFEU.

[89] Now Article 112 TFEU.

In according with this Commission notice we can conclude that not all regional tax relief are automatically state aid, notwithstanding a regional tax relief creates a different treatment between taxpayers that are resident in the same State but in two different region. The Article 117, paragraph 1, of Italian Constitution provides that: "*Legislative powers shall be vested in the State and the Regions in compliance with the Constitution and with the constraints deriving from EU-legislation and international obligations*". This is the acknowledgement of the prevalence of the Community law on domestic law.

With reference to these considerations, we will analyze the new flats deductions on personnel costs from the IRAP[90] taxable base that were introduced in 2006 and later amended because in the first version this provision doesn't comply with the State aid rules. The Law 296/2006 states that from the IRAP taxable base of some firms[91] was deductible either:

a) an amount up to 5.000 euro, on an annual basis, for each permanent employee employed in the tax period.

b) An amount up to 10.000 Euro, on an annual basis, for each permanent employee employed in the tax period in the Italian south regions[92]. The deduction provided in point b is alternative to the one referred to the point A and can be enjoyed within the limits provided under the application of the "*de minimis regime*".[93]

The European Commission, with a letter dated 8 May 2007, asked to the Italian Government the reason of the exclusion of many firms from the IRAP tax relief.

Later this formal request of information, the Italian Government approved the Law-Decree 02 July 2007 n. 81, converted in Law 127/2007, with the purpose to

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[90] IRAP is a Regional Tax on Productive Activity that is applied to a taxable base which is approximately calculated as difference between: a) the production value and b) the production costs. The Article 11 of Law Decree 446/1997 states the costs that are not deductable. In particular, personnel costs are not deductable with reference to salaries and wages. The "average" tax rate is 5,25% but it's different region by region and also it is different among the firms that are located in the same region.

[91] In this law were excluded from the tax relief the banks and insurances firms (and other firms that carry out activity in the other sector noted in the law 296/2006).

[92] With the purpose of these rule the Italian south regions are: Abruzzi, Basilicata, Calabria, Campania, Molise, Puglia, Sardinia and Sicily.

[93] The discipline of the minimis regime in contained in the EC Regulation n. 69/2001.

extent the tax relief also to banks and insurances firms[94]. With this law amendment the IRAP tax relief has become non-selective aid and it didn't fall under the Stat aid rules, except for the above mentioned point b, that fall under "*de minimis regime*" and that wasn't extended to insurances and banks firms.

The followings amendment to this regime were made by Law 244/2007 and Law 214/2011. The Article 1 paragraph 50 of the Law 244/2007 reduced the amount of the flat deduction that became:

a) an amount up to 4.600 with reference to the above mentioned point a;

b) an amount up to 9.200 with reference to the point b.

The Article 2 of Law 214/2011 introduced a new flat deduction of 6.000 that will increase the amounts stated in point a) and b) only in relation at the young until 35 years old and women, regardless of age, employed in tax period.

Settlement of pending litigations

Italian legislation which established a tax relief that may not comply with Community law is the facilitated definition of the pending tax litigation provided under Article 3, paragraph 2 bis of Law Decree N. 40/2010, that was added from the conversion law n. 73/2010. This law provided the "Scrapping" of tax litigation of any value that are pending more than a decade, or the possibility, in favour of the taxpayer, to close, under certain conditions, tax litigation that is pending in front of the Court of Cassation or at the Central Tax Commission.

Under this law, the facilitated definition of tax litigation is possible by paying a percentage of the value of the litigation for all proceedings pending in front of the Supreme Court and Central Tax Commission for more than ten years, where the tax authority results unsuccessful party in the first two levels of judgment. In particular, with the purpose to reduce the duration of the tax trials, in compliance with the provisions of ECH in terms of reasonable duration of trials, the Italian Legislature stated that the tax litigations that, on 25 May 2010 - date of entry into force of Law no. 73/2010 - are resulting pending in front of the Central Tax Commission for more than ten years, and where the Italian tax authority has been

[94] With Law 127/2007 the tax relief for banks and insurances firms was extended only for the provisions stated in point a). The banks and insurances firms cannot benefit of the deduction provided for the Italian south regions.

unsuccessful party in the first two levels of judgment, are automatically closed, without payment of any amount. The tax litigations that are hanging on the same date in front of the Supreme Court for more than 10 years, where, likewise, the Italian tax authority is the unsuccessful party in the first two levels of judgment, can be closed by paying an amount equal to 5 percent of the litigation value. Under this law, the litigations concerning State aid declared unlawful by a decision of the European Commission or the collection of foreign tax credits[95] are not definable, as well as those where resistant part is an entity not attributable to the Administration of the State (such as, for example, a local entity). The tax litigation with the tax collection agency as part of the judgment, are otherwise defined if the holder of the tax claim is a financial administration of the State.
The Italian Supreme Court, Fiscal Section, with interlocutory ordinance n. 18055 of 04 August 2010, in according with the Article 267 of the TFEU, and the Article 295 of the Italian Civil code of procedure, asked to the ECJ with reference to the compliance with the Community Law of the above mentioned Italian rules.

The Judges of the Supreme Court showed more than a perplexity. Firstly, the Judges believe that the "scrapping" of pending litigation is a tax relief which allow to the taxpayer to close a litigation with a symbolic duty. This can be constitute an infringement of the duty to tackle abusive practice not only with reference to the national rules, but with reference to the supposed infringement of the duty stated in the Article 4, paragraph 3 of the TFEU which provides, *inter alia*: "*The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives.*" The Court notes that the ECJ jurisprudence, in many cases, has stated that the Member State cannot introduce discriminatory law, not even with the purpose to avoid the loss of tax revenue. The Supreme Court also noted that this "scrapping" law could not have effect with reference to the tax litigations concerning TVA, that is an own resource of the European Commission. The Judges moreover underlying that, with reference to the direct taxation, this rule does not comply with the fundamental principle of the freedom of movement for

[95] With reference to the mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures.

capital, because it is in favour of Italian firms to the detriment of the firms that are not resident in Italy. In this ordinance, the Supreme Court compares this kind of tax amnesty with others and it notes that the "scrapping law" in question provides a nearly completely renounce to the claimed tax. This renounce could constitute harmful tax competition in particular when, as in the case of the mentioned ordinance, the taxpayer avoided the tax obligation through an abusive practice. Also the Supreme Court supposes that this law doesn't comply with the State aid rules because it's explicit that the renounce to the claimed tax gives a vantage in favour of few taxpayers. A tax amnesty in the direct taxation sector could not be a State aid if the national authorities will be demonstrate that it is a technical measure with the purpose to change or improve the tax collection system of the tax that fall in the measure. The tax amnesties that provide a renounce to the application of a tax or to the income assessment in change of a payment of a trivial amount are not justifiable in relation to the objectives which are inherent in the tax system itself. This kind of tax amnesty may be considered as State aid because there has not been the fulfilment of the procedure provided under Article 108, paragraph three, of the TFEU[96] , so it is unlawful. The Supreme Court concludes that Italy should have notified the measure before its entered in force to obtain the required authorization and to avoid future censorship. With the article 39, paragraph 12, of the Law Decree n. 98/2011[97], it was introduced, for the taxpayers, an other opportunity to close the pending tax litigation but only if they have a value up to 20.000 Euro. In according with this provision it is possible to close pending litigation by paying a percentage from 10 to 50 percent of the litigation value. The percentage applicable depends on the result of the previous judgement. The Italian Supreme Court noted the agreement of a previous similar rule with the Community Law in the judgment n. 19333 of 22 September 2011. In this judgment the Supreme Court has referred to an other United Section

[96] The paragraph three provides: "*The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the internal market having regard to Article 107, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.*"

[97] This Law-Decree was converted, with modification, in Law n. 111/2011.

judgment,[98] where the Judges stated that: "the Article 16 of the Law 289/2002[99] doesn't contain a renounce to tax assessment[100] (already claimed by the tax authority and contested by the taxpayer) but it concerns a settlement of a pending litigation, with the purpose to decrease the pending litigations, in according with percentage parameters already stated. The mentioned Supreme Court judgment also stated that this procedure assures the collection of an undecided treasury credit, with an equal treatment among the taxpayers. If we compare[101] the above mentioned "tax amnesty" we will note that an important difference is constituted from the risible number of taxpayers that has benefitted to the settlement of pending litigation in according with the Law n.73/2010. With reference to the measure provided under this law, we note that the minimum payment amount provided is equal to the maximum (except for the pending litigation in Central Tax Commission tax provides no payment) because it is available only for the taxpayer that have won in the first two levels of judgment. The amount of 5% is in any case lower than the percentage provided under Law Decree n. 98/2010 even if in the last grade of judgment the taxpayer has won (in this case the percentage is 10%):

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[98] The Supreme Corte judgment is the number 3676/2010.

[99] The article 39, paragraph 12 of the Dl 98/2011 refers to the Article 16 of Law n. 289/2002 to determinate the percentage applicable with the purpose to close the litigations.

[100] In the ECJ judgment, case C-132/06, the ECJ stated that: "*a general and indiscriminate waiver of verification of taxable transactions effected in a series of tax years, the Italian Republic has failed to fulfil its obligations under Articles 2 and 22 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, and Article 10 EC*". Italian Judges notes that a general and indiscriminate waiver of verification of taxable transactions it's different from the settlement of a tax litigation.

[101] For further information: A. CRISCIONE, *La sanatoria taglia del 15% le liti pendenti*, in Il Sole 24 ore, 31 December 2011, also available at: http://www.ilsole24ore.com/art/norme-e-tributi/2011-12-31/sanatoria-taglia-liti-pendenti-081551.shtml?uuid=AalhUTZE

Table 2

Kind of "tax amnesty"	Number of Potential beneficiaries	Number of closed cases	Pending litigation value	Minimum payment	Maximum payment	Requirement
Under Article 39 of Law Decree 98/2011	216.000	120.000	Within 20.000 Euro	10% of the pending litigation value	50% of the pending litigation value	All the pending litigation
Under Law n. 73/2010	not available	105	Without limit	5% of the pending litigation value	5% of the pending litigation value	Only pending litigation more than ten years*

Source: personal elaboration

*Other requirements are: a) the pending litigation have to be in front of Supreme Court or the Central Tax Commission;
b) the taxpayer must have won in the first two levels of judgment.

The two measures are different but they have in common the existence of a pending litigation. After the procedure of "scrapping litigation", are the litigations really closed? If the ECJ decide that the "tax amnesty" provided by Law 73/2010 will be in breach of Community Law, what will happen? The solution is probably in the legitimate expectation existence under this case, and this problem will be solved from the ECJ. There are many cases[102] where ECJ stated that when a law (that could constitute State aid) is implemented without prior notification to the Commission, so that it is unlawful under Article 108(3) of TFEU, the recipient of the aid cannot have at that time a legitimate expectation that its grant is lawful. In any case, in the current situation ensuring a balance between supremacy of Community law under Italian law, certainty and stability of legal relations and tax imposition is a task more challenging.

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[102] In Case C-148/04 the ECJ stated that: "*104. In view of the mandatory nature of the review of State aid by the Commission under Article 88 EC, undertakings to which aid has been granted may not, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in that article and, second, a diligent businessman should normally be able to determine whether that procedure has been followed. In particular, where aid is implemented without prior notification to the Commission, so that it is unlawful under Article 88(3) EC, the recipient of the aid cannot have at that time a legitimate expectation that its grant is lawful (Joined Cases C-183/02 P and C-187/02 P Demesa and Territorio Histórico de Álava v Commission [2004] ECR I-10609, paragraphs 44 and 45, and the case-law cited). Neither the Member State in question nor the operator involved can plead the principle of legal certainty either, in order to prevent recovery of the aid, since the risk of national proceedings, as claimed by Unicredito, was foreseeable from the moment that the aid was implemented*."

CHAPTER 3 – MEASURES TO COUNTERACT HARMFUL TAX COMPETITION UNDER ITALIAN TAX LAW

3.1 INTRODUCTION

Italian tax law does not contain general anti-avoidance rules. In their absence and following the "form over substance" principle, the tax consequences of a particular transaction depend on the form attributed to the transaction by the parties, rather than on its economic substance.[103] Tax avoidance is dealt with through specific provisions intended to counter specific tax avoidance practices. Notwithstanding this preamble, some scholars suggested to bring all that variety of forms of tax avoidance under a common roof, which should had been the doctrine of the *abuse of law*[104], as developed in private law. Over the years it was studied the possibility of using the following concepts of civil law as anti-avoidance methods. In private law we find *fraus legis*[105] and the *functional interpretation of contracts*[106]. With reference to "fraus legis" principle, scholar notes that a contract, with tax avoidance purpose, isn't void, but it is valid and operative as stated by Article 10 of Law 212/2000. [107] This is true with reference to civil law, but with reference to tax law the developments of the position taken by the Italian judicial system on the nullity of contracts this concepts reached a different approach[108]. The theory of *functional interpretation of contracts* as anti-avoidance method concern the substance over form interpretation of the contract. In any case this kind of interpretation could be a problem for the taxpayer, as for

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[103] Exceptions may apply, *see* section 10.6 in C. GALLI, *Italy - Corporate Taxation*, Country Analyses, IBFD.

[104] For an analysis on this see P. RESCIGNO, *L'abuso del diritto*, in *Riv. dir. civ.*, 1966, I, p. 205.

[105] In Italian: *contratto in frode alla legge*. This rule is containes in art. 1344 of Italian civil code.

[106] These rules are contained in arts. 1362 – 1371 of Italian civil code.

[107] In this sense also see: F. TESAURO, *Istituzioni di Diritto Tributario, Parte generale*, UTET, 2009.

[108] The Supreme Court in the judgment n. 20816/2005 stated that: "*if the only interest pursed by the parties is to save taxes, their transaction should be considered void because it defects in the cause of the contract*". Also Cass., 5 May 2006, n. 10352 utilized the same principle. Later, with the judgment n. 21170/2008, the Supreme Court stated that a contract with tax avoidance purpose is valid under civil rules but the tax authorities can apply the tax treatment referring to the typical juridical scheme avoided.

example in the case-law treated in the 1998 from the Supreme Court.[109] In this case the Italian tax authorities claimed to the taxpayer that the sale and lease-back contract in question was only a normal bank loan[110]. The consequences of this tax assessment were:

a) the operation would have been VAT exempt (so the VAT paid from the leasing company to the seller was not deductible);

b) the leasing company could not have been the right to deduct the pro-rata depreciation.

In this case the Judges state that the sale and lease-back contract is a valid contract, being a "leasing purpose sale" and not a "guarantee purpose sale[111]".

In an other case law, where the sale and lease back contract was in force from two company that belonged to the same group, the Supreme Court[112] stated that this contract was abusive because created double costs. In this case, as the doctrine[113] has noted, the Supreme Court forgot that in this operation there were also a gain for the seller[114] and a revenue for the new owner of the asset that is equal to the leasing payment.

With reference to the doctrine of anti-abuse law[115], we note that over the years this issue was developed and now it is "*a box in which coexist in symbiotic and almost unacceptable mingling, issue radically different*"[116]. As Falsitta has

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[109] Court of Cassation, judgment n. 4612/1998.

[110] The asset sold, as sustained from the tax administration, was sold with the purpose to guarantee the loan, and this kind of guarantee is forbidden under article 2744 of civil code.

[111] That breaches with article 2744 of civil code.

[112] Court of Cassation, n. 8481 of 08/04/2009.

[113] M. BEGHIN, *L'abuso del diritto e le operazioni infragruppo nel caleidoscopio della Suprema Corte*, in Rivista di diritto tributario, 9/2009.

[114] Because the asset sold had an a book value equal to zero.

[115] P. PISTONE, *Abuso del diritto ed elusione fiscale,* Padova, 1995. G. MELIS, *Trasferimento della residenza all'estero ed elusione fiscale*, in AA.VV. (curated by G. MAISTO), in Elusione ed abuso del diritto tributario. Orientamento attuali in materia di elusione e abuso del diritto ai fini dell'imposizione tributaria, Quaderni della "Rivista di diritto tributario", Giuffré, Milano, 2009, p. 231-262. R. LUPI, *L'elusione come frode alla legge fiscale (abuso del diritto)*, in Diritto tributario. Oggetto economico e metodo giuridico nella teoria della tassazione analitico-aziendale, Giuffrè Editore, 2009, p. 191-196. SALVINI L., *Abuso del diritto e clausole elusive in materia tributaria*, in Giurisprudenza delle imposte, Vol. 1, 2009. F. GALLO, *Note minime sull'abuso del diritto in materia fiscale,* in Dal diritto finanziario al diritto tributario Studi in onore di Andrea Amatucci, Jovene, 2011.

[116] G. FALSITTA, *Spunti critici e ricostruttivi sull'errata commistione di simulazione ed elusione nell'onnivoro contenitore detto "abuso del diritto"*, in Rivista di diritto tributario, 6/2010.

noted[117], *in the judgment n. 4737/2010, the Judges of the Supreme Court used the anti-abuse principle as a "obiter dictum". The abuse of law principle to tackle the tax avoidance became an insidious criteria that must seriously worry who care the business freedom under Article 41 of Italian Constitution*.

In the other hand, we have to note that the anti-abuse clause, developed by judgment, is useful to guarantee[118] the correct application of the tax capability principle[119], stated in the Article 53 of the Italian Constitution. In fact, if the tax authorities or the Judges cannot tackle a dishonest taxpayer that use the tax law only with the purpose to avoid the tax obligations, without the direct infringement of a law, there will be a kind of taxpayer that take benefit without a constitutional justification.

3.2 ANTI ABUSE CONCEPT IN THE JUDICIALLY DEVELOPED

The concept of abuse of law in tax law, over the years, has been a process of evolution both legislative and jurisprudential, both at Community level and at the domestic level. [120] In particular, the Supreme Court, with the judgment n. 10257/2008, stated that: "*the concept of abuse of law is independent from every any reference to fictitious nature or fraudulent transaction, in the sense of a prefiguring of behaviours intended to mislead or make it difficult to understand the true nature of an operation*", and also noted that: "*those acts carried out by the taxpayer, constituting abuses of the law, not take effect against the tax authorities, if they regard operations carried out mainly to obtain a tax benefit; the taxpayer has the burden of proof to demonstrate the existence of economic reasons (or other reasons) that are not risible or theoretical*."

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[117] See G. FALSITTA, *Spunti critici e ricostruttivi sull'errata commistione di simulazione ed elusione nell'onnivoro contenitore detto "abuso del diritto"*, cit.

[118] When this principle is correctly used.

[119] For an analysis of the concept of tax capability see also: G. PUOTI, *Il principio di capacità contributiva nel pensiero di G. A. Micheli*, in Studi in memoria di Gian Antonio Micheli, Jovene, 2010.

[120] *See the Italian Supreme Court judgments: 20398/2005; 22932/2005; 21221/2006; 8772/2008; 1465/2009 and in Community Law, the ECJ case C-255/02 (Halifax) and the case C-425/2006 (Part Service).*

The above mentioned principle has been partially amended with the judgment n. 25374/2008, which noted that the tax authorities have the burden of proof to demonstrate that a juridical form is abusive. In this judgment the Supreme Court also stated that:

- "*the anti-abuse notion is a general clause in the Italian tax law and the Community and the Community matrix provides [.....] an operating principle that includes all the tax typologies...*"
- *"it constitutes a way to tackle all the juridical forms that the taxpayers use with the purpose to take tax benefit as principal aim, also when economic purpose coexisting".*
- *"in any case, the taxpayer has the burden of proof to demonstrate the existence of coexisting economic reasons, which are not merely marginal or theoretical*."

The United Sections of the Supreme Court, with the judgments n. 30055/08, 30056/08 e 30057/08 of 02 December 2008, comply with the above mentioned principle and also the Judges noted that:

"*the source of the abuse law principle, with reference to non - harmonized taxes, as direct taxation, is contained in the Constitutional principle that govern the Italian tax law rather than in Community jurisprudence.*"

In fact, the tax capability principle[121] and the progressive nature of the taxation principle[122] constitute the basis of both taxation rules in the strict sense, and of those that give the taxpayer advantages or benefits of any kind. The abuse of law, intended as principle whereby the taxpayer cannot take unlawful tax benefit by utilizing juridical instruments in distorted way with the purpose of tax saving, without appreciable economic reasons, must therefore be considered a direct derivation of constitutional

[121] This principle is contained in Article 53(1) of the Italian Constitution.
[122] This principle is contained in Article 53(2) of the Italian Constitution.

rules and implicit into Italian law. This principle, stated the Supreme Court, "*can not in any way be considered in breach with the law reserve on taxation under Article 23 of the Constitution, since the recognition of a general prohibition on abuse of tax law does not result into the imposition of additional taxes that don't arising by law but in disregard of the effects of abusive operation put in place solely for the purpose of avoiding the application of tax rules.*"[123]. Also the Supreme Court, with the judgment n. 12249/2010, stated that an operation is abusive, also whether it is valid for the civil law, if it will result, from a set of objective factors, that the operation were made essentially for the purpose of obtaining a tax advantage.

With reference to the relationship between the anti-avoidance rule stated in Article 37-bis of the Presidential Decree 600/1973 and the anti-abuse principle developed by the Judges, we note that the Supreme Court judgment no. 12042/2009 has reaffirmed that the source of the general anti-abuse principle derives from the above mentioned Constitutional principle and that the introduction of specific anti-avoidance rule, as the Article 37-bis of Presidential Decree 600/1973, representing the existence of a general anti-avoidance principle that is in force in all kinds of taxes.

We can note that in Italian tax law the abuse of law is:

- a general principle in force for any kind of taxes and for any kind of operations. The Italian Revenue Agency could claim those tax benefit made from the taxpayer under abuse of law, i.e. that arising from transactions carried out essentially to achieve a tax advantage.

[123] See United Sections of the Supreme Court judgment n. 30055/2008 and Supreme Court judgment n. 12042/2009.

3.3 ART. 37-BIS INCOME TAX ASSESSMENT CODE

The Article 37-bis of Presidential Decree 600/73 is the most important specific provision that qualifies specific practice as tax avoidance practice.

It provides that the tax authorities may disregard single or connected acts, facts and transactions carried out without valid economic reasons, intended to circumvent obligations and limitations provided under tax law and to obtain tax savings or refunds otherwise undue in the case of:

- transformations, mergers, divisions, voluntary liquidations and distributions to the shareholders other than profit distributions;
- contributions to the capital of companies and transactions concerning branches of activity;
- transfers of credits;
- transfers of excess tax credits;
-operations covered by the legislation implementing the Merger Directive;
- classification in the balance sheet;
- operations concerning transfers and valuations of participations and transfers of securities, foreign currencies and precious metals and transactions on derivative instruments;
- payments of interest and royalties eligible for the exemption under the EU Interest and Royalties Directive (2003/49), if made to a person directly or indirectly controlled by one or more persons established outside the European Union;
- transactions between resident entities and their affiliates resident in tax havens and concerning the payment of an amount under a penalty clause (*clausola penale, multa, caparra confirmatoria o penitenziale*).

In order to disregard the above operations for tax purposes, the tax authorities must first inform the taxpayer of the reasons for the application of the anti-avoidance provision. The taxpayer has the right to provide justifications, within sixty days or receiving the specific request from the tax authorities. If such

justifications are rejected, the tax authorities must expressly state the reasons for such rejection in the notice of assessment.[124]

3.4 SANCTIONS APPLIED TO TAX AVOIDANCE (PENAL AND ADMINISTRATIVE)

In Community Law the tax avoidance regard only the recovery of the tax avoided without the application of penalty. In the Halifax judgment,[125] the ECJ stated that: "*It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary.*" In Italian tax law, the administrative penalty stated from Article 2(1) of the Legislative Decree 472/1997, Article 1(2) of the Legislative Decree 471/1997 and Article 32(2) of the Legislative Decree 446/1997, provide the application of a penalty in case of infringement of a tax rule. The scholar[126] notes that these penalty rules don't provide a penalty whether there is an avoidance of a tax rule instead of a direct infringement. With reference to the abuse of law, the doctrine notes that the penalty are not applicable in abuse-law case[127].

Italian lower Court Judges stated that: "*the taxpayer does not have to self-disregard the tax effects of transactions declared as elusive, and even be subject to penalty considering that the rule of Article 37-bis of Presidential Decree no. 600/1973, does not contemplate, neither might, in consideration that avoidance and evasion is no violation of the provisions*".[128] Recently other Judges[129] stated that the administrative penalty are not applicable to tax avoidance because, as they noted, in Italian tax law there aren't specific penalty with reference to tax avoidance. The Supreme Court, in its judgment no. 25537/2011, stated that with the purpose to interpret the Article 1(2) of the Legislative Decree 471/1997, it is not enough "to stop us" at the title of the article that talks about "violations" but we have to interpret in this sense: " *the law* (Article 1(2) of the Legislative Decree

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[124] Adapted from C. GALLI, *Italy - Corporate Taxation*, cit. See also section 7.4.1.6.1. for the limitation on benefits clauses in tax treaties.

[125] See ECJ judgment Case C-255/02.

[126] In this sense see: F. TESAURO, Istituzioni di Diritto Tributario, cit.

[127] In this sense see: L. SALVINI, *l'elusione Iva nella giurisprudenza nazionale e comunitaria*, in Corriere Tributario, Vol. 39, p. 3097 ss.. R. CORDEIRO GUERRA, *Non applicabilità delle sanzioni amministrative per la violazione del divieto di abuso del diritto*, in Corriere Tributario, n. 10/2009, pp. 771-776. B. SANTACROCE, *Il concetto comunitario di abuso del diritto in una recente circolare delle Entrate sull'elusione nell'Iva*, in Dialoghi Tributari, 1/2008.

[128] Provincial Tax Commission of Milan, no. 278, 13 December 2006.

[129] Regional Tax Commission of Lombardy, judgment no. 199/44/11.

471/1997 e.d.) *does not consider the application of sanctions as a criterion for discriminating the violation of the law or its avoidance or evasion, it is necessary and sufficient that the items indicated in the tax return are lower than those claimed or are "improper" adjective expressly mentioned in 'Article. 37 bis, paragraph 1 cit.*" In the same sense, but with reference to the criminal relevance of tax avoidance the Supreme Court, in its judgment no. 7739/12[130]. In this judgment, the Judges stated that: considering that the Article 16 of the Legislative Decree 74/2000 notes that the behaviour that complies with the positive tax ruling have no relevance in criminal tax evasion it means that the avoidance behaviour has criminal relevance. This judgment was criticised by many scholars[131] because the judgment had entailed that which it did not implement for instance the legislature purpose was to distinguish tax evasion from tax avoidance in criminal relevance. In the above mentioned case - law the anti-avoidance rule applied by tax authorities and judges is a practical example which the role of these rule in tackle harmful tax competition. The judgment no. 7739/12 was referred to a famous Italian clothing company that have sold its brand to a Luxemburg company that was controlled from the same Italian stylists that sold the brand. Later tax inspection, that has claimed the fictitious foreign residence of the Luxembourg company, the company moved in Italy and now the Supreme Court confirm that the behaviour of these stylists was criminal relevant also because they didn't asked to tax authorities if this operation (the fiscal residence of the Luxembourg company) was complying with the tax rules. Moreover, we have to note that with the tax ruling[132] no. 123/2005, the Italian Revenue Agency noted that it isn't its competence to analyze the fiscal residence in the tax ruling step.

We can conclude that the criminal relevance of tax avoidance is an issue that needs of a legislative intervention, to clarify firstly when a behaviour is abusive and secondly to clarify if avoidance/abusive behaviour fall in the administrative and criminal penalties.

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[130] In the same sense, also: Court of Cassation judgment no. 26723/2011.

[131] A. IORIO, *Elusione, rischio penale al massimo*, in Il Sole 24 Ore, 01 March 2012. A. TRAVERSI, *Eludere non è evadere I giudici forzano la legge*, in Il Sole 24 ore, 03 March 2012.

[132] See also tax ruling 3 December 2008, no.471/E.

3.5 EXCHANGE OF INFORMATION

As an OECD member and a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum), Italy[133] is committed to implementing the international standards of transparency and exchange of information for tax purposes. Italy is a member of the Peer Review Group of the Global Forum. Italy has signed 93 EOI agreements contained in its DTCs, of which 85 are in force. These 85 agreements cover 91 jurisdictions.

Italy already has adequate domestic measures to give effect to its exchange of information arrangements. According to the Italian hierarchy of legal norms, international agreements override the provisions of the domestic legislation and have direct effect. Once the Parliament has approved the treaty, through a ratification law, the treaty partner will be informed of the completion of the Italian procedures in accordance with the entry into force of the treaty. Usually, such notice is given through diplomatic channels. Once a treaty has been ratified, Italy gives effect to it by using its domestic legislation and in particular, as regards EOI, its domestic information gathering powers.

Italy has also ratified the European Convention on Mutual Assistance in Criminal Matters including the fiscal protocol, and is party to a number of bilateral legal assistance arrangements.

As a member of the EU, Italy is able to exchange information in tax matters under the EU Mutual Assistance Directive 77/799/EEC. Italy is a party to, and has ratified, the COE/OECD Convention on Mutual Administrative Assistance in Tax Matters and is in the process of ratifying the protocol of 27 May 2010 amending this convention. Italy is also involved in Council Directive 2003/48/EC of 3 June 2003 on Taxation of Savings Income in the Form of Interest Payments (the EU Savings Directive). To this extent, Italy sends and receives automatically, and on an annual basis, information on interest payments received by natural persons from/to its EU partners (and from all other countries and

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[133] See OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews*, OECD Publishing. http://dx.doi.org/10.1787/9789264115026-en39

jurisdictions involved in these exchanges). A new Mutual Assistance Directive was adopted by the European Council on 15 February 2011 and will come into force on 1 January 2013.

From a legal perspective the Italian registration system is strong and ensures the availability of ownership information regarding all types of domestic companies that can be incorporated in Italy and it complies with the OECD standard.[134]

Banks and financial institutions and intermediaries are, pursuant to s.7 of DPR 605/1973, required to keep identification data, including the TINs, on all persons they have a relationship with and to communicate this information to the Anagrafe Tributaria where it becomes available to revenue authorities[135]. With the

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[134] See also OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews*, cit., p. 29. In this report also OECD notes: "*Foreign companies are subject to the same registration and tax requirements as domestic companies. Considering the registration requirements for companies, the practices of the Italian authorities as well as the comments received from Italy's treaty partners, it is possible to conclude that the Italian registration system for companies is compliant with the standard set out in the Terms of Reference.*"

[135] As OECD, in the above mentioned work, notes: "*The Anagrafe Tributaria does not allow revenue authorities to directly obtain account numbers or to access bank statements. However, it is possible, to determine for all persons holding a bank account in Italy, the number of financial relationships they have and the address of the relevant financial institutions. This information can be accessed using the TIN or the personal data of that person. A requesting jurisdiction wishing to know if a taxpayer holds bank accounts in Italy can therefore obtain an answer directly from the revenue authorities. In the same way, a request for bank information sent to the Italian authorities without stating the bank account number can still be processed as the information on the bank where the account is held is contained*
in the system. Where more detailed information is requested, powers to collect bank information on a case by case basis are foreseen by s.32(7) of DPR 600/1973. The Italian revenue authorities have general access to information held by banks and financial intermediaries. Requests for bank information are made electronically and include mention of the TIN of the account holder. Financial institutions are given at least 30 days to answer these requests. When a treaty partner wants to obtain bank information, the same rules apply: the request must be sent by the Italian authorities to the financial institution electronically, TIN included. If the requesting party is able to note the relevant TIN/ TINs in the request sent to the AE or the GDF, this will ensure quicker provision of the answer by the Italian authorities. When no TIN is provided in the initial request, the revenue authorities are nevertheless able to access the information. However, this cannot be done electronically. In such cases, the revenue authorities ask for information by mail and, if not satisfied, directly go to the premises of the financial institution to collect the information. This possibility is clearly envisaged by s.33 of DPR 600/1973 but it leads to delay the provision of information. However it must be noted that since spring 2010, pursuant to Decree-Law 78/2010, each natural or legal person wishing to open a bank account in Italy, even when living abroad, is required to have a TIN. This new requirement that all holders of accounts have unique identifiers is likely to speed up the provision of bank information in future even though it applies only to the opening of new bank accounts. Considering the sophisticated tools in place to gather bank information, and given that the inputs received from Italy's international partners in tax matters

Law Decree 201/2011,[136] since 2012 the financial institution and intermediaries have to send all the financial operations of their customers to the Revenue Agency, but the future implementing regulation could mitigate this law provision because it regards four billions of financial data[137]. In any case, Italian Revenue Agency cannot obtain information[138] and exchange financial data that are referred to financial account that complied with the tax amnesty, so called "tax shield", also explained in paragraph 1.7.

In this mentioned report, OECD said[139] that: "*As regards bank secrecy, whilst the Italian constitution encourages the protection of individuals and the right to confidentiality, there is no provision in Italian legislation providing for bank secrecy. Bank confidentiality is a contractual obligation between banks and their clients that can be overridden, in particular for tax purposes. The communication between a client and an attorney is only privileged to the extent that the attorney acts in his or her professional capacity as attorney. Where an attorney acts in any other capacity, the attorney client privilege does not apply. In this case, exchange of information resulting from and relating to any such communications cannot be declined because of the attorney-client privilege. The situation is the same for accountants/auditors. There is no other professional secrecy that can be invoked when information is requested for tax purposes by revenue authorities. Article 103 Code of Criminal Procedure, which is referred to in Article 52 of DPR. 633/1972 states that for tax purposes professional secrecy rules, applies only if and to the extent that the professional concerned acts as defending in a criminal procedure case. Finally, according to Italy's partners, there does not seem to have been any case where a request for information was not answered due to secrecy provisions.*" All the above mentioned conclusions are true but we have to note

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do not mention any specific difficulties, requirements or delays in obtaining bank information from the Italian revenue authorities, it can be concluded that the Italian system satisfactorily ensures the collection of this information."

[136] Converted in Law 214/2011, also known as "Save Italy Decree".

[137] In this sense see also: G. PARENTE, *La lotta all'evasione passerà al setaccio 40 milioni di conti correnti*, in Il sole 24 ore, 12 December 2011.

[138] As stated in Article 14 of Law Decree 350/2001.

[139] See OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews,* cit., p. 37.

that OECD forgot to analyze the case of "shielded account" that could involve third State interests as explained in paragraph 1.7.
The concept of “domestic tax interest” describes a situation where a contracting party can only provide information to another contracting party if it has an interest in the requested information for its own tax purposes. Italy has no domestic tax interest with respect to its information gathering powers. Information gathering powers provided to Italy’s revenue authorities under DPR 600/1973 can be used to respond to international requests for information regardless of whether or not Italy needs the information for its own domestic tax purposes. The powers to gather information granted by DPR 600/1973 are further reinforced by specific sanctions. Since the beginning of 2010[140], the AE has also set up a network of contact points for international matters at the Italian regional level. These people are highly skilled in international tax matters and in particular are trained in EOI. Amongst other things, the purpose of this network is to directly answer the questions of local offices when they relate to EOI. Even though it is relatively new, and with results not yet available, the AE sees this network as a good way to improve practices. Guidance is also issued by the AE and the GDF. For the AE, there is no specific handbook for officials responsible for gathering information at the local level to explain how this information should be collected. However, recommendations are provided by the AE headquarters to encourage and improve the involvement of tax officials in the field of EOI, in particular as regards spontaneous exchanges. In 2008 the GDF published an EOI guide which is available to local units. This handbook contains all legal provisions[141] under which EOI can take place as well as the forms[142] to be used for these exchanges. In addition, both the AE and the GDF are involved in the European Fiscalis program, the purpose of which is, through various tools such as exchange of officials or seminars, to ensure continuous improvements to administrative

[140] See OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews,* cit., p. 83.
[141] Details on the content of Article 26 of the OECD Model Tax Convention, the Mutual Assistance Directive 77/799/EEC or the COE/OECD Convention are for example provided in this handbook.
[142] At the EU level, VAT exchanges take place on common forms (SCAC 2004) and common forms can also be used in the field of direct taxation even though their use is still not mandatory.

procedures and practices to the benefit of administrations and business within the EU and ensuring the exchange of information between national administrations. There is no evidence that restrictive conditions are placed on Italy's information exchange practices, either in its legislation or in practice, which would limit the exchange of information other than as provided for in Article 26 of the OECD Model Tax Convention. Indeed, the competent authorities participate in a number of forms of exchange of information with Italy's partners.

The Italian revenue authorities' officials are also bound[143] by domestic secrecy provisions. Pursuant to Article 68 of DPR 600/1973, unless disclosure is based on a court order or provided for by law, sharing any information or communication about a tax case with persons outside the respective administrations is forbidden. The exchange of information with the competent authorities of foreign States in accordance with DTCs in force is not considered to be a violation of the secrecy requirement because in the Italian legal system a DTC overrides domestic provisions. Further, under s.31-bis(5) of DPR 600/1973, the communication of information in response to a request made by another competent authority under the EU Mutual Assistance Directive is not considered as a violation of confidentiality. The GDF, as the financial police, is also covered by even stronger secrecy rules when it acts as Judicial Police during a criminal investigation in order to prevent the early disclosure of facts that could adversely affect the proper prosecution of the investigation (see art. 329 of the Italian Criminal Procedure Code).

With reference to rights and safeguards of taxpayers and third parties, OECD notes that:

"*Each of Italy's exchange of information agreements ensures*[144] *that the parties are not obliged to provide information which would disclose any trade, business, industrial, commercial or professional secret or information which is the subject of attorney client privilege or information the disclosure of which would be*

[143] See OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews,* cit., p. 76.

[144] See OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews,* cit., p. 78.

contrary to public policy. Section 12 of Law No 212/2000 provides for the rights and safeguards of taxpayers (e.g. times when taxpayers' premises may be entered, providing the taxpayer with information regarding the rationale of the audit and his rights and obligations in connection with it), but this "charter" should in no way hamper the acquisition of the information required. All of Italy's EOI agreements allow the Italian competent authorities to decline to exchange information where the information is covered by attorney-client privilege. Attorney-client privilege only applies to communications between a client and an attorney to the extent that the attorney acts in his or her professional capacity as an attorney. Italy can decline to exchange information where the information contains a trade, business industrial, commercial or professional secret; or where disclosure would be contrary to public policy (ordre public) and this is in accordance with the international standards. Information received from foreign competent authorities indicates that there have been no instances where Italy's EOI practices have not respected the rights and safeguards of taxpayers and third parties."

3.6 MONEY LAUNDERING AND TAX CRIMES

Legislative Decree No. 74 of 10 March 2000, published in Official Gazette No. 76 of 31 March 2000, amended the criminal tax penalties system. The provisions of the decree, which are summarized below, apply both for the purposes of income taxes and VAT and entered into force on 15 April 2000.[145]

(a) Fraudulent tax returns which is considered as *tax fraud*. If a taxpayer files an incorrect tax return using false invoices or other documents in respect of fictitious transactions, the penalty is imprisonment for between 18 months and 6 years.[146]

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[145] Legislative Decree 74/2000 was recently amended by Law Decree 138/2011. For an update on the amendment made under Law 244/2007, see: G. PUOTI, F. SIMONELLI: *I reati tributari, aggiornato con la legge 24 dicembre 2007, n. 244*, Cedam, 2008.

[146] See Article 2 of Legislative Decree 74/2000. Law Decree 138/2011 has abrogated the provision, which was provided under Article 2(3) of Legislative Decree 74/2000: "*Where the tax*

If the incorrect tax return is based on false entries in books and accounts or on other methods used to prevent the assessment of unpaid tax and:

– the amount of the unpaid tax exceeds Euro 30.000; and

– the amount of the undeclared taxable base is greater than 5% of the total taxable base disclosed in the tax return or, in any event, is greater than Euro one million, the penalty is imprisonment for between 18 months and 6 years[147].

In other cases, if the taxpayer wilfully files an incorrect tax return and:

– the unpaid tax exceeds Euro 50.000; and

– the amount of the undeclared taxable base is greater than 10% of the total taxable base disclosed in the tax return or, in any event, is greater than Euro two million, the penalty is imprisonment for between 1 and 3 years[148]. This offence configures a *tax offence.*

(b) Failure to file tax returns. If a taxpayer fails to file a tax return in order to avoid the payment of tax, the penalty is imprisonment for between 1 and 6 years if the amount of the tax evaded exceeds Euro 30.000. For the purposes of the application of this rule, a tax return filed within 90 days of the filing deadline or unsigned or filed on non-standard forms is deemed to have been filed[149]. In this case the taxpayer behaviour configures a *tax crime*.

(c) False record-keeping. The issue of false invoices or other false documentation for tax purposes in respect of fictitious transactions is punishable by imprisonment for between 18 months and 6 years.[150]

The concealment or destruction of books and accounts for the purposes of

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evaded does not exceed Euro 154.937, the period of imprisonment is between 6 months and 2 years."

[147] See Article 3 of Legislative Decree 74/2000, entitled: "fraudulent tax return through other subterfuges".

[148] See Article 4 of Legislative Decree 74/2000.

[149] See Article 5 of Legislative Decree 74/2000.

[150] See Article 8 of Legislative Decree 74/2000. Law Decree 138/2011 has abrogated the provision, which was provided under Article 8(3) of Legislative Decree 74/2000: "*If the aggregate amount indicated in the false invoices or documentation does not exceed Euro 154.937, the penalty is imprisonment for between 6 months and 2 years*." This is the other side of the coin with reference to the abrogation of the Article 2(3), above mentioned.

avoiding tax is punished by imprisonment for between 6 months and 5 years[151]. Also Article 10-bis, 10-ter and 10-quater of Legislative Decree 74/2000 punish by imprisonment for between 6 months and 2 years the taxpayer that, over the limit of Euro 50.000, doesn't pay VAT or withholding taxes held, or that utilizing unlawful credit tax to pay other taxes.

(d) Advance rulings and avoidance of penalties. All of the above penalties do not apply if a taxpayer's actions conform with an advance ruling issued by the tax administration.[152]

Art. 7 of Legislative Decree No. 74/2000 identifies two cases where sanctions are not to be imposed, both of which represent circumstances where there was no fraudulent intention to evade tax[153]. With reference to criminal tax risks under Italian law on transfer pricing violation, scholars[154] note that:

"Italian tax law provides (in Art. 26 of Decree Law No. 78/2010) for the non-applicability of the (administrative tax) penalty set forth under Art. 1 of Legislative Decree No. 471/1997 in the event the taxpayer provides the documentation relating to the matter indicated in the Regulation issued by the Director of the tax authorities of 29 September 2010. This article has outlined the conditions that have to be met in order to be exempted from administrative violations. Notwithstanding the fact that Art. 26 does not provide a possibility for

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[151] See Article 10 of Legislative Decree 74/2000.

[152] The definition of tax crimes was adapted and updated with the last legislative amendment by developing: Italy - New criminal tax penalties introduced (04 July 2000), News IBFD.

[153] The first pertains to a violation of the method used to determine transfer prices for the relevant tax year, which is not punishable if such violation derives from the application of routine accounting methods and procedures. In order to benefit from this relief, the adoption of improper imputation criteria and the inaccurate accounting of profits, expenses and other income debits or credits must be the consequence of a defective accounting structure that has resulted in the repetition of erroneous "entries" for several consecutive tax years, since, in such circumstances, tax is simply deferred.
The second, which is rather interesting, concerns discrepancies and valuation estimates in circumstances where the criteria actually adopted are clearly outlined in the documents annexed to the financial statements. Given that the criteria for the estimates have been disclosed in the financial statements, there can be no argument that the taxpayer has attempted to deceive the tax authorities.
In such circumstances, it is clear that the facts will not support a finding that there was intent to commit fraud for the purpose of evading tax. In this sense see: P. VALENTE, I. CARACCIOLI, *Transfer Pricing - Criminal Tax Risks under Italian Law*, in European Taxation European taxation. Amsterdam. Vol. 51 2011, no. 7; p. 296.

[154] In this sense see: P. VALENTE, I. CARACCIOLI, Transfer Pricing - Criminal Tax Risks under Italian Law, cit., p. 300.

virtuous taxpayers to also avoid the criminal tax penalties set forth (for tax return discrepancies) under Art. 4 of Legislative Decree No. 74/2000, the cooperative behaviour of the taxpayer should be considered, in terms of his provision of documentation deemed suitable to enable the tax authorities to properly carry out their tax inspections."

In its 2006 Report, IMF[155] describe the Italian money laundering legal system (contained, *inter alia,* in Article 648-bis and 648-ter of Italian Penal Code) in these terms: "*The offence of money laundering is defined in line with the definition in existing conventions, and extends to the proceeds from any crime committed intentionally. The offence does not extend to the author of the predicate offence ("self-laundering"). Money laundering is punished by 4 to 12 years of imprisonment, and by fines of a maximum of €15,240. While the imprisonment penalty provided by law is in line with normal standards, fines seem extremely low for a financial crime which can generate considerable amounts of proceeds. There is no penal liability for legal persons, but a system of administrative liability in the case of the commission of some penal offences committed by legal persons, which include financing of terrorism but not money laundering at present.*"

In this report, IMF also recommended to criminalize self-laundering with the purpose to better counteract this illegal phenomenon. Italian national anti-Mafia Prosecutor, in many occasions[156], has noted the necessity of introducing this kind of financial offense. The administrative penalties referred to money laundering infringements are stated in Legislative Decree 231/2007.

Italy has ratified[157] the European Convention on Mutual Assistance in

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[155] In this sense see: IMF, *Country Report No. 06/112*, 2006:
http://www.imf.org/external/pubs/ft/scr/2006/cr06112.pdf
[156] *Il procuratore Grasso: «Il piano antimafia è positivo, ma non esaustivo»,* in Il Sole 24 ore, 05 May 2010. *Pietro Grasso: "Nuove leggi contro la mafia"* in Repubblica, 31 December 2011.
[157] The European Convention on Mutual Assistance in Crime Matters was signed at Strasbourg on 20 April 1959, and made effective in Italy with Law 215 of February 23, 1961. With Law 24 July 1985, n. 436. In accordance with Article 24 and for the purposes of the Convention the following authorities are to be considered Italian judicial authorities:
- Directors of Public Prosecution,
- Assistant Public Prosecutors,
- Ordinary Courts of Justice,
- Military Courts,
- Offices of the Public Prosecutor attached to the Military Courts,

Criminal Matters including the fiscal protocol, and is party to a number of bilateral legal assistance arrangements. The mutual assistance in crime matters has as its object[158] carrying out of a preliminary investigation activity for acquiring the proofs referred to a certain offense and may include: hearing of witnesses and accused, a precautionary sequestering and delivery of proofs, documents and other goods relating to the offense, in house search, in the notification of judgments and other legal documents that can not be performed in the territory of the requesting State.

The matter mutual assistance is governed, under Italian law, by the Constitution (Article 10); by law (Book XI, Title III, Art. 723 and forward Code of Criminal Procedure (c.p.p.p), Arts. from 201 to 206 implementing rules c.p.p.) from international conventions and rules of general international law which, according to art. 696 cpp, where they exist take precedence over ordinary laws. The code of criminal procedure distinguishes between the so-called "incoming requests", ie requests for assistance received from abroad, and cd "active requests" or requests made abroad.

The Article 724 of c.p.p. stated the cases where the abroad request for assistance cannot be carry out, i.e. this request could prejudice other pending penal trial or pending investigation.

With reference to the use of the information received under an international agreement in tax matters, for other purpose, the old Directive 77/799/EEC of 19 December 1977 forbade[159] the use of these data for other purpose.

The new Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation, that repealing the Directive 77/799/EEC, provides that: "*It is important for the efficiency of administrative cooperation that*

- Examining Magistrates,
- Superior Magistrates,
- Praetors.

[158] Adapted from: Ministero della Giustizia, Atti Internazionali: http://www.giustizia.it/giustizia/it/mg_1_3.wp?detail=y&tabait=y&tab=t&ait=AIT32552&aia=AIA32670#TopAi

[159] Article 7 of Council Directive 77/799/EEC of 19 December 1977, *inter alia,* provides that: - *shall in no circumstances be used other than for taxation purposes or in connection with judicial proceedings or administrative proceedings involving sanctions undertaken with a view to, or in relation to, the making or reviewing the tax assessment.*

information and documents obtained under this Directive could, subject to the restrictions laid down in this Directive, be used by the Member State that received them ***also for other purposes****. It is also important that Member States could transmit that information to a third country, under certain conditions.*" The Article 29 of this Directive provides that Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive with effect from 1 January 2013. Italy has not yet transposed this Directive. The borderline between the application of administrative assistance on the basis of "tax treaties" and the administrative assistance on the basis of conventions for the assistance in criminal matters is constituted from the existence of a tax offence (and related proofs) by the taxpayer. The Italian fiscal authorities normally acquire the proofs of tax evasion that, after the tax assessment could have penal relevance. [160] In this case, they have to inform (under Article 331 c.p.p.) the judicial authority which could carry on with the mutual convention on mutual assistance in crime matters, if it deems appropriate. In any case, the two kind of assistance procedures are parallels. The principle of dual[161] criminality provides that assistance can only be provided if the conduct being investigated (and giving rise to an information request) would constitute a crime under the laws of the requested country if it had occurred in the requested country. In order to be effective, exchange of information should not be constrained by the application of the dual criminality principle.

None of Italy's DTCs specifically includes a dual criminality principle to restrict exchange of information. Italy does not have any domestic legislation resulting in such a principle. Information exchange may be requested both for tax administration purposes and for tax prosecution purposes. The international standard is not limited to information exchange in criminal tax matters but extends to information requested for tax administration purposes (also referred to as "civil tax matters"). Italy is able to exchange information in both civil and criminal

[160] For an analysis of the relationship between EOI and Criminal Proceedings see: C. SACCHETTO, *Exchange of Tax Information. Connections with Criminal Proceedings*. *The Italian approach*, in Rivista di diritto tributario internazionale, n. 1/2, 2009.

[161] Adapted from: OECD (2011), Global Forum on Transparency and Exchange of Information for Tax Pur-poses Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews, cit., p. 70.

matters. When a matter is under criminal investigation abroad and if Italy is required to provide information linked to this case, such information can be furnished by the Italian competent authorities.

3.7 OTHER MEASURES TO COUNTERACT HARMFUL TAX COMPETITION

In Italian tax law there is a rule that prevent the excessive deduction of interest under Article 96 of Presidential Decree 917/1986162. According with this law, the taxpayer can deduct passive interest up to an amount that is equal to active interests. Also the taxpayer have to calculate the gap163 between the total negative interests and the total active interests. This gap is deductible up to a percentage of 30% of the gross operative income.164 The undeductable interests will be deductable in following years. This law has entered into force for the fiscal year in progress after 31 December 2007. The so-calculated amount deductable can be increased, for the first two years of the entered in force of the law, for an amount as ten thousand and five thousand Euro. This rule has replace the thin cape rule, that was applicable only with reference to the shareholder's fund. The new rule doesn't take into account the difference between a shareholder's fund and others lenders, including all the kind of funding.

Italian exit tax complies with the principles stated by ECJ in Case C-371-10[165].

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[162] The above mentioned Article 96(6) also refers to the priority application of other undeductable rules contained in TUIR.

[163] As shown in income statement at the end of the fiscal year.

[164] With the purpose of Article 96, the gross operative income is calculating as difference between the letter A of the income statement (production value) and the letter B of income statement (production costs, with the exceptions of amortisation and depreciation that fall under letter a and b of point 10, and the leasing fee related to instrumental assets).

[165] The principles state in Case C-371/10 are:

1. A company incorporated under the law of a Member State which transfers its place of effective management to another Member State, without that transfer affecting its status of a company of the former Member State, may rely on Article 49 TFEU for the purpose of challenging the lawfulness of a tax imposed on it by the former Member State on the occasion of the transfer of the place of effective management.

2. Article 49 TFEU must be interpreted as:

– not precluding legislation of a Member State under which the amount of tax on unrealised capital gains relating to a company's assets is fixed definitively, without taking account of decreases or increases in value which may occur subsequently, at the time when the company, because of the transfer of its place of effective management to another Member State, ceases to obtain profits taxable in the former Member State; it makes no difference that the unrealised capital gains that are taxed relate to exchange rate gains which cannot be reflected in the host Member State under the tax system in force there;

The Law Decree 91/2012 has introduced the paragraph 2-quater in the Article 166 of the Presidential Decree 917/1986:

"2-quater The taxpayer who move his place of effective management for the purposes of income tax in states inside the EU or in states included in the EEA and in the list referred to in Decree issued pursuant to Article 168-bis, with which Italy has signed an agreement on mutual assistance in tax collection comparable to that provided by Council Directive 2010/24/EU, of 16 March 2010, in alternative to what is stated in paragraph 1[166]*, may request suspension of the effects of realize provided therein in accordance with the principles established by judgment of 29 November 2011, Case C-371-10, National Grid Indus BV*."

Italy has removed the previous incompatible rule (with Community Law) that prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company that transferring its place of effective management to another State without distinguished between Member State and non-Member State. After this amendment, the immediate recovery of tax on unrealised capital gains is in force only with reference to seat transferring toward State that don't fall in the provision stated in the above mentioned paragraph 2-quater.

Italian tax law provides switch-over clauses both in some DTCs agreements that in domestic legislation.

Italy - Germany treaty include switch-over-clauses, thus replacing exemption with credit and effectively countering potentially abusive cases. This clauses is provided under the Protocol to this Convention.[167]

– precluding legislation of a Member State which prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another Member State at the very time of that transfer.

[166] Paragraph 1 prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another State.

[167] 18. With reference to Articles 24 and 26
As regards paragraph 3 of Article 24 and Article 26, the following arrangement shall apply: where income is categorized or attributed differently in the Italian Republic and the Federal Republic of Germany and it is not possible to solve this difference by the mutual agreement procedure under Article 26, the following shall apply:
(a) if the relevant income would be subject to double taxation, the Federal Republic of Germany shall avoid such double taxation by a tax credit in accordance with the principles of subparagraph (b) of paragraph 3 of Article 24;
(b) if the relevant income would not be subject to taxation or would only be subject to a reduced taxation in the Italian Republic and at the same time exempt from German tax, the Federal Republic of Germany shall not grant a tax exemption in accordance with subparagraph (a) of

Under the activities clause[168], Italy switches from the exemption method to the credit method if the party liable to tax falls to prove that at least 50% of the foreign PE or controlled company's gross income is derived from precisely defined "active" activities. The Italian cfc rules are justified with reference to a lower tax rate applicable in another State[169] and formally complying with the Community Law[170] because there is a safe-harbour rule[171] that prevent the application of the provision in case of a non-artificial arrangement[172].

The profits of a foreign entity are attributed to an Italian person on the last day of the financial year of the foreign entity. The income is computed by applying the Italian provisions regulating the computation of business income and is taxed separately (i.e. CFC income cannot be offset by the Italian person's losses) at the taxpayer's average tax rate. This average rate cannot, however, be lower than 27%. Under article 15 of the Income Tax Code, final taxes paid abroad are creditable against the Italian taxes levied on the CFC income.

In addition to controlled companies, the CFC legislation[173] is also applicable to "affiliated companies"[174], i.e. where an Italian resident entity directly or indirectly

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paragraph 3 of Article 24 but shall grant a tax credit in accordance with the principles of subparagraph (b) of paragraph 3 of Article 24.

[168] This provisions, known as cfc rules are stated in article 167 and 168 of the Presidential decree 917/1986. If the controlled company is located in Eu State, there will be a safe-harbour clause with reference to the non-artificial arrangement company, in according with the ECJ jurisprudence. If the controlled company have the legal seat in a black list State, the cfc rules are more strict and it is "necessary" tax ruling procedure to avoid the application the cfc rule by proving that the controlled company carry out an industrial or commercial activity or that there isn't and evasive purpose localizing the income in black list country. If the taxpayer doesn't fill the tax ruling, the tax authorities have to apply higher penalty, as stated in Circular 32/E/2010, but it can also prove, during the tax inspection, that the black list controlled company doesn't fall in the provisions of Article s 167 and 168.

[169] For an analysis of this justification under Community Law see: M. LANG, *CFC Legislation and Community Law*, European Taxation, 2002, p. 376.

[170] For an analysis of this topic see: G. MARINO, *La compatibilità delle CFC Legislation con il diritto europeo e con le convenzioni contro le doppie imposizioni in Paradisi,* in Paradisi e paradossi fiscali. Il rovescio del diritto tributario internazionale, Egea, 2009, p. 60-63

[171] This safe-guard clause is provided under Article 167(8-ter) of DPR 9171986.

[172] See also: Communication of 19 December 2006 from the Commission to the Council, the European Parliament and the European Economic and Social Committee - Coordinating Member States' direct tax systems in the Internal Market COM(2006) 823 final.

[173] The definition of cfc rule, also as extended to affiliated company was adapted from: C. GALLI, *Italy - Corporate Taxation sec. 10.4*, Country Analyses, IBFD.

[174] For an analysis of this see: P. SELICATO, *Estensione alle società collegate delle norme antielusive in materia di imprese estere controllate: si riducono le possibilità di disapplicazione?*, in G. Marino (curated by), I profili internazionali e comunitari della nuova imposta sui redditi delle società, Milano, 2004, 128 ss., where the author notes that the explicit aim of the rule contained in

holds 20% (10% in the case of listed companies) or more of the entitlement to profits right of an entity resident or established in a state or territory having a privileged tax regime. This extension of the scope, however, does not apply to income derived by companies resident in states or territories not having a privileged tax regime through permanent establishments in states or territories having a privileged tax regime (article 168 TUIR).

Income attributable to Italian resident entities holding directly or indirectly at least 20% of the entitlement to profits rights of the CFC but not controlling it is determined as the higher between:

(1) the pre-tax profits resulting from the profit and loss account of the CFC; and

(2) the income resulting from the application of certain coefficients to the assets held by the CFC, as follows:

- 1% of the value of shares and other participation rights, bonds and other securities and receivables held;

- 4% of the value of real estate and ships held; and

- 15% of the value of other fixed assets held.

Other anti-tax-haven legislation.

Article 110(10) of the TUIR limits the deductibility of expenses and other deductible items if they relate to transactions between resident and certain non-resident entities (as defined below) or professionals. Such expenses are not deductible unless the resident person proves that:

- the non-resident carries on a real business activity; or
- the relevant transaction(s) had a real business purpose and actually took place.

The legislation (article 110(10) TUIR) applies to transactions between a resident person (individual or corporate) and a company or professional resident in a state or territory not included in the white list. Until the issuance of the decree

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article 167 of the TUIR is to counteract the "tax deferral" but this rule also contain an implicit presumption with reference to the power to dispose of the income produced by the controlled company. Author also notes that, in line with the above mentioned implicit presumption, the affiliated company are not comparable with the controlled company as far as the power to dispose of the income. So the extensions of "cfc rule" to affiliated company could be unlawful.

containing the list and for five years thereafter, all states and territories not already included in the current black list will be treated as included in the white list. Ministerial Decree of 23 January 2002 provides a list of such countries and territories, as subsequently amended.

Under article 110(10) of the Income Tax Code (TUIR), a country or territory has a privileged tax regime if it levies no income tax or levies an income tax on the income of the relevant companies at a rate which is lower than the one to be determined by the Ministry of Finance and the Ministry of Treasury.[175]

The cfc rule override the provision stated under Article 110(10) of the TUIR.

With reference to the specific regulations to counteract tax avoidance involving tax arbitrage through hybrid instruments or entities, Italian law provides that profits[176] distributed by non-resident entities are 95% exempt for tax purposes only if the following conditions are met: (i) the profits are fully linked to the economic results of the issuer or of any other companies which are part of the same group or of the specific business in relation to which financial instruments have been issued; and (ii) the profits are not deductible in the foreign country where the issuer is resident[177]. The condition that the income distributed is non-deductible in the issuer's jurisdiction must be proved by a declaration from the issuer itself or by other appropriate evidence.

Italy, have introduced rules that deny the exemption of income which is deductible in the other country. This latter approach has also been agreed upon by the EU Code of Conduct Group (Business Taxation) in relation to hybrid instruments.[178] Italian tax law provides a specific rule which can be used to

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[175] C. GALLI, *Italy - Corporate Taxation sec. 10.6*, in Country Analyses IBFD.

[176] In this sense see: OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues*, 2012, p.19.

[177] See Articles 89.3 and 44.2.a of the Italian Consolidated Italian Income Tax Code.

[178] The EU Code of Conduct Group (Business Taxation) "agreed that a problem arises when the Member State of the corporate taxpayer paying interest allows its deduction from the tax base, whereas the Member State of the corporate taxpayer which receives the income considers it as a tax exempted dividend income. In that case, such income would remain untaxed in both Member States". To avoid these mismatches, the Group agreed that "… in as far as payments under a hybrid loan arrangement are qualified as a tax deductible expense for the debtor in the arrangement, Member States shall not exempt such payments as profit distributions under a participation exemption". However, as there was no agreement regarding the legal form through which this solution should be implemented, it was agreed that further work was needed in this respect and decided to come back subsequently (see the Report of the Code of Conduct group (Business Taxation) to the ECOFIN Council of 8 June 2010, No. 1033/10).

tackle foreign tax credit generator schemes. [179] Specifically, in the case of Repurchase agreement (Repo) and Securities lending or other transactions that yield similar effects, the Italian taxpayer (borrower) receiving dividends, interests or other proceeds is entitled to a foreign tax credit, only if these benefits would have been granted to the beneficial owner (lender) of the said income flows (i.e. if the lender is subject to the same tax regime of the borrower). As a consequence, the borrower can claim a foreign tax credit only if the lender is an Italian entity or a foreign entity with a permanent establishment in Italy.

[179] This rule is focused on dividend exemption only and is contained Sub Art. 2, Paragraph 2, of the Legislative Decree n. 461/1997. The provision was amended on 12 April 2009 to expressly tackle schemes seeking to obtain foreign tax credits in Italy and in a foreign country, where only one withholding tax was suffered.

CHAPTER 4 – HARMFUL TAX COMPETITION AND DOUBLE TAX TREATY LAW

4.1 INTRODUCTION

As stated in Article 38 of the International Court of Justice statute:

1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;

b. international custom, as evidence of a general practice accepted as law;

c. the general principles of law recognized by civilized nations;

d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

2. This provision shall not prejudice the power of the Court to decide a case ex aequo et bono, if the parties agree thereto.

If in a case law there is no international conventions in force between the two party, international custom assumes relevance in the resolution of the litigation.
Scholar[180] has generally excluded and excludes the existence of a customary international law prohibition of double taxation.
Tax treaties law are written sources of international law. Their nature is comparable to the contract one: two or more states decide to directly regulate a particular matter according to the principles they consider most appropriate. In this sense, scholar has defined the conventions as: "*the only way States can consciously create international law*"[181] .
When a tax treaties in tax matter is ratified by an Italian law then it enters in force

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[180] K. VOGEL, *Der räumliche Anwendungsbereich der Verwaltungsnorm*, Frankfurt/Berlin, 1965, p. 197; K. VOGEL, *Klaus Vogel on double taxation conventions*, London, 1997, p. 12.
[181] M. DIXON, Textbook on international law, London, 1993, p. 21. In this sense also see C. SACCHETTO, *Le fonti del diritto tributario internazionale,* in Diritto tributario internazionale, coordinated from V. UCKMAR, Cedam, 2005.

and it is considered as special law that overrides under general law in case of conflict. With reference to the effectiveness of the law in time, the Constitutional Court, with its judgment n. 10/1993, stated that a conventional law overrides over a later domestic law, being reportable to an atypical competence that cannot be abrogated by an ordinary law.

Article 117 of Italian Constitution states, *inter alia,* that: "*Legislative powers shall be vested in the State and the Regions in compliance with the Constitution and with the constraints deriving from EU legislation and international obligations*."

The international obligations, which the above mentioned Article refers to, are[182]: the Article 10 of the Italian Constitution states, *inter alia*, that: "*The Italian legal system conforms to the generally recognised principles of international law*", and the following Article 11 that provides, inter alia, that: "*Italy agrees, on conditions of equality with other States, to the limitations of sovereignty that may be necessary to a world order ensuring peace and justice among the Nations".*

Scholar notes that the Article 117(1) has introducted a Constitutional relevance of the international treaties[183].

The Article 169 of Presidential Decree 917/1986, provides that: "*The provisions of this consolidated law shall apply, if more favourable for the taxpayer, notwithstanding the international treaties against double taxation*".

This Article does not confirm a general principle of specialty, but the effects of moderation of this principle, allowing the taxpayer to make a choice regarding the applicable rule. Thus, where the standard domestic rule is more favourable for the taxpayer it may apply these one.[184]

The connection between the domestic anti-abuse/anti-avoidance provisions and

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[182] As stated in Article 1(1) of Law 131/2003.

[183] In this sense see: C. SACCHETTO, *Le fonti del diritto tributario internazionale*, cit., p. 58. In this work, Sacchetto explains other doctrine addresses with reference to the amendment of Article 117 of the Constitution by Constitutional Law n. 3/2001.

[184] In this sense see: G. MELIS, *Vincoli internazionali e norma tributaria interna*, in Rivista di diritto tributario, 2004. In this work the author also notes that : Article 169 does not specify, however, if most favourable provision is meant that "in theory" is more favourable, or that "in practice" more favourable. The author argues for latter, because it is an option for the taxpayer.

the benefits granted under tax treaties agreement was analyzed, *inter alia*, under four point of view by scholar[185]:

- the overlap of conventional rules and anti-avoidance domestic rules, being both substantial rules;
- the impossibility to note that the override of the domestic anti-avoidance rules over tax treaty law with reference to the Constitutional principle that provides their foundation;
- the non-automatic override of conventional rules over domestic anti-avoidance rules on the basis of the prevalence of the first ones;
- autonomy and specialties of the rules of interpretation of agreements provided by the international treaties (Article 31 and following of the 1969 Vienna Convention on the Law of Treaties, art. 3, paragraph 2, of the OECD Model Convention) different and distinct from those that oversee the interpretation of the internal rules.

The scholar also argues that the contrast to tax avoidance, does not represent one of the primary goals of the OECD Convention up to the point of using this principle as a key point in determining whether the domestic anti-avoidance provisions comply with the commitments undertaken by the Contracting State. The application of domestic anti-avoidance rules would determine a unilateral amendment of the interpretation of the conventions that, if it had only relevance for one of the Contracting States, would not ensure a common interpretation of the Convention.

Paragraph 9.5 of the commentary on Article 1 states that: "*A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.*"

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[185] In this sense see: G. MAISTO, *Norme anti-elusive*, *abuso del diritto e convenzioni internazionali per evitare le doppie imposizioni sul reddito*, in Elusione ed abuso del diritto tributario. Orientamento attuali in materia di elusione e abuso del diritto ai fini dell'imposizione tributaria, Quaderni della "Rivista di diritto tributario", Giuffré, Milano, 2009.

4.2 ANTI AVOIDANCE PRINCIPLE IN TAX TREATIES

In some double taxation agreement signed from Italy and third States, there is an explicit provision that allows the application of domestic anti-abuse/anti-avoidance measures which override the application of the treaty. The Article 24(6)[186] of the DTC in force between Italy and Sultanate of Oman[187] provides that:

"*However, the provisions of the preceding paragraphs of this Article shall not affect the application of internal provisions in order to avoid evasion and tax avoidance. The present provision includes in any case, the limitations of the deductibility of expenses and other negative items arising from transactions between companies of a Contracting State and companies located in the other Contracting State*."

This Article concerns the application of the Article 110(10) of the Presidential Decree 917/1986, that override the application of the treaty.

Another kind of treaty-override is contained in the DTC signed from Italy and United States of America. The Article 1(9) of the Protocol provides that:

"The provisions of Article 9 (Associated Enterprises) of the Convention do not limit the provisions of law of each Contracting State that allow the distribution, sharing or allocation of income, deductions, credits or benefits between persons owned or controlled, directly or indirectly, by the same interests when it is necessary to prevent tax evasion."

The DTC signed between Italy and United Kingdom[188] contains bona-fide provision that excludes cases that are note abusive. In particular, Article 10(5)[189]

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[186] Article 24 is entitled "non discrimination".

[187] This agreement was signed on 06 May 1998 and ratified in Italy with Law n. 50/2002. Other DTCs that contains similar provisions are: DTC signed with Kuwait in 1987 (letter m, second period of the Protocol, as amended in 1998), Ukraine in 1997 (paragraph 9 of Protocol, Emirates Arabs in 1995 (letter e of the Protocol), Ethiopia in 1997 (Article 24, paragraph 6), Uzbekistan in 2000 (paragraph 6 of Protocol), Macedonia in 1996 (Article 25, paragraph 6), Ghana in 2004 (Article 2005, paragraph 6) and Latvia in 1997 (Article 30, paragraph 2). In this sense also see: G. MAISTO, Norme anti-elusive, abuso del diritto e convenzioni internazionali per evitare le doppie imposizioni sul reddito, cit., p. 304.

[188] This agreement was signed in Pallanza on 21 October 1988 and ratified in Italy with Law 5 November 1990, n. 329.

[189] Article 10(5) provides that: "*The provisions of neither sub-paragraph (b) nor (c) of paragraph (3) and neither subparagraph (a) nor (b) of paragraph (4) of this Article shall apply unless the*

(Dividends) provides that the benefit of double treaty agreement are denied if the recipient of a dividend has acquired the participation with the only or the main purpose to benefit of the treaty. In the same agreement, Article 11(9)[190] (Interests) provides a similar provision. A similar clause is contained in DTC in force between Italy and France.[191]

The general anti-avoidance concept inherent tax treaties has been treated by scholar and jurisprudence. Scholar[192] notes that it is necessary a case-by-case analysis in order to determine if a cross-border operation could be considerate as elusive. The tax arbitrage called *rule shopping*[193], i.e. are not abusive in any case but we can note that it is necessary to analyze the total taxpayer situation with reference to this operation.

Scholar[194] also notes that the double non-taxation could not be caused by a different qualification of the same tax treaty rules by the two governments. If the source state had applied the same tax treaty rules as the residence state, double non-taxation would also have arisen due to the policy decision taken by the source

recipient of a dividend shows (if required to do so by the competent authority of the United Kingdom or Italy respectively on receipt of a claim by the recipient to have the tax credit set against United Kingdom or Italian income tax respectively chargeable on him or to have the excess of the credit over that income tax paid to him) that the shareholding in respect of which the dividend was paid was acquired by the recipient for ***bona fide*** *commercial reasons or in the ordinary course of making or managing investments and it was not the main object nor one of the main objects of that acquisition to obtain entitlement to the tax credit referred to in sub-paragraph (b) or sub-paragraph (c) of paragraph (3) or in subparagraph (a) or sub-paragraph (b) of paragraph (4) of this Article, as the case may be."*

[190]Article 11(9) provides that: *The provisions of this Article shall not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons.*

[191] This agreement was signed in Venice on 05 October 1989 and ratified in Italy with Law n. 20/2002. The bona fide clause is contained in Article 10(8) of the Convention.

[192] In this sense see: V. UCKMAR, G. CORASANITI, P. DE' CAPITANI DI VIMERCATE, *L' "abuso" del diritto e l'elusione fiscale internazionale*, in Manuale di diritto tributario internazionale, Cedam, 2009, p. 54.

[193] The words "rule shopping" does not denote an abuse of a subjective nature (as in treaty shopping), but denotes an abuse of objective nature, which comprises the structuring of transactions and activities so that a convention, otherwise not applicable, is applied (i.e. it is not applied a convention otherwise applicable). The tax planning in such cases is aimed at creating "artificially" a particular circumstances of production of income, in relation to which the convention provides that only one of the two states may exercise its exclusive right to levy tax. The tax advantage is, for example, the avoidance of application of withholding taxes in the state of the source that would otherwise have been levied, or in the benefit from of a double exemption and so on. In this sense see: C. GARBARINO, *Pianificazione Fiscale ed Elusione Internazionale*, in Manuale di tassazione internazionale, Wolters Kluwer Italia 2005, p. 758.

[194] In this sense see: M. LANG, *"2008 OECD Model: Conflicts of Qualification and. Double Non-Taxation"*, 63 Bulletin for International Taxation, 2009, p. 205.

state not to tax. So why should it make a difference whether the source state would be entitled to tax if that state had already decided not to tax domestically? If double non-taxation is legitimate where both states apply the same tax treaty rule, but the residence state is prevented from taxing under the treaty and the source state does not levy tax domestically, then it is difficult to understand why double non-taxation becomes illegitimate just because the source state would have applied a different tax treaty rule if it had to apply the treaty.

Italian inferior Court, in a case-law[195] relating financial cross-border operation carried out between an Italian Bank and an English Bank stated that the claimed operation didn't configure an abuse of domestic law under 37-bis of Presidential Decree 600/1973 because the exclusive goal of this operation was to benefit of a foreign tax credit without having the right. Also the Court stated that: "*the operation was complex and in breach with the bona fide duty that represent a cardinal principle in international lax, not only with reference to the interpretation. One of the purposes of the DTC is also to avoid tax evasion and tax avoidance. The problem of counteract this practices has been in mind of editors of "Convention Model", revealing itself in an evident way in a series of conventional rules designed to prevent the use of abusive practices. The specific anti-abuse rules, do not represent a limit of using general principle, other than the explicit cases contemplated, constituting instead a proof of the existence of a general principle that disapproves the behaviours aimed to reach an illegal benefit of a taxation scheme."*

OECD Commentary[196], with reference to anti-avoidance concept inherent tax treaties notes that:

"*The Committee on Fiscal Affairs continues to examine both the improper use of tax conventions and international tax evasion. The problem is referred to in the Commentaries on several Articles. In particular, Article 26, as clarified in the Commentary, enables States to exchange information to combat these abuses*."[197]

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[195] In this sense see Provincial Commission of Reggio Emilia, judgment n. 242.01.10 deposited on 29 November 2010.

[196] With reference to the Articles of the Model Tax Convention.

[197] In this sense see: Commentary on model tax convention (condensed version), OECD, 2010, p. 16.

Also OECD notes that "*Taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries' laws.*"[198]

The two fundamental questions[199] that are discussed in the paragraphs of Commentary are:

- whether the benefits of tax conventions must be granted when transactions that constitute an abuse of the provisions of these conventions are entered into (the related answer is in paragraphs 9.2 and following below); and

- whether specific provisions and jurisprudential rules of the domestic law of a Contracting State that are intended to prevent tax abuse conflict with tax conventions (the answer is in paragraphs 22 and following below).

The role of OECD Commentary with the purpose of interpreting bilateral convention in Italian jurisprudence is not defined. The Supreme Court judgment n. 7689/2001 stated its relevance and the following judgments n. 17609/2006 and 3889/2008 stated that OECD Commentary is only a soft law without a strong relevance in interpretation.

Italian Revenue Agency mentioned OECD Commentary in some tax rulings, i.e. in the Tax ruling 341/2008, where the taxpayer asked for the correct taxation of cross-border severance pay. Also in Guidance 58/2010 tax administration refer to OECD Transfer Pricing Guidelines.

Other domestic rule which have the aim to counteract harmful tax competition are the following:

- with the purpose to assess dividends from tax haven jurisdictions, in Article 47(4) and 89(3) of Presidential Decree 917/1986 is provided that, in absence of preventive tax ruling, the dividends that indirectly originate from tax haven will be taxed in Italy, without the exemption of 95%.

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[198] In this sense see: Commentary on model tax convention (condensed version), OECD, 2010, p. 59. In the following point OECD notes that: "*8. It is also important to note that the extension of double taxation conventions increases the risk of abuse by facilitating the use of artificial legal constructions aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in double taxation conventions.*"

[199] In this sense see: Commentary on model tax convention (condensed version), OECD, 2010, p. 60.

- Article 37(3)[200] of Presidential Decree 600/1973 that counteract the interposition[201] in possession of income; this rule can be applied when there is a presumptive[202] proof that the taxpayer is only a legal-owner and tax authority wants impute income to an other taxpayer[203].

-Article 73(5-bis and 5-ter) of Presidential Decree 917/1986 that counteract the "foreign dressed" companies, shifting the burden of proof to the taxpayer[204] if the shareholder of the company or the board of directors are mainly resident in Italy. Scholar notes [205] that it is an anti-evasive rule because the aim of this law is to avoid that holdings company are located in foreign country without having a real place of effective management abroad. In 2007 there were two judgments[206] with reference to Luxottica companies. The evident aim of the companies was to exploit improperly the German participation exemption regime attributing shares to German resident companies of the group. In this case Italian Revenue Agency

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[200] For an analysis of this Article see: V. UCKMAR, F.M. GIULIANI , *Interposition in Italian Taxation on Income and International Transactions*, in Intertax, 1994, at 440 et seq.

[201] The fictitious interposition of persons, which refers to a transaction between two parties carried out through the interposition of a third party ("straw man"). Altough the third party party formally acts in his own name, he actually acts on behalf of one of the paties, who remains unknown. In other words, the three parties agree that the transcaction will have consequences not for the straw man, but for the undisclosed party. This type of interposition is distinguishable from an "actual interposition" which occours when a person acts on behalf of another without disclosing the name of the principal, hence a form of agency. Since actual interposition is expressly recognized by the Italian tax laws, it is commonly acknowledged in the literature and in the case law that Article 37(3) of the ITAC applies only to fictitious interposition. In this sense see: C. ROMANO, *Advance Tax rulings and Principles of Law: Towards a European Tax rulings System?*, Vol. IV, IBFD Doctoral Series, 2002, p. 55. Scholar also notes that the concept of "benficial owner", in the meaning of OECD, would also allow the application of Article 37(3) to the "actual" interposition. In this sense see: C. GARBARINO, *Manuale di tassazione internazionale*, Wolters Kluwer Italia, 2005, p.752. For an analysis of the different kind of trust company in Italy see: *MARCHETTI F., RASI F., "Fiducia romanistica" e "Fiducia germanistica" nella recente prassi dell'Agenzia delle Entrate: la circolare n. 28/E del 2008*, in Fiscalitax n. 6/08 pagg. 795- 799.

[202] In this case presumption have to be serious, precise and concordant.

[203] Most scholars agree, however, that such a rule applies only in sham transactions where income actually owned by one person is disclosed as owned by another person. For example, in the case of an undisclosed distribution of profits, the profits appear as owned by the company but they are actually owned by the shareholders. Therefore, such a rule cannot be applied generally to closely held companies to attribute undistributed income to the shareholders. In this sense see: C. GALLI, *Italy - Corporate Taxation sec. 10.5*, in Country Analyses, IBFD.

[204] With reference to the presumptive fiscal residence in Italy.

[205] G. MELIS, *La residenza fiscale dei soggetti Ires e l'inversione dell'onere della prova di cui all'art. 73, commi 5-bis e 5-ter t.u.i.r.*, in Diritto e pratica tributaria internazionale, 2007, p. 876.

[206] Judgments 173.01.2007 and 174.01.2007 of the Commissione Tributaria Provinciale of Belluno. They are different only for the type of tax reassessed by the Agency.

grounded her assessment on a sort of substance over form approach[207] and the Judges agreed with the position of Italian tax authority.
In 2004 Italy has also introduced the participation exemption[208] regime with the aim to counteract this phenomenon and to avoid that the capital loss were located in Italy and capital gain abroad, with a double loss of tax revenue. The treaty shopping[209] is counteracting mainly with the look-through approach[210], which, in relation to dividends, interest and royalties, provides for the applicability of lower conventional withholding tax only if the subject who receives such income shall be the beneficial owner.
The Article 11(Interest) of the DTC in force between Italy and UK provides that:

(1) Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

(2) However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 per cent of the gross amount of the interest.

Italy also use the abstinence approach, even if Italy has signed the agreements against double taxation agreements with certain states, which are considered tax havens, tout court or in relation only to certain types of companies (i.e. United Arab Emirates[211]). Where tax-exempt (or nearly tax-exempt) companies may be distinguished by special legal characteristics, the improper use of tax treaties may

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[207] One of the proof was a mail of the Holding Tax Advisor Company to the legal representative. In that message it was suggested to have the shareholders assembly in Germany in order to limit the risk that the Italian tax authority could consider the company as resident in Italy. This fact, according to the Agency, is a clear evidence of the elusive scope pursued by the taxpayer, i.e. to avoid the taxation in Italy on dividends and capital gains.
[208] This regime is provided under Article 87 of Presidential Decree 917/1986. The capital gain that referring to participation classified as Financial fixed asset, under certain conditions, are exempt from income corporate tax for an amount of 95%. Capital loss relating to these participations are not deductable.
[209] With reference to the tax treaties clause.
[210] In this sense see, i.e., DTCs between: Italy and UK (1988); Italy and France (1989); Italy and Germany (1989); Italy and The Netherland (1990); Italy and Portugal (1980).
[211] The DTC between Italy and United Arab Emirates was made in Abu Dhabi on 22 January 1995 and ratified with Law n. 309 of 28 August 1997, later than the introduction of Law n. 413/1991 (anti tax haven law)!.
[211] Italy Luxembourg DTC was signed in Luxembourg on 03 June 1981 and was ratified with Law n. 747/1982.

be avoided by denying the tax treaty benefits to these companies; in this cases Italy uses the "exclusion approach" in some DTC.

The Article 1 of Protocol to Italy-Luxembourg DTC[212] entitled: "Holding companies and Articles 1,3 and 4," provides that:

This Convention shall not apply to holding companies resident in Luxembourg, which benefit from the special reliefs as laid down in the Law of 31 July 1929 and the Grand-Ducal Decree of 17 December 1938 (taken in pursuance of Article 1(7), paragraphs 1 and 2 of the Law of 27 December 1937) or in any other similar law entering into force after the signature of the Convention. It also does not apply to income which a resident of Italy receives from such companies or to shares or other forms of stock of such companies which that person owns.

In the Article 2 of the Protocol to DTC signed on 25 August 1999 between Italy and United States of America there is a LOB (limitation-on-benefit) clause that provides:

1. A resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by the Convention only to the extent provided in this Article.

2. A resident of a Contracting State shall be entitled to all the benefits of the Convention if the resident is:

(a) an individual;

(b) a qualified governmental entity;

(c) a company, if:

(i) all the shares in the class or classes of shares representing more than 50 percent of the voting power and value of the company are regularly traded on a recognized stock exchange, or

(ii) at least 50 percent of each class of share in the company is owned directly or indirectly by five or fewer companies entitled to benefits under clause (i), provided that in the case of indirect ownership, each intermediate owner is a person entitled to benefits of the Convention under this paragraph;

(d) described in subparagraph 5(a)(i) of Article 1 of this Protocol;

(e) described in subparagraph 5(a)(ii) of Article 1 of this Protocol, provided that more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State; or

(f) a person other than an individual, if:

(i) On at least half the days of the taxable year persons described in subparagraphs (a), (b), (c), (d) or (e) own, directly or indirectly (through a chain of ownership in which each person is entitled to benefits of the Convention under this paragraph), at least 50 percent of each class of shares or other beneficial interests in the person, and

(ii) less than 50 percent of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State (unless the payment is attributable to a permanent establishment situated in either State), in the form of payments that are deductible for income tax purposes in the person's State of residence.

4.3 The application of art 26 OECD MC in Italian tax law

The international standard for exchange of information envisages information exchange on request to the widest possible extent. Nevertheless it does not allow "fishing expeditions," i.e. speculative requests for information that have no apparent nexus to an open inquiry or investigation. The balance between these two competing considerations is captured in the standard of "foreseeable relevance" which is included in Article 26(1) of the OECD Model Taxation Convention set out below:

"The competent authorities of the contracting states shall exchange such information as is foreseeably relevant to the carrying out of the provisions this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the contracting states or their political subdivisions or local authorities in so far as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2."

Of the 85 treaties signed by Italy that are in force, the two signed with Cyprus and Malta include the wording "foreseeably relevant". However, of these

85 treaties, 80 refer to the exchange of information where it is “necessary”, referring to both application of the treaty and domestic laws. The phrase “as is necessary” is recognised in the commentary to Article 26 of the OECD Model Taxation Convention to allow for the same scope of exchange as does the term “foreseeably relevant”. The three remaining treaties in force are not to the standard. The treaties with Brazil, Malaysia and Switzerland only refer to “such information as is necessary for the carrying out of this Convention”.

For exchange of information to be effective it is necessary that a jurisdiction’s obligation to provide information is not restricted by the residence or nationality of the person to whom the information relates or by the residence or nationality of the person in possession or control of the information requested. For this reason the international standard for exchange of information envisages that exchange of information mechanisms will provide for exchange of information with respect to all persons.

Fifteen of Italy’s DTCs limit the application of the treaty to residents of the contracting parties: Brazil, Ireland, Ivory Coast, Japan, Kuwait, Malaysia, Morocco, Portugal, Singapore, Switzerland, Tanzania, Thailand, Trinidad & Tobago, United Kingdom, former USSR, former Yugoslavia, and Zambia.

These treaties cover 22 jurisdictions. With Ireland, Portugal, and the UK, Italy can exchange information under the term of the EU Mutual Assistance Directive which allows for exchange of information with respect to all persons. Exchange of information with respect to all persons will also be allowed with Azerbaijan when the OECD/COE Convention enters into force.

Jurisdictions cannot engage in effective exchange of information if they cannot exchange information held by financial institutions, and nominees or persons acting in an agency or a fiduciary capacity. Both the OECD Model Taxation Convention and the OECD Model TIEA, which are the authoritative sources of the standards, stipulate that bank secrecy cannot form the basis for declining a request to provide information and that a request for information cannot be declined solely because the information is held by nominees or persons acting in an agency or fiduciary capacity or because the information relates to an ownership interest. Apart from the recently treaties signed with Malta and Cyprus, none of

Italy's 85 DTCs in force includes the wording of Article 26(5) of the OECD Model Tax Convention. The Italian authorities have indicated that their DTC policy is to include the full text of Article 26 of the OECD Model Tax Convention in all new treaties negotiated, whether the purpose of the negotiations would be purely EOI or not. Thus, the most recent treaties signed but not yet in force with Libya and Panama as well as the Protocols to the treaties signed and not yet in force with Mauritius and Russia contain provisions the wording of which is consistent with Article 26(5) of the Model Tax Convention.[213] With reference to rights and safeguards of taxpayers and third parties under Article 26(3) see the paragraph 3.5.

The Italian definition of "fishing expeditions" was contained, *inter alia*, in Guidance n. 32/2006, with reference to financial investigation: "*It should be noted in conclusion that the operational guidelines just provided in particular with regard to the specific power can only be activated against trust company has the principal purpose of avoiding practice that fall under the so-called fishing expeditions, which are requests that are not rooted in the objective requirements of inquiry activities related to current investigation. These requests, since it does not meet the ratio legis that inspired the novel introduced by law, must be considered not properly justified and, as such, must be rejected by the competent authorities of granting authorization.* "

Regarding TIEAs, Italy is currently negotiating with several jurisdictions and has signed only one agreement[214]. That said, it is also Italy' policy to conclude TIEAs that are fully consistent with all requirements set forth in the OECD Model/G20-standard regarding TIEA and therefore containing provisions allowing for the exchange of information held by banks, nominees and any other person acting in an agency or a fiduciary capacity. Even in those cases where the Italian treaties currently in force do not contain specific provisions regarding the exchange of bank information, there are no restrictions in the Italian legislation as regards the

[213] This paragraph was adapted from: OECD (2011), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews*, OECD Publishing.

[214] This agreement was signed on 17 May 2011 but it isn't still ratified.

access of the revenue authorities to information held by banks. Therefore, insofar as neither Italy nor its partners suffer from limitations in accessing bank information, the absence of provisions in line with Article 26(5) of the OECD Model Tax Convention does not result in an agreement falling below the international standard. For some of Italy's partners which have domestic restrictions on access to bank information – Austria, Belgium, Luxemburg or Switzerland for example – the absence of provisions corresponding to Article 26(5) means that the exchange of all types of information is not possible. It is, in particular, of high importance for the Italian authorities to update the treaties with Austria, Belgium Luxemburg and Switzerland and to bring them to the standard by incorporating a wording consistent with Article 26(5) of the OECD Model Tax Convention. Italian authorities have advised the assessment team that negotiations to bring the existing DTCs to the standard are nearing finalisation with Belgium, Austria, and Luxemburg. there is no domestic tax interest requirement in Italy and the Italian authorities can access all types of information whether this information is needed for domestic or exchange of information purposes. Italy is able to exchange information, including in cases where the information is not publicly available or where it is not already in possession of the government authorities.
Lastly, the peer-review by OECD Global Forum was positive in any points.
OECD notes that: "*The Italian network of treaties to the standard currently allows exchange of information to take place with Italy's main diplomatic, economic and financial partners. In addition, there are no cases where Italy has refused to enter into negotiations or to conclude an EOI arrangement. While having a heavy negotiation program, Italy will in the future continue to monitor its request for negotiations*".[215]
We conclude that: Italy can recover the lost "rating", *inter alia*, counteracting tax havens, but the main goal shall be lowering taxes to will be more competitive.

[215] In this sense see: OECD (2011), Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Italy 2011: Combined: Phase 1 + Phase 2, Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews, cit, p. 75.

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Allocation of income between states

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Chapter I. General aspects of allocation of income

1. Introduction

In international tax law, the allocation of income between States is an important issue. In fact, income of taxpayer, without a specific treaty between States, may be taxed twice. The income is taxed in the origin State of tax payer and in the source State.

Such phenomenon is called double taxation. There are two forms of double taxation: juridical and economic.

The juridical double taxation is realized when the same income is taxed in two States (in the State of residence and in the State where the income is produced) within the same taxpayer. The economic taxation provides a taxation of income that refers to different subjects[1].

These effects, which are produced between States, influence the transnational business and, generally, the allocation of income (have a no-neutrality effects).

Firstly, for clear comprehension of double taxation and allocation of notions, it's necessary to analyze the general principles of taxation in the international tax lax. The income taxation in the State follows different rules.

In fact, in order to define the right to tax with respect to the tax subject, the person's residence or place of establishment (residence principle) and nationality (nationality principle) can function as connecting factors. These are also called the personal principles of jurisdiction to tax. With respect to the taxable item, the principle of origin of income (principle of origin) or the source (principle of source) is used to allocate the jurisdiction to tax.

The connecting factors described above offer a start point in order to determine the scope of the taxable jurisdiction. In this regard, the personal principles of the jurisdiction to tax (residence and nationality) are elaborated further through the principle of universality, which states that if a person resides

[1] See, C. GARBARINO, *Manuale di tassazione internazionale*, IPSOA, 2008, pp. 55-56.

or is established in a certain State he may be taxed in that State on both his domestic and foreign-source income, or on his world wide income.

Moreover, emigration taxes in particular use the connecting factor of moving the residence or place of establishment to another state[2].

Under the principle of origin, a state has the right to tax because the income has its origin in that state.

Under the principle of source, a State may tax because a certain source is located in that State. This does not necessary mean that the origin of the income is also in that State. When a dividend is paid, the shares (source) may be in a certain state (because the company is established there), but this does not mean that the profits (from which the dividend arises) have their origin in that same State[3].

Besides the principles described above and in order to avoid this problem OECD created a model against double taxation. This model is used by the States to sign the treaty against double taxation. The goal of this treaty is the elimination of fiscal discrimination because it could limit free trade between the States.

Moreover, OECD Model provides different rules for the allocation of income between States.

The first rule, which is of more interest for this subtopic, regards the immovable property taxation.

The Article 6 provides the following:

"*1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.*

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of

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[2] D. WEBER, *Tax avoidance and the EC treaty freedoms*, EUCOTAX, Kluwer lax international, 2005, p. 109.

[3] D. WEBER, *Tax avoidance and the EC treaty freedoms*, EUCOTAX, Kluwer lax international, 2005, p. 110.

immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.
3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.
4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise."

This article provides the application of the "source method". In fact, the income derived of immovable property shall be taxed in the state where the property is situated[4].

The second rule, for a clear exposition of principle of allocation of in income in OECD model, is labour income taxation.

Model tax convention between States includes labour taxation, which applies when taxpayer has the residency in a State and works in another State. According to OECD model, the labour income is taxed in State in which is produced.

It's important to report the definition of art. 15, called "*Income from employment*".

This article provides:
"*1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.*
2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and

[4]See V. UCKMAR, *Corso di diritto tributario internazionale*, Cedam, Padova, 2002, pp. 600-601.

b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
c) the remuneration is not borne by a permanent establishment which the employer has in the other State.
3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated."

With respect to the general rules of international taxation, this article provides the application of principle of residence when particular conditions occur.

The first condition regards a short period of employment in another State. The second is applied when the employer is not resident in the other State. This income, therefore, is taxed in worker's State of residency. The last condition provides the taxation in the worker's State of residence when the employer in that other State has not a permanent establishment[5]. The articles described below are examples of the allocation of income.

On the contrary, the income shall be taxable following the articles 23 A or 23 B.

In the OECD Model, in fact, these two articles provide the elimination of double taxation.

There are tree methods for elimination the double taxation. The first is exception method[6]. With the exception of one of the contracting States, according

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[5] The reasons of this disposition are explained in the second section.
[6] This article provides :
"*1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.*
2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10 and 11, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.
3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in

to OECD, model rules shall exempt the income taxed in the other State. The second is the deduction method[7]. OECD Model previsions, the State of income produced levies it and shall be applied, in the residence State of tax payer, a deduction equal to taxation of that other State.

The last method for elimination of double taxation is called credit[8]. In this case, the tax payer income is taxed in source State and the tax payer has a credit, equal to the amount of tax paid in that other State, that he applies in the State of residency. There are some differences between the credit method and exemption method. In both instances the States remove double taxation, but with exemption: the tax payer does not pay any tax in his State of residency for the same income derived in that other State, while with credit method the residence State gives to the tax payer a credit, an amount equal to the tax paid in that other State.

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calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.
4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income."

[7] See note 4.

[8] See art. 23 B:
"*1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:*
a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;
b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.
Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.
2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital."

2. Italian treaty against double taxation and respect the concept of allocation of income

After the analysis of methods for elimination of double taxation, in order to concept of allocation of income between states, it's necessary to focus the attention to the OECD Model's Italian application.

In OECD Model in Italian treaties the most important aspect is the application the principle of international tax law.

The first treaty at issue is an Italy-US treaty. This convention between Italy and the United States follows a general lines of OECD Model and US Model 1996 for elimination double taxation. In fact, there are different sections regulating tax profiles between contracting States. The first Tax Treaty was signed in 1985 by the same States[9] and it was modified in 1999 and 2000[10].

In order to fully understand of principles of international tax law, it's necessary to analyze the introduction in this treaty of the tax called IRAP. Such tax is provided in the Italian tax law and its basis is calculated on value of organization activity business[11]. For the elimination the double taxation, the provision includes the creditability in the United States of the Italian Regional Tax on Production Activities.

Besides this particular aspect of treaty, Art. 10 of Tax Treaty examined is very important. This rule provides a tax profile of permanent establishment. According to *Internal revenue code* of US, this Treaty authorizes US to the taxation of income derived by a permanent establishment in US. This taxation called "branch profits tax" (5%). On the contrary, in Italy there is not such fiscal treatment.

The last rule does not respect the principles of international tax law and general rules of OECD Model, founded on the correct allocation of income between States. This fiscal treatment in the US, which is more favorable in this

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[9] See A.A. ROSSI, L. PERIN, *La branch profits tax nel nuovo trattato Italia-USA*, in *Il Fisco*, n. 13, 2000, pp. 3550-3554.

[10] See R. DOMINICI, *La ratifica della convenzione Italia -Usa contro le doppie imposizioni: un decennio di innovazioni*, in *Fiscalità Internazionale*, n. 3, 2010, pp. 209-214.

[11] See decreto legislativo n. 446/1997.

respect, is not neutral and produces a negative effects for international transactions between businesses of contracting States.

Another example of the correct application of OECD Model principles is Italy-Giordania Tax Treaty[12]. This convention between the these States was signed in 2010 and produced its effects since 1th January 2011.

As the Italy-US Tax Treaty, the convention examined includes the Italian Regional Tax on Production Activities (IRAP). This Treaty respects a general profiles of OECD Model and the concept of allocation of income between States.

According to common procedural of Italian policy, the credit method against double taxation was adopted .

In conclusion, the tax treaty that Italy has contracted with Siria in 2007 should be analyzed. Connecting to Giordania Tax Treaty, this convention is a clear example of the balance between the application of the rules of OECD Model and the respect for the developing country[13]. In fact, the first annotation concerns the introduction, between tax treaty's object, the Italian tax on production activities (IRAP)[14]. In Syrian tax system there is each tax and to avoid the double taxation the tax treaty provides a credit method.

A second point regards the exemption of property tax. This convention concerns only income derived by business (e.i. limited liability society) or person.

The property is taxed in the State of production, according to the source principle and to fiscal domestic law[15].

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[12] See A. TURINA, *Applicabile dal 1° gennaio 2011 la convenzione Italia-Giordania in Fiscalità e commercio internazionale,* n. 2, 2011.

[13] N. AL NAJJARI, *La convenzione Italia - Siria per l'eliminazione delle doppie imposizioni: un'analisi*, in *Fiscalità Internazionale*, n. 1, 2009, pp. 37 e ss. affirms "*Per quanto riguarda le definizioni di stabile organizzazione non ci sono particolarità da segnalare in quanto la nozione recepita nel testo del trattato è in linea con il modello OCSE ed il termine breve di sei mesi per la configurabilità di una stabile organizzazione in caso di cantiere di costruzione o di montaggio, ovvero di progetto di installazione, è stato già previsto dall'Italia in numerosi altri accordi, Portogallo, Turchia Marocco.*"

[14] N. AL NAJJARI, *La convenzione Italia - Siria per l'eliminazione delle doppie imposizioni: un'analisi*, in *Fiscalità internazionale*, n. 1, 2009, pp. 37 e ss who tells "*Si ravvisa l'esclusione dell'imposizione patrimoniale, e l'inclusione tra le imposte considerate dell'IRAP. In Siria infatti, è prevista un'imposta addizionale destinata a sostenere i bilanci degli enti locali. Soddisfa pertanto la creditability, pur non avendo affrontato il problema della natura di imposta. Quella siriana, infatti è annoverata tra le imposte dirette, mentre l'Irap ha natura di imposta indiretta.*"

[15]N. AL NAJJARI, *La convenzione Italia - Siria per l'eliminazione delle doppie imposizioni: un'analisi*, in *Fiscalità internazionale*, n. 1, 2009, pp. 37 e ss "*Per quanto riguarda i redditi immobiliari, la convenzione, restando come detto esclusa l'applicazione a qualsiasi imposta di*

These particular elements help the development of transnational business with respect to concept of allocation of income.

The examples reported shows the Italian Tax Treaty policy, that is conformed to the international tax law principles described above.

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tipo patrimoniale, stabilisce che i redditi relativi ai beni immobili sono tassabili esclusivamente nello stato contraente ove essi sono realizzati, indipendentemente dalla residenza dell'effettivo beneficiario di essi."

Chapter II. Allocation of income between head offices and permanent establishment

1. Notion of permanent establishment in OECD Model

An important issue concerning the allocation of income regards the relationship between head offices and permanent establishment. In fact, this problem is most important if a company which is resident in State and has a business activity also in the other State.

This company can have a controlled company that is resident in the other State, in which is applied a domestic law. A company controlled is taxed in that State. Its profits is taxed in that State, while the dividends perceived by the first company are taxed in that State and, with exemption or credit method, are taxed in the residency State.

In the international tax law there is a second way. The company which has a business activity in the other State can have a permanent establishment. Such solution was introduced in OECD Model with art. 5[16].

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[16] "*1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*
2. The term "permanent establishment" includes especially:
a) a place of management;
b) a branch;
c) an office;
d) a factory;
e) a workshop, and
f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.
4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:
a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

In respect of the principle of source and worldwide taxation of income system, a permanent establishment was introduced in an OECD Model for resolution tax jurisdiction issues.

Art. 5 provides two forms of permanent establishment: material and personal[17]. The first section of this rule (1-4) describes the objective and subjective elements of material permanent establishment (basic rules). This article defines it as *a fixed place of business through which the business of an enterprise is wholly or partly carried on*.

A fixed place of business, which is situated in the other State, must carry an instrumental activities for enterprise resident in the first State. If this condition, named also power of disposition test or right of use test, is realized, Article 5 OECD[18] is applied. Another requirement of permanent establishment, which concerns a fixed place, is activities frequency of business in the other State. This notion can be defined also "permanence"[19].

Moreover, OECD Model provides that business which has an activity in the other State follows the fiscal principles of host country. This activity in the state which gives hospitality to permanent establishment must respect notion of business described in tax treaty signed between same States. Its activity must be instrumental[20] and essential for a business of enterprise resident in the first State.

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5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.
6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.
7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other."

[17] See G. FALSITTA, *Manuale di diritto tributario. Parte speciale,* Padova, pp. 579-580.

[18] See P. VALENTE, *Manuale di governante fiscale,* IPSOA, 2011, pp. 882-883.

[19] Compare with Commentary OECD, art. 5, par. 6.

[20] F. TUNDO, *Stabile organizzazione personale e determinazione del reddito secondo le recenti direttive OCSE*, in *Rass. Trib.,* n. 2, 2011, p. 305, "*L'ultima condizione che deve essere verificata al fine di poter parlare di stabile organizzazione materiale è la strumentalità della sede fissa di affari rispetto all'esercizio dell'attività di impresa [...]*."

These elements described configure a location test of fixed place.

An important element introduced by OECD is a duration concept for application of art. 5. In fact, the establishment has a place in the other State for a long and continuous period, in other terms, there is a permanent establishment if a business in a fixed place satisfies a permanent test.

Moreover, paragraph 2, art. 5 introduces particular situations in which are applied a permanent establishment rules, positive list[21].

On the contrary, paragraphs 3 and 4 describe limits of this taxation. In fact, there are factual conditions in which do not exist a permanent establishment, named negative list[22].

These paragraphs state:

"*4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:*

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

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[21] F. TUNDO, *Stabile organizzazione personale e determinazione del reddito secondo le recenti direttive OCSE*, *Rass. Trib.,* n. 2 del 2011, p. 305, who tells that: "*chiarisce che una sede d'affari può consistere in ogni tipo di edificio, strutture o installazioni utilizzate per lo svolgimento anche non esclusivo dell'attività di impresa. Occorre infatti specificare a quest'ultimo proposito che ai fini della configurabilità di una stabile organizzazione non è necessaria la presenza di personale ad essa stabilmente addetto. Lo stesso paragrafo 10 del Commentario afferma all'art. 5 che, al fine della configurabilità di una stabile organizzazione materiale, l'uso del personale può essere limitato alla fase dell'istallazione, alla manutenzione o al controllo.*"

[22] See a commentary of art. 5 OECD Model, par. 11 and P. VALENTE, cit, pp. 885-886; G. FALSITTA, cit., pp. 580-583. See P. MANDARINO, *I depositi e magazzini come strumento di pianificazione commerciale e fiscale internazionale: l'ombra della permanent establishment*, in *Dir. Comm. Intern.*, n. 2, 2010, p. 359.

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character."

The first part includes a smart period of business in the host country and it's a temporal limit for tax rule application.

The second part provides an objective conditions which do not fall into a permanent establishment category, for example a fixed place that don't carried on essential, instrumental and significant activity for the enterprise situated in the first State.

Another type of permanent establishment is personal. According to definition by OECD Model, a personal permanent establishment concerns *notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State.*

Connecting with a factors of material establishment, for this category they also are necessary two important conditions.

The agent, in fact, person or corporate[23], exercises in the other State in the name of the enterprise because its activities are instrumental and essential for a

[23] For more informations about notion personal of PE, see F. TUNDO, cit., p. 306, who talks: "*Per determinare il significato del termine "persona" cui la norma convenzionale fa riferimento (art. 5, par. 5) la più autorevole dottrina suggerisce di fare rinvio al disposto dell'art. 3 del modello di convenzione OCSE, contenente appunto la definizione di "person" ai fini convenzionali. A norma dell'art. 3 del Modello di Convenzione OCSE, il termine include "persone fisiche" (individuals), "società" (body corporates) ed "ogni altra associazione di persone" (any other body of persons). Lo stesso commentario (par. 32 e seguenti) specifica che il termine "persona" non è esaustivo, e deve essere interpretato in modo da includere nel concetto di "any other bodies of persons" qualsiasi associazione o ente, che "pur non avendo personalità giuridica è considerato persona giuridica ai fini dell'imposizione", ed è dunque considerato quale centro di imputazione autonomo. A tale categoria, anche la migliore dottrina riconosce un contenuto ampio, ricomprendendovi, in particolare, ed a titolo esemplificativo – vagliando le ipotesi presenti negli ordinamenti giuridici dei vari Stati membri aderenti all'OCSE – le "associazioni non riconosciute" (clubs that lack of legal capacity) ovvero "le società di persone" (parterships). Ciò che emerge palese da tale ricostruzione è la assoluta necessità che anche per la determinazione di "persona" ai fini convenzionali occorre che vi sia un substrato sostanziale definito e riconosciuto*

business of the same enterprise. Clearly, the agent is deemed a dependent subject of enterprise[24].

The second condition is the usual business element. In other terms, the agent dependent concludes some contracts in a fixed place[25] for a long and continuous period.

The commentary of art. 5 OECD gives a detailed indications about different relationship between dependent agent and independent agent. The last subject, who has independent activities in the other State without juridical and economic dependence with enterprise, is not deemed a permanent establishment. These elements define a notion of personal establishment[26].

2. Profits allocation

A precedent description is focused on basis elements of permanent establishment. Actually, it is most important to analyze relevant issues about the allocation of income between States. In fact, OECD Model describes the

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dall'ordinamento giuridico nel quale opera, anche se non necessariamente mediante la formale attribuzione di personalità giuridica."

[24] See paragraphs 32-33 of Commentary OECD Model. M. PIAZZA, *La presunzione di stabile organizzazione "personale" nel contratto di agenzia*, in *Fiscalità e commercio internazionale*, n. 11, 2011 "*Come si desume dal par. 32 del Commentario all'art. 5 del modello OCSE, sarebbe di ostacolo alle relazioni economiche internazionali una previsione che consideri stabile organizzazione ogni persona che non goda di uno status indipendente e che agisca per conto di un'impresa non residente. Pertanto, la presunzione deve operare solo nei confronti dei soggetti che, in relazione ai propri poteri e alla natura dell'attività svolta, rappresentino una significativa presenza dell'impresa estera nell'economia dello Stato. Per questo il paragrafo 5 dell'art. 5 del modello OCSE presume che un agente "dipendente" costituisca stabile organizzazione dell'impresa estera solo se abbia il potere di concludere contratti a nome della stessa. L'individuazione dei casi in cui l'agente ha il potere di concludere contratti a nome dell'impresa è oggetto di notevole dibattito soprattutto a livello internazionale. Il punto 32.1 del Commentario all'art. 5 precisa che la frase "potere di concludere contratti a nome dell'impresa" non va interpretata letteralmente; il paragrafo 5 dell'art. 5 si applica anche agli agenti che concludono contratti vincolanti per l'impresa anche se essi non sono formalizzati a nome dell'impresa.*"

[25] In this case, a fixed place shall be not necessary for personal permanent establishment. See M. PIAZZA, *La presunzione di stabile organizzazione "personale" nel contratto di agenzia*, in *Fiscalità e commercio internazionale*, n. 11, 2011 "*La stabile organizzazione personale, quindi, può esistere anche quando l'impresa estera non disponga di una sede fissa d'affari (stabile organizzazione cosiddetta "materiale") nel territorio dello Stato, ma si avvalga di un intermediario che agisca per suo conto.*"

[26] See paragraph 38 of Commentary OECD Model.

attribution of profits in the permanent establishment to avoid the double taxation. OECD Model provides these fiscal profiles in the art. 7[27].

The first paragraph concerns the profits localization in the contracting States and their distribution for taxation. According to OECD definition, if enterprise exercises an activity through a permanent establishment in the other State, the profits derived by such business is taxed in same State, applying a credit or exemption method. On the contrary, when the enterprise carried on business without permanent establishment is not taxed in that State.

In other terms, the phrase ―profits of an enterprise in Article 7(1) should not be interpreted as affecting the determination of the quantum of the profits that are to be attributed to the PE, other than providing specific confirmation that the right to tax does not extend to profits that the enterprise may derive from that State otherwise than through the permanent establishment (*i.e.* there should be no ―force of attraction principle). Profits may therefore be attributed to a permanent establishment even though the enterprise as a whole has never made profits. Conversely, Article 7 may result in no profits being attributed to a permanent establishment even though the enterprise as a whole has made profits[28].

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[27] This article provides that: "*1. Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.*
2. For the purposes of this Article and Article [23 A] [23B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.
3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.
4. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article."
[28] See *Report on the attribution of profits to permanent establishments*, OECD, 2010, pp. 12-13.

Instead, the second paragraph of art. 7, describes basis calculation of income. For taxation of profits OECD gives detailed instructions that must report in convention for elimination of double taxation.

In accordance with art. 7, par. 2, profits is calculated through a functionally separate entity approach. The authorized OECD approach is that the profits to be attributed to a PE are the profits that the PE would have earned at arm‘s length, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise[29]. In particular, there are two steps that it's necessary to follow.

The first is a functional and factual analysis. With this operation there is an attribution of dealings and transactions acting by permanent establishment in the name of enterprise in the other State. Another elements which they belong to the first step, are economic ownership of assets[30]. For basis calculation of profits, in fact, it needs to indentify all activities that has a permanent establishment, for example the attribution of capital based on the assets and risks attributed to the PE. Moreover, this step provides a negative elements of income as risks and all costs derived by its business.

The second step, introduced with reform of art. 7, OECD Model, in 2008, concerns the profits computation with arm's length principle and recognized dealings, in accordance with Guidelines of Transfer pricing, OECD Model, 2010. In fact, if the profits taxation follows the functionally separate entity approach, the permanent establishment is said a legal fiction, as if it were a company, and is applied the transfer price rules proposed by OECD. The pricing on an arm‘s length basis of recognized dealings through:

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[29] See *Report on the attribution of profits to permanent establishments*, OECD, 2010, p. 15; see a commentary of art. 7, par.2, OECD, P. VALENTE, cit. pp. 897- 899.

[30] See *Report on the attribution of profits to permanent establishments*, OECD, 2010, pp. 15-16 "*As used in this Report, the ―economic‖ ownership of assets in the Article 7 context means the equivalent of ownership for income tax purposes by a separate enterprise, with the attendant benefits and burdens (e.g. the right to the income attributable to the ownership of the asset, such as royalties; the right to depreciate a depreciable asset; and the potential exposure to gains or losses from the appreciation or depreciation of the asset).*"

- The determination of comparability between the dealings and uncontrolled transactions, established by applying the Guidelines‘ comparability factors directly (characteristics of property or services, economic circumstances and business strategies) or by analogy (functional analysis, contractual terms) in light of the particular factual circumstances of the PE; and
- Selecting and applying by analogy to the guidance in the Guidelines the most appropriate method to the circumstances of the case to arrive at an arm‘s length compensation for the dealings between the PE and the rest of the enterprise, taking into account the functions performed by and the assets and risks attributed to the PE[31].

2.1. US Model and a Branch profits tax

A relevant issue about a permanent establishment in the international tax law is a branch profits tax. This taxation ignores the principles of OECD described in paragraphs 1 and 2. In fact, a State that applies a branch profits tax provides a taxation of permanent establishment profits which has a business in the name of enterprise resident in the other state. Such tax profile results in the restriction of worldwide taxation of income system, in accordance with a principles explained in OECD model.

The phenomenon analyzed does not remove a double taxation. A significant example of branch profits tax is contained in US Model. In the art. 10, US Model against double taxation, a tax of PE’s profits is authorized[32]. This taxation follows a domestic tax law, in particular an internal revenue code of US.

[31] See *Report on the attribution of profits to permanent establishments*, OECD, 2010, p. 22.

[32] A paragraph of art. 10 tells that: “*6. Una persona giuridica che e' residente di uno degli Stati ed ha una stabile organizzazione nell'altro Stato o che e' assoggettata ad imposizione nell'altro Stato su base netta sui propri redditi che sono imponibili nell'altro Stato ai sensi dell'articolo 6 (Redditi immobiliari) o ai sensi del paragrafo 1 dell'articolo 13 (Utili di capitale) può essere assoggettata in detto altro Stato ad un'imposta aggiuntiva rispetto alle imposte previste dalle altre disposizioni della presente Convenzione. Detta imposta, tuttavia, può essere applicata solamente alla parte degli utili d'impresa della persona giuridica attribuibili alla stabile organizzazione, ed alla parte di reddito di cui alla frase precedente che e' soggetta ad imposta ai sensi dell'articolo 6 (Redditi immobiliari) o ai sensi del paragrafo 1 dell'articolo 13 (Utili di capitale), che, per quanto riguarda l'Italia, e' costituita da un importo analogo all'ammontare equivalente dei dividendi e, per quanto riguarda gli Stati Uniti, è costituita dall'ammontare equivalente dei dividendi di tali utili o redditi.*

Such levy is an additional tax. In other terms, the States contracting regulate the double taxation and provide in this tax convention a branch profits tax only in favor of US, one of state contracting[33].

3. Notion of permanent establishment according with the Italian tax law

For this subtopic, it's most important a concept of permanent establishment in Italian tax law. This notion was introduced by legge n. 344/2003, with reformation of unit text of income tax. In particular, a permanent establishment is contained by a lot of norms of aforesaid. The first rule and the most relevant is art. 162[34].

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7. L'imposta di cui al paragrafo 6 non può essere applicata con un'aliquota eccedente l'aliquota indicata al paragrafo 2 (a)."

[33] See A.A. ROSSI, L. PERIN, *La branch profits tax nel nuovo trattato Italia-USA*, in *Il Fisco*, n. 13, 2000, pp. 3550-3554. R. DOMINICI, *La ratifica della convenzione Italia -Usa contro le doppie imposizioni: un decennio di innovazioni*, in *Fiscalità Internazionale*, n. 3, 2010, pp. 209-214.

[34] Art. 162. - Stabile organizzazione:

"*1. Fermo restando quanto previsto dall'articolo 169, ai fini delle imposte sui redditi e dell'imposta regionale sulle attività produttive di cui al decreto legislativo 15 dicembre 1997, n. 446, l'espressione «stabile organizzazione» designa una sede fissa di affari per mezzo della quale l'impresa non residente esercita in tutto o in parte la sua attività sul territorio dello Stato.*

2. L'espressione «stabile organizzazione» comprende in particolare:

a) una sede di direzione;

b) una succursale;

c) un ufficio;

d) un'officina;

e) un laboratorio;

f) una miniera, un giacimento petrolifero o di gas naturale, una cava o altro luogo di estrazione di risorse naturali, anche in zone situate al di fuori delle acque territoriali in cui, in conformità al diritto internazionale consuetudinario ed alla legislazione nazionale relativa all'esplorazione ed allo sfruttamento di risorse naturali, lo Stato può esercitare diritti relativi al fondo del mare, al suo sottosuolo ed alle risorse naturali.

3. Un cantiere di costruzione o di montaggio o di installazione, ovvero l'esercizio di attività di supervisione ad esso connesse, è considerato «stabile organizzazione» soltanto se tale cantiere, progetto o attività abbia una durata superiore a tre mesi.

4. Una sede fissa di affari non è, comunque, considerata stabile organizzazione se:

a) viene utilizzata una installazione ai soli fini di deposito, di esposizione o di consegna di beni o merci appartenenti all'impresa;

b) i beni o le merci appartenenti all'impresa sono immagazzinati ai soli fini di deposito, di esposizione o di consegna;

c) i beni o le merci appartenenti all'impresa sono immagazzinati ai soli fini della trasformazione da parte di un'altra impresa;

Such present disposition follows general principles contained in the articles. 5 and 7, OECD Model[35]. In fact, in the first part, a material permanent establishment is introduced, including a "positive list". This positive list clearly reports different fixed place which is established in Italian State. Art. 162 TUIR is in accordance with a principle of source income and a general worldwide taxation income of system. This concept respects the notion of allocation of income between States. The second part, on the contrary, concerns a personal permanent establishment. The second paragraph describes a dependent agent who has an activity in Italian State in the name of enterprise resident in the other State.

This taxation respects the guidelines distributed by OECD Model, in 2010, with Reports of attribution profits in Permanent establishment. In the Italian tax

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d) una sede fissa di affari è utilizzata ai soli fini di acquistare beni o merci o di raccogliere informazioni per l'impresa;

e) viene utilizzata ai soli fini di svolgere, per l'impresa, qualsiasi altra attività che abbia carattere preparatorio o ausiliario;

f) viene utilizzata ai soli fini dell'esercizio combinato delle attività menzionate nelle lettere da a) ad e), purché l'attività della sede fissa nel suo insieme, quale risulta da tale combinazione, abbia carattere preparatorio o ausiliario.

5. Oltre a quanto previsto dal comma 4 non costituisce di per sé stabile organizzazione la disponibilità a qualsiasi titolo di elaboratori elettronici e relativi impianti ausiliari che consentano la raccolta e la trasmissione di dati ed informazioni finalizzati alla vendita di beni e servizi.

6. Nonostante le disposizioni dei commi precedenti e salvo quanto previsto dal comma 7, costituisce una stabile organizzazione dell'impresa di cui al comma 1 il soggetto, residente o non residente, che nel territorio dello Stato abitualmente conclude in nome dell'impresa stessa contratti diversi da quelli di acquisto di beni.

7. Non costituisce stabile organizzazione dell'impresa non residente il solo fatto che essa eserciti nel territorio dello Stato la propria attività per mezzo di un mediatore, di un commissionario generale, o di ogni altro intermediario che goda di uno status indipendente, a condizione che dette persone agiscano nell'ambito della loro ordinaria attività.

8. Nonostante quanto previsto dal comma precedente, non costituisce stabile organizzazione dell'impresa il solo fatto che la stessa eserciti nel territorio dello Stato la propria attività per mezzo di un raccomandatario marittimo di cui alla legge 4 aprile 1977, n. 135, o di un mediatore marittimo di cui alla legge 12 marzo 1968, n. 478, che abbia i poteri per la gestione commerciale o operativa delle navi dell'impresa, anche in via continuativa.

9. Il fatto che un'impresa non residente con o senza stabile organizzazione nel territorio dello Stato controlli un'impresa residente, ne sia controllata, o che entrambe le imprese siano controllate da un terzo soggetto esercente o no attività d'impresa non costituisce di per sé motivo sufficiente per considerare una qualsiasi di dette imprese una stabile organizzazione dell'altra."

[35] G. FALSITTA, cit., p. 580; S. MENCARELLI, G. TINELLI, *Lineamenti giuridici dell'imposta sul reddito delle persone fisiche*, Torino, 2007, p. 43-45; P. VALENTE, cit., pp. 878-879.

law, in fact, there is not a tax restriction or discrimination and it is not provided a branch profits tax, while other States have introduced it.

This norm also puts in a negative list that provides taxation exclusion of fixed places in the Italian State without objective and subjective elements of permanent establishment.

Moreover, in this subtopic, it is necessary to analyze particular forms of PE. Art. 162 TUIR has introduced some limits for the application of PE Taxation about a building site and construction. In this hypothesis, Art. 162 TUIR deems such subject as a permanent establishment if lasts more than three months, while the OECD Model provides that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

The second exception of PE's notion regards a taxation of "e-commerce". A paragraph 5 of art. 162 can be deemed a permanent establishment if through a website or another electronic instruments carries on business of enterprise resident in that other State[36].

Besides the precedent provisions, there is art. 23 TUIR[37]. This rule is referred a worldwide taxation of income system. In other terms, the income derived in the

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[36] See A.M. PROTO, *Considerazioni in tema di applicabilità delle nozioni tradizionali di residenza e stabile organizzazione alle nuove realtà telematiche,* in *Riv. Dir. Fin*., n. 3, 2005, p. 352.

[37] "*1. Ai fini dell'applicazione dell'imposta nei confronti dei non residenti si considerano prodotti nel territorio dello Stato:*

a) i redditi fondiari;

b) i redditi di capitale corrisposti dallo Stato, da soggetti residenti nel territorio dello Stato o da stabili organizzazioni nel territorio stesso di soggetti non residenti, con esclusione degli interessi e altri proventi derivanti da depositi e conti correnti bancari e postali;

c) i redditi di lavoro dipendente prestato nel territorio dello Stato, compresi i redditi assimilati a quelli di lavoro dipendente di cui alle lettere a) e b) del comma 1 dell'articolo 50;

d) i redditi di lavoro autonomo derivanti da attività esercitate nel territorio dello Stato;

e) i redditi d'impresa derivanti da attività esercitate nel territorio dello Stato mediante stabili organizzazioni;

f) i redditi diversi derivanti da attività svolte nel territorio dello Stato e da beni che si trovano nel territorio stesso, nonché le plusvalenze derivanti dalla cessione a titolo oneroso di partecipazioni in società residenti, con esclusione:

1) delle plusvalenze di cui alla lettera c-bis) del comma 1, dell'articolo 67, derivanti da cessione a titolo oneroso di partecipazioni in società residenti negoziate in mercati regolamentati, ovunque detenute;

2) delle plusvalenze di cui alla lettera c-ter) del medesimo articolo derivanti da cessione a titolo oneroso ovvero da rimborso di titoli non rappresentativi di merci e di certificati di massa negoziati in mercati regolamentati, nonché da cessione o da prelievo di valute estere rivenienti da depositi e conti correnti;

other State is taxed in the resident State of taxpayer. For elimination a double taxation when there is not a particular tax treaty between same States, a tax subject can have a tax credit, according with art. 165 TUIR[38].

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3) dei redditi di cui alle lettere c-quater) e c-quinquies) del medesimo articolo derivanti da contratti conclusi, anche attraverso l'intervento d'intermediari, in mercati regolamentati;
g) i redditi di cui agli articoli 5, 115 e 116 imputabili a soci, associati o partecipanti non residenti.
2. Indipendentemente dalle condizioni di cui alle lettere c), d), e) e f) del comma 1 si considerano prodotti nel territorio dello Stato, se corrisposti dallo Stato, da soggetti residenti nel territorio dello Stato o da stabili organizzazioni nel territorio stesso di soggetti non residenti:
a) le pensioni, gli assegni ad esse assimilati e le indennità di fine rapporto di cui alle lettere a), c), d), e) e f) del comma 1 dell'articolo 17;
b) i redditi assimilati a quelli di lavoro dipendente di cui alle lettere
c), c-bis), f), h), h-bis), i) e l) del comma 1 dell'articolo 50;
c) i compensi per l'utilizzazione di opere dell'ingegno, di brevetti industriali e di marchi di impresa nonché di processi, formule e informazioni relativi ad esperienze acquisite nel campo industriale, commerciale o scientifico;
d) i compensi corrisposti da imprese, società o enti non residenti per prestazioni artistiche o professionali effettuate per loro conto nel territorio dello Stato."

[38] "*1. Se alla formazione del reddito complessivo concorrono redditi prodotti all'estero, le imposte ivi pagate a titolo definitivo su tali redditi sono ammesse in detrazione dall'imposta netta dovuta fino alla concorrenza della quota d'imposta corrispondente al rapporto tra i redditi prodotti all'estero ed il reddito complessivo al netto delle perdite di precedenti periodi d'imposta ammesse in diminuzione.*
2. I redditi si considerano prodotti all'estero sulla base di criteri reciproci a quelli previsti dall'articolo 23 per individuare quelli prodotti nel territorio dello Stato.
3. Se concorrono redditi prodotti in più Stati esteri, la detrazione si applica separatamente per ciascuno Stato.
4. La detrazione di cui al comma 1 deve essere calcolata nella dichiarazione relativa al periodo d'imposta cui appartiene il reddito prodotto all'estero al quale si riferisce l'imposta di cui allo stesso comma 1, a condizione che il pagamento a titolo definitivo avvenga prima della sua presentazione. Nel caso in cui il pagamento a titolo definitivo avvenga successivamente si applica quanto previsto dal comma 7.
5. Per i redditi d'impresa prodotti all'estero mediante stabile organizzazione o da società controllate di cui alla sezione III del capo II del Titolo II, la detrazione può essere calcolata dall'imposta del periodo di competenza anche se il pagamento a titolo definitivo avviene entro il termine di presentazione della dichiarazione relativa al primo periodo d'imposta successivo. L'esercizio della facoltà di cui al periodo precedente è condizionato all'indicazione, nelle dichiarazioni dei redditi, delle imposte estere detratte per le quali ancora non è avvenuto il pagamento a titolo definitivo.
6. Nel caso di reddito d'impresa prodotto, da imprese residenti, nello stesso Paese estero, l'imposta estera ivi pagata a titolo definitivo su tale reddito eccedente la quota d'imposta italiana relativa al medesimo reddito estero, costituisce un credito d'imposta fino a concorrenza della eccedenza della quota d'imposta italiana rispetto a quella estera pagata a titolo definitivo in relazione allo stesso reddito estero, verificatasi negli esercizi precedenti fino all'ottavo. Nel caso in cui negli esercizi precedenti non si sia verificata tale eccedenza, l'eccedenza dell'imposta estera può essere riportata a nuovo fino all'ottavo esercizio successivo ed essere utilizzata quale credito d'imposta nel caso in cui si produca l'eccedenza della quota di imposta italiana rispetto a quella estera relativa allo stesso reddito di cui al primo periodo del presente comma. Le disposizioni di cui al presente comma relative al riporto in avanti e all'indietro dell'eccedenza si applicano anche ai redditi d'impresa prodotti all'estero dalle singole società partecipanti al consolidato nazionale e mondiale, anche se residenti nello stesso paese, salvo quanto previsto dall'articolo 136, comma 6.
7. Se l'imposta dovuta in Italia per il periodo d'imposta nel quale il reddito estero ha concorso a formare l'imponibile è stata già liquidata, si procede a nuova liquidazione tenendo conto anche

In conclusion, according the concept of the elimination of double taxation provided in the articles 23 (A) and 23 (B) OECD that describe different method, in the Italian tax law, the art. 165 gives to the permanent establishment which has an activity in the other State a tax credit.

3.1. Italian Case law

The sentence of *Corte di Cassazione* n. 7682/2002 gives an important interpretation of permanent establishment, applying concept of art. 5, OECD Model[39] and art. 162 TUIR. Philip Morris had a business relationship with an auxiliary organization in Italian State. Following the principle of the international tax law, an auxiliary activity practiced in Italian State is not taxed in this State because isn't considered as a fixed placed or a dependent agent. On the contrary, the Italian Supreme judge has though that a supervisor and control activity on contracting activity of Italian subject is a non auxiliary function. So, a business activity exercised by Italian subject in the name of enterprise resident in the other State (Philip Morris) is deemed as Permanent establishment. Such judgment represents a correct lecture of principle of permanent establishment.

Another important case is n. 16106/2011. A limited liability company resident in Italian State had a business activity connected with an enterprise resident in the other State. There was a royalty's transaction from Limited Liability Company to such enterprise and other similar operations. This shows juridical and economic dependence of LLC towards the enterprise. According a PE's notion, a different

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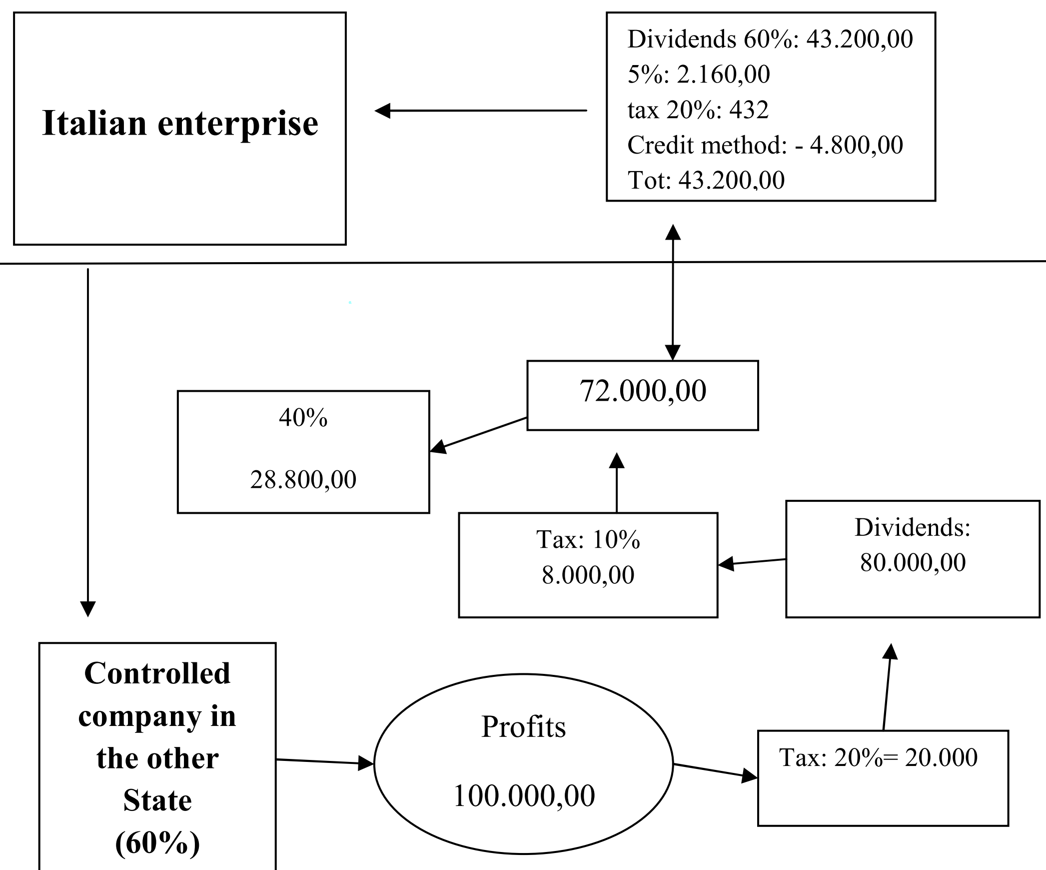
dell'eventuale maggior reddito estero, e la detrazione si opera dall'imposta dovuta per il periodo d'imposta cui si riferisce la dichiarazione nella quale è stata richiesta. Se è già decorso il termine per l'accertamento, la detrazione è limitata alla quota dell'imposta estera proporzionale all'ammontare del reddito prodotto all'estero acquisito a tassazione in Italia.
8. La detrazione non spetta in caso di omessa presentazione della dichiarazione o di omessa indicazione dei redditi prodotti all'estero nella dichiarazione presentata.
9. Per le imposte pagate all'estero dalle società, associazioni e imprese di cui all'articolo 5 e dalle società che hanno esercitato l'opzione di cui agli articoli 115 e 116 la detrazione spetta ai singoli soci nella proporzione ivi stabilita.
10. Nel caso in cui il reddito prodotto all'estero concorra parzialmente alla formazione del reddito complessivo, anche l'imposta estera va ridotta in misura corrispondente."
[3939] Italian Judge has considered correct the application of notions into Commentary of OECD Model. See Sentence Cassazione Civile n. 3889/2008 commented by M. CERRATO, *La rilevanza del Commentario OCSE ai fini interpretativi: analisi critica dei più recenti indirizzi giurisprudenziali*, in *Riv. Dir. Trib.*, n. 1, 2009, pp. 11 ss.

income basis has been calculated and this company is considered as a permanent establishment[40].

4. **Taxation examples**

First Hypotesis

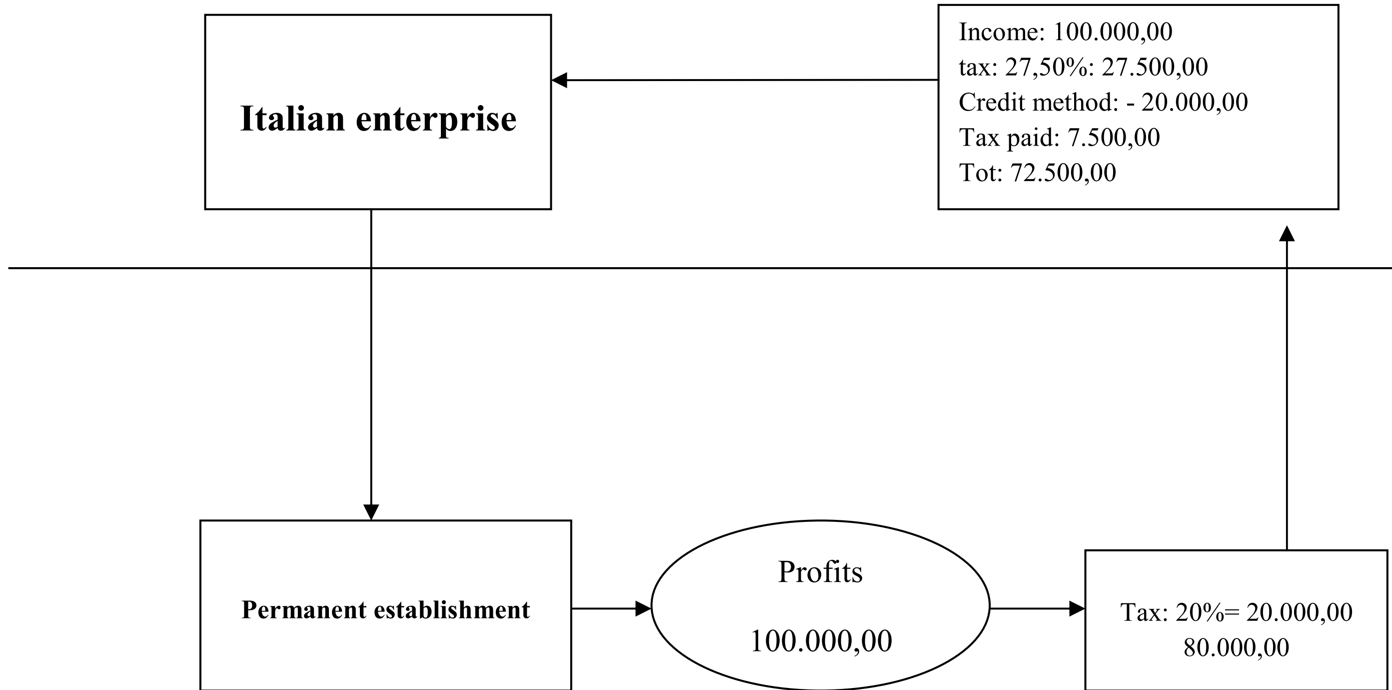
Company group



[40] See also jugdment n. 20597/2011, commented by P. VALENTE, *La stabile organizzazione nelle disposizioni interne e convenzionali e nella sentenza della Corte di Cassazione n. 20597/2011*, in *Il Fisco*, n. 42, 2011, pp. 6831-6840.

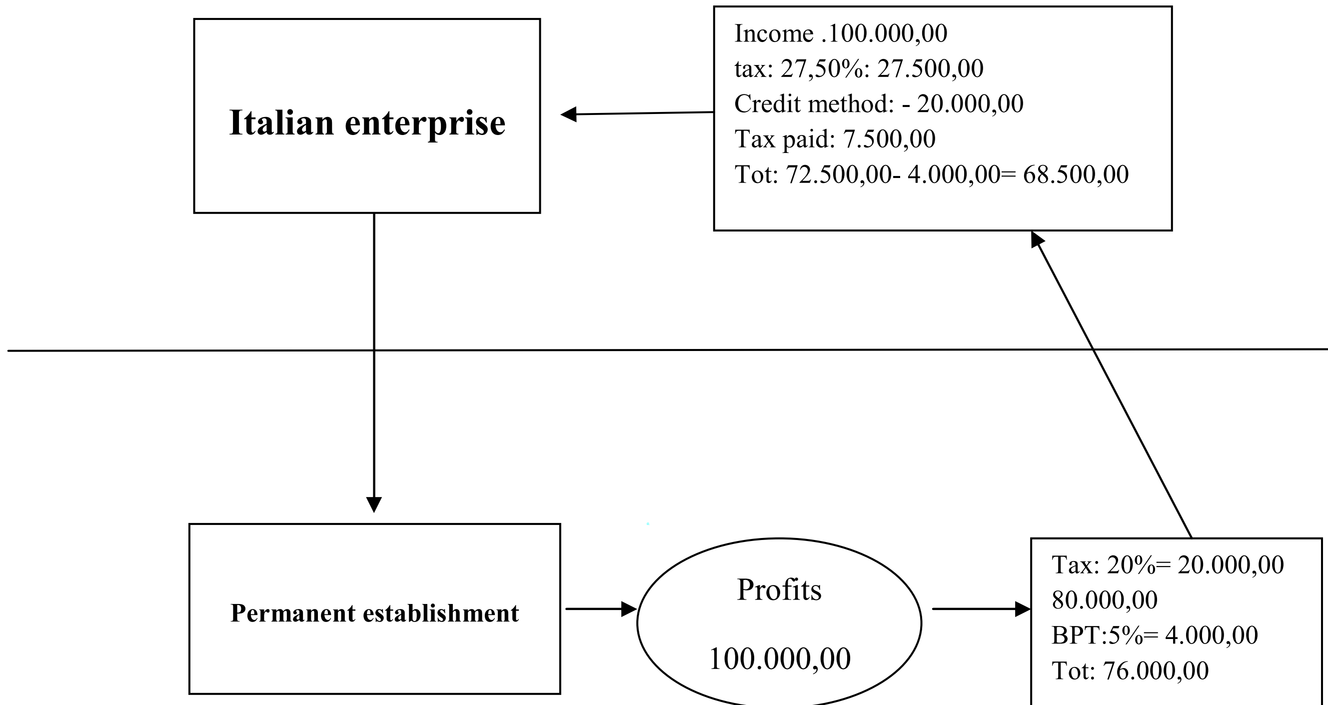
Second Hypothesis

Permanent Establishment



Third Hypothesis

Permanent establishment with Branch profits Tax (BPT)



Chapter III. Transfer pricing in the international tax law

1. Introduction

Pursuing its analysis on the allocation of income in international tax law, it is necessary to consider on the transfer pricing policy. In fact, according with elimination of double taxation principles, the international authority (OECD) has proposed general rules, which are adopted by almost all member States of OECD, on the distribution and, subsequent taxation, of profits between subsidiaries or affiliates[41].

The regulation of such tax mechanism is provided by the art. 9 OECD Model[42]. The first paragraph introduces subjective and objective elements for its application. regarding the subjective requirement of Article refers to subsidiaries or related residents in two different States.

The second element, objective, concerns, however, the taxation profits which would have accrued, but have not been, if the two companies had acted in an independent or unrelated control[43]. Indeed, as mentioned before, in a group of

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[41] See E. DELLA VALLE, *Il transfer price nel sistema di imposizione sul reddito,* in *Riv. Dir. Trib.*, 2009, n. 2, p. 133, who states: "*Con le espressioni transfer price e transfer pricing si fa riferimento al corrispettivo dello scambio di beni e servizi tra aziende divise della stessa impresa ovvero tra società appartenenti allo stesso gruppo, che si tratti o meno, rispettivamente di impresa con attività transnazionale o di gruppo multinazionale. La prima espressione pone l'accento sul profilo statico del fenomeno, la seconda sul profilo dinamico del procedimento volto a prezzare lo scambio in questione; devono comunque ritenersi equivalenti qui sono utilizzate indifferentemente.*"

[42] This article tells as follows:

"*1. Where*

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other."

[43] See P. Valente, *Convenzioni internazionali contro la doppia imposizione, IPSOA, 2008, p. 413.*

companies, a company may carry out transactions with another of group with prices different from those in the market to reduce taxes owed in a State[44].

The explained method is called a separate and independent entity approach, without control juridical and economic rapport[45]. For this reason the second purpose of the paragraph mentioned, is the elimination of tax avoidance[46].

In particular OECD Model has introduced, to calculating a tax basis of enterprise for dealings between related parties, the arm's length principle.

2. The arm's length principle

It is introduced an arm's length principle to discipline the dealings acted between companies of same group. In particular, a clear notion is given by commentary of paragraph 1 of art. 9 OECD Model. In fact, it tells as follows:
"*No re-writing of the accounts of associated enterprises is authorized if the transactions between such enterprises have taken place on normal open market commercial terms (on an arm's length basis).*"[47].

When it results that there are transactions between multinational enterprises with a higher price to give a higher cost to one of companies of the same group, can apply the above principle. In other terms, this instrument has created for elimination a tax avoidance in the State where has a residence one of company group.

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[44] The Commentary on art. 9 OECD Model states:
"*This paragraph provides that the taxation authorities of a contracting State my, for the purpose of calculating tax liabilities of associated enterprises, re-write accounts of the enterprises if, as a result of the special relations between the enterprises, the do not show the true taxable profits arising in that State.*"

[45] See the first part about the permanent establishment OECD's rules.

[46] E. DELLA VALLE, cit., who affirms that: "*Con le espressioni transfer price e transfer pricing si fa riferimento al corrispettivo dello scambio di beni e servizi tra aziende divise della stessa impresa ovvero tra società appartenenti allo stesso gruppo, che si tratti o meno, rispettivamente di impresa con attività transnazionale o di gruppo multinazionale. La prima espressione pone l'accento sul profilo statico del fenomeno, la seconda sul profilo dinamico del procedimento volto a prezzare lo scambio in questione; devono comunque ritenersi equivalenti qui sono utilizzate indifferentemente.*"

[47] See also the arm's length notion in the *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 23.

Moreover the principle analyzed can be found also in art. 11, par. 6, OECD Model, named *Interest*[48], and art. 12, par. 4[49], for resolving the income allocation between States and the elimination of the double taxation, as it happens for art. 9[50].

Therefore, there are several reasons why OECD member countries and other countries have adopted the arm's length principle. A major reason is that the arm's length principle provides broad parity of tax treatment for members of MNE groups and independent enterprises. Because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity. In so removing these tax considerations from economic decisions, the arm's length principle promotes the growth of international trade and investment[51].

The arm's length principle has also been found to work effectively in the vast majority of cases. For example, there are many cases involving the purchase and sale of commodities and the lending of money where an arm's length price may readily be found in a comparable transaction undertaken by comparable

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[48] This paragraph provides that:
"*6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.*"

[49] This section affirms that:
"*4. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.*"

[50] See also A. DRAGONETTI, V. PIACENTINI, A. SFONDRINI, *Manuale di fiscalità internazionale*, IPSOA, 2008, p. 89.

[51] A. STORCK, *The Financing of Multinational Companies and Taxes: An Overview of the Issues and Suggestions for Solutions and Improvements*, in *Bulletin for International Taxation*, 2011, p. 28 et seq. who tells that: "*Some 15 years ago, the OECD Member countries reconfirmed in the revision of the Transfer Pricing Guidelines the arm's length principle as the international consensus. The arm's length principle was considered to be sound in theory, as it provides the closest approximation of market situations where goods and services are transferred between associated enterprises and where financing is provided. While the OECD realized that it is not always straightforward to apply the arm's length principle in practice, and the finance area confirms this, the results from the application of the arm's length principle were considered to be appropriate and to reflect in the best way the economic realities of a controlled taxpayer's particular facts and circumstances, benchmarked with normal market operations.*"

independent enterprises under comparable circumstances. There are also many cases where a relevant comparison of transactions can be made at the level of financial indicators such as mark-up on costs, gross margin, or net profit indicators[52].

The general conditions described in this section are necessary for a material application of transfer pricing policy by Member State of OECD, that have been adopted OECD Model against the double taxation. OECD Guidelines about Transfer price, recently modified in 2010, give specific instructions for correctly applying the arm's length principle.

The paragraphs that follow will address the individual methods provided in the guidelines and their peculiarities.

3. Comparability analysis

Transfer pricing issues are resolved by guidelines OECD using a specific instruments for value dealings between related parties and subsequently basis calculating of each companies in different States. In general, this mechanism is named comparability analysis. In other terms, according with guidelines of transfer pricing, tax administrations of OECD's members States, may be apply comparable methods to determinate income derived in the same State.

Before the amendment of 2010, OECD Test Guideline had placed a definite order for the application of different methods of comparison. In fact with the change said the guidelines have abolished the exceptional nature of the "income" methods of income favoring the application of "*most appropriate method to the circumstances of the case*"[53].

This modification is most important because it attaches great importance to the specific market conditions, making it more realistic use of the specific method.

Moreover, when evaluating the terms of a potential transaction, enterprises will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is

[52] See *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 36.

[53] See P. VALENTE, *Manuale di governance fiscale*, IPSOA, 2011, p. 942.

clearly more attractive. For example, one enterprise is unlikely to accept a price offered for its product by an independent enterprise if it knows that other potential customers are willing to pay more under similar conditions. This point is relevant to the question of comparability, since independent enterprises would generally take into account any economically relevant differences between the options realistically available to them when valuing those options.

Therefore, when making the comparisons entailed by application of the arm's length principle, tax administrations should also take these differences into account when establishing whether there is comparability between the situations being compared and what adjustments may be necessary to achieve comparability[54].

Therefore, in order to comparability analysis, it is necessary to treat separately the different methods, which can be divided into two categories: transactional and income.

3.1. Traditional Transaction method

The first category that is called transactional method regards a comparison of transactions with free competition between two or more independent contractors.

These contractors are necessarily a parties related and residents in different States and with transactional method they are considered an identical or similar dealings acted by independent subject, as told before[55].

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[54] See Guidelines *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 44.

[55] About comparables, *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 64 tells as follows:

"*2.11 The arm's length principle does not require the application of more than one method for a given transaction (or set of transactions that are appropriately aggregated following the standard described at paragraph 3.9), and in fact undue reliance on such an approach could create a significant burden for taxpayers. Thus, these Guidelines do not require either the tax examiner or taxpayer to perform analyses under more than one method. While in some cases the selection of a method may not be straightforward and more than one method may be initially considered, generally it will be possible to select one method that is apt to provide the best estimation of an arm's length price. However, for difficult cases, where no one approach is conclusive, a flexible approach would allow the evidence of various methods to be used in conjunction. In such cases, an attempt should be made to reach a conclusion consistent with the arm's length principle that is satisfactory from a practical viewpoint to all the parties involved, taking into account the facts and*

The transfer price Guidelines approved by OECD distinguishes three particular transactional methods:

a) Comparable uncontrolled price (CUP) method.

The aforementioned method regards the comparison of the price specified in a transaction between two companies within the same group and two independent companies without relationship of control, named external comparison, or price dealing confrontation between related parties of the same group and one of multinational group and an independent subject, internal comparison[56].

The complete structure, as described above, makes this method preferable to other and privileged, because it guarantees fairness in trade between companies with a control and connection relationship[57].

Moreover, it could happen that it is more difficult applying this method because there are not similar transactions in free trade. In other terms, it is not appropriate the use of comparable uncontrolled price[58]. To avoid such issue, OECD's Guidelines has been introduced two alternative methods.

b) Resale price method.

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circumstances of the case, the mix of evidence available, and the relative reliability of the various methods under consideration. See paragraphs 3.58- 3.59 for a discussion of cases where a range of figures results from the use of more than one method."

[56] See G. FALSITTA, cit., p. 520. *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 62 states: "*2.13 The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.*"

[57] See P. VALENTE, cit., p. 943.

[58] *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 63: "*2.16 In considering whether controlled and uncontrolled transactions are comparable, regard should be had to the effect on price of broader business functions other than just product comparability (i.e. factors relevant to determining comparability under Chapter I). Where differences exist between the controlled and uncontrolled transactions or between the enterprises undertaking those transactions, it may be difficult to determine reasonably accurate adjustments to eliminate the effect on price. The difficulties that arise in attempting to make reasonably accurate adjustments should not routinely preclude the possible application of the CUP method. Practical considerations dictate a more flexible approach to enable the CUP method to be used and to be supplemented as necessary by other appropriate methods, all of which should be evaluated according to their relative accuracy. Every effort should be made to adjust the data so that it may be used appropriately in a CUP method. As for any method, the relative reliability of the CUP method is affected by the degree of accuracy with which adjustments can be made to achieve comparability.*"

Following transactional method principles OECD has been provided, for transfer pricing rules application, another and alternative method: resale price method.

Resale price concerns the comparison between the purchase price of an good by a company of the group and the subsequent resale by the same to an independent company. The resale price, clearly, must contain cost production or cost of modify the same good. Thus, method is a correct application of arm's length principle. However, for objective reasons this method cannot be applied to the provision of services[59]or to particular categories of goods[60].

c) Cost plus method.

The third transactional method provided by OECD Guidelines is cost plus method. Substantially, according to comparability analysis, this method regards price determination of dealing, acted by a company of multinational group,

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[59] See P. VALENTE, cit., p. 943; G. FALSITTA, cit., p. 520. *Transfer price Guidelines for multinational enterprises and tax administrations,* p. 66-67 that states: "*The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin on this price (the "resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between the associated enterprises. This method is probably most useful where it is applied to marketing operations.*
2.22 The resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items pprourchased and sold in comparable uncontrolled transactions ("internal comparable"). Also, the resale price margin earned by an independent enterprise in comparable uncontrolled transactions may serve as a guide ("external comparable"). Where the reseller is carrying on a general brokerage business, the resale price margin may be related to a brokerage fee, which is usually calculated as a percentage of the sales price of the product sold. The determination of the resale price margin in such a case should take into account whether the broker is acting as an agent or a principal."

[60] For more information, see *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p 67, that affirms: "*Where the reseller is clearly carrying on a substantial commercial activity in addition to the resale activity itself, then a reasonably substantial resale price margin might be expected. If the reseller in its activities employs valuable and possibly unique assets (e.g. intangible property of the reseller, such as its marketing organization), it may be inappropriate to evaluate the arm's length conditions in the controlled transaction using an unadjusted resale price margin derived from uncontrolled transactions in which the uncontrolled reseller does not employ similar assets. If the reseller possesses valuable marketing intangibles, the resale price margin in the uncontrolled transaction may underestimate the profit to which the reseller in the controlled transaction is entitled, unless the comparable uncontrolled transaction involves the same reseller or a reseller with similarly valuable marketing intangibles.*
Where the accounting practices differ from the controlled transaction to the uncontrolled transaction, appropriate adjustments should be made to the data used in calculating the resale price margin in order to ensure that the same types of costs are used in each case to arrive at the gross margin. For example, costs of R&D may be reflected in operating expenses or in costs of sales. The respective gross margins would not be comparable without appropriate adjustments."

calculating cost derived for goods or services production and business risks. This price must include also a probable profit that generally an independent company provides (it follows *id quod plerumque accidit* rule)[61].

The cost plus method presents some difficulties in proper application, particularly in the determination of costs. Although it is true that an enterprise must cover its costs, over a period of time, to remain in business, those costs may not be the determinant of the appropriate profit in a specific case for any one year.

While in many cases companies are driven by competition to scale down prices by reference to the cost of creating the relevant goods or providing the relevant service, there are other circumstances where there is no discernible link between the level of costs incurred and a market price (*e.g.* where a valuable discovery has been made and the owner has incurred only small research costs in making it)[62].

3.2. Transactional profit method

The second category for arm's length principle is transactional profit method. Before the OECD' Guidelines about transfer pricing, 2010,, this category was considered like *last resort method*. In other terms, it could use when the tradition transaction method was not applicable because there were not comparability elements. In such cases of last resort, practical considerations may

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[61] See *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 74-75:
"*2.39 The cost plus method begins with the costs incurred by the supplier of property (or services) in a controlled transaction for property transferred or services provided to an associated purchaser. An appropriate cost plus mark up is then added to this cost, to make an appropriate profit in light of the functions performed and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction. This method probably is most useful where semi finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.*
2.40 The cost plus mark up of the supplier in the controlled transaction should ideally be established by reference to the cost plus mark up that the same supplier earns in comparable uncontrolled transactions ("internal comparable"). In addition, the cost plus mark up that would have been earned in comparable transactions by an independent enterprise may serve as a guide ("external comparable")."
[62] See also P. VALENTE, cit., p. 943; G. FALSITTA, cit., p. 520; *OECD Transfer price Guidelines for multinational enterprises and tax administrations,* p. 75.

suggest application of a transactional profit method either in conjunction with traditional methods or its own[63].

As affirmed before, with a reform of OECD' Guidelines in 2010, this hierarchical order was removed. Moreover, while the transactional methods, like described in precedent paragraph, are used to apply the arm's length principle, transactional profit methods, or so-called by Italian doctrine and practice "*reddituali*", are used to approximate arm's length conditions where such methods are the most appropriate to the circumstances of the case.

In addition, there are two different approach for such method: transactional profit split method and transactional net margin method.

a) Transactional profit split method.

The total profit of the transaction or the sum of transactions of the group of companies is divided among the companies applying the same functional economic analysis. However, this method respects the principle of free competition in line with the general rules on transfer pricing. Moreover, the reasons of the mechanism described are in a particular nature of transactions acted between related parties. In fact, it may happen that there are some prices differences between transactions acted in a multinational companies group and transactions of independent parties[64].

b) Transactional net margin method.

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[63] See *OECD Transfer price Guidelines for multinational enterprises and tax administrations*, 1995, par. 3.50. See also P. VALENTE, cit., p. 944; P. VALENTE, *Le novità del transfer pricing*, IPSOA, 2010, pp. 195-196.

[64] P. VALENTE, *Le novità del transfer pricing*, IPSOA, 2010, p. 196.

See *OECD Transfer price Guidelines for multinational enterprises and tax administrations*, 2010 that tells:

"*2.108 The transactional profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction (or in controlled transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12) by determining the division of profits that independent enterprises would have expected to realise from engaging in the transaction or transactions. The transactional profit split method first identifies the profits to be split for the associated enterprises from the controlled transactions in which the associated enterprises are engaged (the "combined profits"). References to "profits" should be taken as applying equally to losses. See paragraphs 2.124-2.131 for a discussion of how to measure the profits to be split. It then splits those combined profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. See paragraphs 2.132–2.145 for a discussion of how to split the combined profits.*"

The second method, that refers to this category, is the transactional net margin method. It regards a specific calculation of net margin profit[65] derived by transactions of all companies of the same multinational group and the subsequent comparison of transactions acted between independent parts.

OECD Guidelines give to member States the following definition:

"*2.58 The transactional net margin method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled transaction (or transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12). Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods. This similarity means that in order to be applied reliably, the transactional net margin method must be applied in a manner consistent with the manner in which the resale price or cost plus method is applied. This means in particular that the net profit indicator of the taxpayer from the controlled transaction (or transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12) should ideally be established by reference to the net profit indicator that the same taxpayer earns in comparable uncontrolled transactions, i.e. by reference to "internal comparables" (see paragraphs 3.27-3.28). Where this is not possible, the net margin that would have been earned in comparable transactions by an independent enterprise ("external comparables") may serve as a guide (see paragraphs 3.29-3.35). A functional analysis of the controlled and uncontrolled transactions is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results.*"[66].

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[65] About net profit the OECD Guidelines state:
"*2.77 As a matter of principle, only those items that (a) directly or indirectly relate to the controlled transaction at hand and (b) are of an operating nature should be taken into account in the determination of the net profit indicator for the application of the transactional net margin method.*
2.78 Costs and revenues that are not related to the controlled transaction under review should be excluded where they materially affect comparability with uncontrolled transactions. An appropriate level of segmentation of the taxpayer's financial data is needed when determining or testing the net profit it earns from a controlled transaction (or from transactions that are appropriately aggregated according to the guidance at paragraphs 3.9-3.12). Therefore, it would be inappropriate to apply the
transactional net margin method on a company-wide basis if the company engages in a variety of different controlled transactions that cannot be appropriately compared on an aggregate basis with those of an independent enterprise."
[66] OECD, cit., pp. 79-80.

4. The elimination of double taxation

4.1. In OECD Model

The precedent paragraphs are necessary to comprehend the calculation of income produced by companies of multinational group and derived by one or more transactions operated by the same companies, as parties related. When, according to methods described before, a tax administration of a member state ensures a higher income in his state, in another State it must be a change in income to avoid double taxation[67]. In fact, if there is not this adjustment of income, the company, that situated in the other State, cannot deduct the increased costs or allocate more income.

OECD Model for avoid this phenomenon, has been introduced a particular procedure resolving and avoiding the double taxation, which are adopted also in the Italian fiscal system, as a OECD member State[68].

[67] In this case it's referred to economic double taxation as described in the first part of this subtopic. In other terms, the same income is taxed to different taxpayers situated in different member States. See also Commentary of OECD Model and P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, IPSOA, 2008, pp. 22, 413. See J. WITTENDORFF, *The Transactional Ghost of Article 9(1) of the OECD Model*, in *Bulletin For International Taxation*, March 2009, p. 114 who tells that: "*International double taxation may be defined as the imposition of comparable taxes in two or more states in respect of the same income for identical periods. Identity with respect to the taxpayer gives rise to juridical double taxation. Art. 7 of the OECD Model governs international juridical double taxation of business profits. In the absence of taxpayer identity, double taxation is of an economic nature.84 Art. 9 of the OECD Model governs international economic double taxation. Income distortions between associated enterprises may take different forms, which is reflected in the means available to the tax authorities to adjust distortions. The discussion below analyses whether Art. 9(1) addresses the economic double taxation caused by a transfer pricing adjustment, by an assignment of income adjustment and by a transactional adjustment.*"

[68] In fact, OECD, cit., pp. 141-142, affirms that:

"*4.32 To eliminate double taxation in transfer pricing cases, tax administrations may consider requests for corresponding adjustments as described in paragraph 2 of Article 9. A corresponding adjustment, which in practice may be undertaken as part of the mutual agreement procedure, can mitigate or eliminate double taxation in cases where one tax administration increases a company's taxable profits (i.e. makes a primary adjustment) as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction. The corresponding adjustment in such a case is a downward adjustment to the tax liability of that associated enterprise, made by the tax administration of the second jurisdiction, so that the allocation of profits between the two jurisdictions is consistent with the primary adjustment and no double taxation occurs. It is also possible that the first tax administration will agree to decrease (or eliminate) the primary adjustment as part of the consultative process with the second tax administration, in which case the corresponding adjustment would be smaller (or perhaps unnecessary). It should be noted that a corresponding adjustment is not intended to provide a benefit to the MNE group greater than would have been the case if the controlled transactions had been undertaken at arm's length conditions in the first instance.*"

The first disposition is Art. 9, par. 2, that provides as follows:

"*2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.*"

For applying of this paragraph, OECD Model has been introduced another disposition more important for this discussion. In fact, the corresponding adjustments operated by the tax administrative, that has not done tax control, are not automatically and it is necessary a specific mutual agreement procedure[69].

It's referred to Art. 25, OECD Model. This norm, named "*Mutual agreement procedure*", affirms that:

"*1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.*

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the

[69] See, P. VALENTE, *Convenzioni contro la doppia imposizione*, IPSOA, 2008, pp. 414-415. For more information about agreements procedure seee also Commentary on art. 9, par. 2.

Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.
3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.
4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.
5. Where, a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

Thank to this disposition it is possible removing the double taxation with responding adjustments acted by the tax administration situated in second State. In addition, the OECD's Guidelines states that:

"*Paragraph 2 of Article 9 specifically recommends that the competent authorities consult each other if necessary to determine corresponding adjustments. This demonstrates that the mutual agreement procedure of Article 25*

may be used to consider corresponding adjustment requests. However, the overlap between the two Articles has caused OECD member countries to consider whether the mutual agreement procedure can be used to achieve corresponding adjustments where the bilateral income tax convention between two Contracting States does not include a provision comparable to paragraph 2 of Article 9. Paragraphs 11 and 12 of the Commentary on Article 25 of the OECD Model Tax Convention now expressly state the view of most OECD member countries that the mutual agreement procedure is considered to apply to transfer pricing adjustment cases even in the absence of a provision comparable to paragraph 2 of Article 9. Paragraph 12 also notes that those OECD member countries that do not agree with this view in practice apply domestic laws in most cases to alleviate double taxation of bona fide enterprises."[70].

In conclusion, with regard to income ascertained as a result transfers price for transactions between companies within a multinational group, the mutual agreement procedure, that juridically has the nature of an agreement, strictu sensu intended to avoid double taxation.

4.2. In EC law

In addition to mutual agreement procedure provided by OECD Model, for elimination double taxation, when there is transfer price caused by transactions acted of companies, residents in different EU Member States, within a multinational group, the EC Convention 90/436 is applied.

In fact, with rules complex, for multinational group that conducts business in the European territory and has resident companies in different countries, it is used a specific mutual agreement procedure provided with the mentioned law. following the setting of Articles 9 and 25 of the OECD agreement also provides for the elimination of double taxation and comply with the general principles contained in the Treaties of the European Community and CEDU.

In the same Convention, that firmed also by Italy, Art. 4 gives specific instructions for the transfer pricing rules application. In particular, it states that:

[70] See OECD, cit., p. 141.

“*The following principles shall be observed in the application of this Convention:*

1. Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of another Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one Contracting State and an enterprise of another Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ form those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where an enterprise of a Contracting State carries on business in another Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.”

In this case, in respect the general principles contained in OECD Model and, subsequent, in OECD Guidelines about Permanent Establishment and Transfer Pricing, a common notion of arm’s length principle is applied[71].

If the tax administration decides to apply transfer price rules on company within multinational group, Art. 5, instead, provides that:

“*Where a Contracting State intends to adjust the profits of an enterprise in accordance with the principles set out in Article 4, it shall inform the enterprise of the intended action in due time and give it the opportunity to inform the other enterprise so as to give that other enterprise the opportunity to inform in turn the other Contracting State.*

[71] See P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni,* IPSOA, pp. 418 - 419. See also P. BORIA, *Diritto tributario europeo*, Giuffrè ed., Milano, 2010, pp. 279-280.

However, the Contracting State providing such information shall not be prevented from making the proposed adjustment.

If after such information has been given the two enterprises and the other Contracting State agree to the adjustment, Articles 6 and 7 shall not apply."

In conclusion, the articles 6 and 7 regulate the mutual agreement procedure between tax administrations of each EC Member States. Moreover, this procedure is facultative and it however, does not prohibit the application of similar rules inside the country where he was made the fiscal control[72].

5. Judgments of the EU Court of Justice

To understand the application of general principles of international tax law in the Italian tax system and the orientation of the Italian Supreme Court, it is useful to analyze some important judgments of the Court of Justice.

The first is *Lankhorst-hohorst case*. The European Judge has ruled about a restrictive tax measure adopted by a Member State to contrast the tax avoidance. In particular it is referred to thin capitalization. The EU Court affirmed that generally the restriction tax measure used against abusive deduction of debt by company within multinational can be adopted, in respect of arm's length principle[73]. But, in this case, there are not juridical and economic reasons for

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[72] See E. DELLA VALLE, *Il transfer price nel sistema di imposizione sul reddito,* in Riv. Dir. Trib., 2009, n. 2, pp. 133 and subseq, who tells: "*In ogni caso la procedura amichevole non sostituisce i rimedi a disposizione del contribuente sulla base della propria legislazione domestica, bensì si affianca agli stessi.*"

[73] EU Court states that:

"*First, the German, Danish and United Kingdom Governments and the Commission submit that the national measure at issue in the main proceedings is intended to combat tax evasion in the form of the use of 'thin capitalization' or 'hidden equity capitalization'. All things being equal, it is more advantageous in terms of taxation to finance a subsidiary company through a loan than through capital contributions. In such a case, the profits of the subsidiary are transferred to the parent company in the form of interest, which is deductible in calculating the subsidiary's taxable profits, and not in the form of a non-deductible dividend. Where the subsidiary and the parent company have their seats in different countries, the tax debt is therefore likely to be transferred from one country to the other. The Commission adds that Paragraph 8a(1), Head 2, of the KStG does indeed provided for an exception in the case of a company which proves that it could have obtained the loan capital from a third party on the same conditions, and fixes the permissible amount of loan capital in comparison with equity capital. However, the Commission points to the existence, in the present case, of a risk of double taxation since the German subsidiary is subject to German taxation on interest paid, whereas the non-resident parent company must still declare*

application of such restrictive measure and there has been a violation of Article. 43 of the EC Treaty[74].

The second judgment regards another case about a thin capitalization: C-524/04.

A Member State's thin capitalization legislation, which is only applied to interest payments to non-resident lenders, in principle constitutes a restriction on the freedom of establishment. Such restriction may, however, be justified by the prevention of tax avoidance provided that it is proportionate to that aim, i.e. the legislation (i) provides for the consideration of objective and verifiable elements to identify purely artificial arrangements, (ii) allows taxpayers to produce, without being subject to undue administrative burden, evidence as to the commercial justification for the transaction, and (iii) applies only to that part of the interest that exceeds the arm's length standard.

Thus, in this case, on the contrary, the EU Court found no infringement of Article. 43, namely the freedom of establishment[75].

In accordance with the principles developed by EU Court for the precedent cases analyzed, the European Judge, subsequently, confirmed them[76].

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the interest received as income in the Netherlands. The principle of proportionality requires that the two Member States in question reach an agreement in order to avoid double taxation."

[74] So the EC Court affirmed as follows:

"*Second, the German and United Kingdom Governments submit that Paragraph 8a(1), Head 2, of the KStG is also justified by the need to ensure the coherence of the applicable tax systems. More specifically, that provision is in accordance with the arm's length principle, which is internationally recognized and pursuant to which the conditions upon which loan capital is made available to a company must be compared with the conditions which the company could have obtained for such a loan from a third party. Article 9 of the Model Convention of the Organisation for Economic Cooperation and Development (OECD) reflects that concern in providing for inclusion in profits for tax purposes where transactions are concluded between linked companies on conditions which do not correspond to market conditions. Although in Bachmann and Commission v Belgium, since the taxpayer was one and the same person, there was a direct link between deductibility of pension and life assurance contributions and taxation of the sums received under those insurance contracts and preservation of that link was necessary to safeguard the coherence of the relevant tax system, there is no such direct link where, as in the present case, the subsidiary of a non-resident parent company suffers less favourable tax treatment and the German Government has not pointed to any tax advantage to offset such treatment (see, to that effect, Wielockx, paragraph 24; Case C-484/93 Svensson and Gustavsson [1995] ECR I- 3955, paragraph 18; Eurowings Luftverkehr, paragraph 42; Verkooijen, paragraphs 56 to 58, and Baars, paragraph 40).*"

[75] See ECJ Case Law IBFD.

[76] *Ex plurimis*, see c-331/08, in which EU Court told that:

"*Article 43 EC, read in conjunction with Article 48 EC, must be interpreted as not precluding, in principle, legislation of a Member State, such as that at issue in the main proceedings, under*

In conclusion, with this subparagraph it is demonstrated the arm's length principle application, in respect of the general rules of TFUE, and the attribution to transfer pricing rules the tax avoidance nature against the abuse conduct company's Multination group. Indirectly, EC Court has considered more relevant OECD Model dispositions and OECD Guidelines about Transfer price.

which a resident company is taxed in respect of an unusual or gratuitous advantage where the advantage has been granted to a company established in another Member State with which it has, directly or indirectly, a relationship of interdependence, whereas a resident company cannot be taxed on such an advantage where the advantage has been granted to another resident company with which it has such a relationship. However, it is for the referring court to verify whether the legislation at issue in the main proceedings goes beyond what is necessary to attain the objectives pursued by the legislation, taken together."

6. Transfer pricing rules in Italian tax law

6.1. Notion

In the Italian tax law, a specific disposition about transfer pricing is provided. In particular, this norm is contained in *Consolidated income tax*, or named TUIR (Testo Unico delle Imposte sui redditi).

The art. 110, par. 7, TUIR, so-called *Norme generali sulle valutazioni*, states that the income derived by transactions between companies that are not resident in the Italian State and they control a company resident in the Italian State or they are controlled (directly or indirectly) by company that stays in the Italian State, is valued through the arm's length principle.

This provision is characterized by some important and relevant elements necessary for application of transfer pricing and comparison with international tax law.

The first element regards objective factor. In fact, the rule mentioned describes factual phenomenon that refers to transfer price. In other terms, when a determinate subject carries out operations with another subject, both characterized by control or connection relationship, the arm's length principle is applied. The Italian tax system received arm's length principle described in the OECD Model and provides with the introduction in TUIR of art. 9[77].

[77] See the art. 9 TUIR that affirms:
"*[...]*
3. Per valore normale, salvo quanto stabilito nel comma 4 per i beni ivi considerati, si intende il prezzo o corrispettivo mediamente praticato per i beni e i servizi della stessa specie o similari, in condizioni di libera concorrenza e al medesimo stadio di commercializzazione, nel tempo e nel luogo in cui i beni o servizi sono stati acquisiti o prestati, e, in mancanza, nel tempo e nel luogo più prossimi. Per la determinazione del valore normale si fa riferimento, in quanto possibile, ai listini o alle tariffe del soggetto che ha fornito i beni o i servizi e, in mancanza, alle mercuriali e ai listini delle camere di commercio e alle tariffe professionali, tenendo conto degli sconti d'uso. Per i beni e i servizi soggetti a disciplina dei prezzi si fa riferimento ai provvedimenti in vigore.
4. Il valore normale è determinato:
a) per le azioni, obbligazioni e altri titoli negoziati in mercati regolamentati italiani o esteri, in base alla media aritmetica dei prezzi rilevati nell'ultimo mese;
b) per le altre azioni, per le quote di società non azionarie e per i titoli o quote di partecipazione al capitale di enti diversi dalle società, in proporzione al valore del patrimonio netto della società o ente, ovvero, per le società o enti di nuova costituzione, all'ammontare complessivo dei conferimenti;
c) per le obbligazioni e gli altri titoli diversi da quelli indicati alle lettere a) e b), comparativamente al valore normale dei titoli aventi analoghe caratteristiche negoziati in mercati

This principle represents the objective part of transfer price rule contained in the Art. 110 TUIR. As shortly analyzed, this element is wholly conform with Art. 9 OECD Model.

Proceeding the Italian transfer price rules study, it is necessary to focalize on subjective elements, contained in the first part of par. 7, Art. 110 TUIR. In fact, the dealings may be acted by two or more multinational subjects and rather one of parties related must be resident in other State. Moreover, the transaction must be made by companies that have between them a controlling relationship or connection. This relationship is considered, *latu sensu*, following the notion provided by Italian civil code[78]. Also in this case the par. 7, art. 110 TUIR, is totally in line with subjective elements introduced by OECD Model and EC Convention n. 436/90. Clearly, the notion of control refers to, not only, a relevant

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regolamentati italiani o esteri e, in mancanza, in base ad altri elementi determinabili in modo obiettivo.
5. Ai fini delle imposte sui redditi le disposizioni relative alle cessioni a titolo oneroso valgono anche per gli atti a titolo oneroso che importano costituzione o trasferimento di diritti reali di godimento e per i conferimenti in società." See also G. COTTANI, *Italian Transfer Pricing Legislation: An International Perspective*, in *Bulletin For International Taxation*, August/September 2010, pp. 465-466, who tells that: "*Based on this premise, the fundamental issue is to determine whether or not the "normal value" concept, as embodied in Art. 9(3) of the ITC, complies with the concept of the arm's length principle as endorsed in Art. 9 of the OECD Model. In order to properly answer this question, the author deems it necessary to investigate the origin of the domestic transfer pricing provision. To this end, the author doubts that, as it was originally conceived within the Italian corporate tax system, Art. 110(7) of the ITC was introduced so as to serve the primary purpose of transfer pricing rules, i.e.: (1) guaranteeing a proper allocation of taxable income among countries; and (2) domestic provision seems to have been conceived as a sort of peculiar anti-avoidance provision. In detail, Art. 110 of the ITC contains a number of different provisions regarding the valuation of items of income that are to be taken into account for purposes of the computation of business income. As far as transfer pricing is concerned, the provision refers, in Para. 7, to a peculiar criterion – that of "normal value" – which supersedes the general principle of Italian tax law, and which provides that, for the purposes of computing the tax base, income should reflect the amounts reported in the profit and loss account (the principle of "payments actually performed" (principio della effettività dei corrispettivi).*"

[78] See art. 2359 c.c. that establishes:
"*Sono considerate società controllate:*
1) le società in cui un'altra società dispone della maggioranza dei voti esercitabili nell'assemblea ordinaria;
2) le società in cui un'altra società dispone di voti sufficienti per esercitare un'influenza dominante nell'assemblea ordinaria;
3) le società che sono sotto influenza dominante di un'altra società in virtù di particolari vincoli contrattuali con essa.
[Ai fini dell'applicazione dei numeri 1) e 2) del primo comma si computano anche i voti 2] spettanti a società controllate, a società fiduciarie e a persona interposta: non si computano i voti spettanti per conto di terzi.
Sono considerate collegate le società sulle quali un'altra società esercita un'influenza notevole. L'influenza si presume quando nell'assemblea ordinaria può essere esercitato almeno un quinto dei voti ovvero un decimo se la società ha azioni quotate in mercati regolamentati."

participation of a company in the other company, but also, a connection with the same company that attributes to the first company the relevant influence, economic and juridical, on the second[79].

Art. 110 TUIR does not give specific instructions about arm's length principle because the provisions analyzed are general and have not technical content.

Thus, for calculating value of dealings between related parties, according the Italian Transfer price rules, it is necessary analyzed Italian tax administration instructions and, if conform, also the comparability analysis provided by OECD Guidelines[80].

In fact, with publication of Instructions document n. 32/1980, the Italian Tax authority recognized the validity of the OECD guidelines for application arm's length principle and the valuation of intercompany transactions according to comparables. The Tax Administrative underlined the need to comply with the provisions contained in international rules and to standardize the criteria for calculation of transactions for transfer pricing[81].

In particular, the subsequent pages of this document, the tax authority explained the practical application of comparability analysis. In the first part introduced the tradition transactional method, as CUP, internal and external, and cost plus method. Also this element demonstrates the general conformation of transfer price Guidelines given by OECD[82].

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[79] See G. COTTANI, *Italian Transfer Pricing Legislation: An International Perspective*, in *Bulletin For International Taxation*, August/September 2010, pp. 464-465.
[80] For this analysis see a precedent paragraph about the transfer price in the International tax law.
[81] In fact, Tax Authority states that: "*Di qui la necessità - anche in rapporto alla presente fase di attuazione del nuovo sistema tributario ed alla esigenza di assicurare uniformità interpretativa ed applicativa delle richiamate disposizioni – di opportune istruzioni in materia che tengano adeguatamente conto delle esperienze acquisite in altri Paesi e degli orientamenti dei vari Organismi internazionali ed in particolare dell'Organizzazione per la Cooperazione e lo Sviluppo Economico (OCSE) che, nel pubblicare il rapporto 16 maggio 1979 sull'argomento, ebbe anche a raccomandare alle amministrazioni fiscali degli Stati contraenti il rispetto del principio della libera concorrenza in sede di esame e di aggiustamento dei prezzi di trasferimento. Nell'approfondimento del problema saranno esaminati dapprima i presupposti soggettivi di applicazione della normativa e, in secondo luogo, i criteri di determinazione del valore normale rispetto alle varie specie di transazioni poste in essere nell'ambito internazionale.*"
[82] See 32/1980 pp. 5-6 and for comparison OECD Guidelines about transfer price described in the precedent subparagraph. See, also, P. VALENTE, *Le novità del transfer pricing,* IPSOA, 2010, pp. 89-90. See G. COTTANI, cit., pp. 466 and subseq.

Thanks, then, to the circulars issued by the tax administration over the years and thanks to changes made in the text of the income tax (TUIR) it has been possible to standardize the rules of the Italian tax system with transfer price in the international tax law.

Proceeding this analysis, there is a Circular n. 58/2010, Italian Tax authority ordered for the multinational group specific presenting documents, conforming transfer price rules and according with art. 110, par.7. the most important document that contains the transactions acted by company with another company, characterized by connection or control rapport, is named Master file. This documents also is provided by international and European tax law.

Moreover, subsequently by press release of same Authority, 29.09.2010, affirmed the relevance of D.L. n. 78/2010. With this provision, to the company that falls within the legislation on transfer pricing and presents the documents required by law, if the tax assessment acted by Tax Administration, does not apply sanctions. Those documents required are the same as the international standards and European Community. The presentation of documents demonstrates the absence of willingness to violate the tax laws[83]. With Circular n. 28/2010, the same orientation was confirmed.

In addition, Art. 110, par. 7, TUIR provides the respect a mutual agreement procedure when in the other State there has been a tax control, applying the transfer price rules. Italian Tax administrative may be responding adjustments with international and European mutual agreement introduced by OECD Model and Convention n. 436/1990. This part of art. 110 has been

[83] Tax authority states that: "*Il provvedimento firmato oggi dal Direttore dell'Agenzia delle Entrate richiama espressamente il Codice di Condotta sulla documentazione dei prezzi di trasferimento per le imprese associate nell'Unione Europea, battezzando in tal modo i documenti che consentono di riscontrare che i prezzi di trasferimento praticati dalle imprese multinazionali siano allineati al valore normale. Il dl 78/2010 ha, infatti, previsto che ai contribuenti che si doteranno di questa documentazione non sarà applicata alcuna sanzione. Il regime documentale è stato diversificato a seconda che venga adottato da una holding, da una subholding, da una società partecipata o da una stabile organizzazione. Agevolazioni specifiche sono anche previste per le piccole e medie imprese, le quali, al verificarsi di determinate condizioni, sono esentate dall'aggiornamento annuale di alcuni dati dell'analisi di comparabilità.*"

provided for elimination the economic double taxation[84]. In fact, the double taxation is contrasted by art. 53 of Italian Costitution[85] and by 163 TUIR[86].

Those elements aforementioned describe the transfer price in the Italian tax law and regulate the allocation of income between States, as the permanent establishment rules.

6.2. Thin capitalization rule

Moreover, in determining income and resulting taxation in transfer of price, plays a decisive role the thin capitalization rule. As mentioned in the sub paragraph precedent about EC case law, the thin capitalization concerns the abuse of the company in financing dealings toward another company of the same multinational or internal group. In particular, this rule has been introduced in Italian Income tax Code with the art. 98[87] and subsequently deleted by l. n.

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[84] See A. FANTOZZI, *Commentario breve alle leggi tributarie*, Tomo III, CEDAM, 2010, pp. 605-606. P. VALENTE, *Manuale di governante fiscale*, IPSOA, 2011, p. 944. See M. PROCOPIO, *L'inerenza nel sistema delle imposte sui redditi*, Giuffrè Ed., 2009, pp. 309-310.

[85] This article provides that:
"*Tutti sono tenuti a concorrere alle spese pubbliche in ragione della loro capacità contributiva. Il sistema tributario è informato a criteri di progressività.*"

[86] The mentioned disposition states that:
"*1. La stessa imposta non può essere applicata più volte in dipendenza dello stesso presupposto, neppure nei confronti di soggetti diversi.*"

[87] This article provides that:
"*1. La remunerazione dei finanziamenti eccedenti di cui al comma 4, direttamente o indirettamente erogati o garantiti da un socio qualificato o da una sua parte correlata, computata al netto della quota di interessi indeducibili in applicazione dell'articolo 3, comma 115 della legge 28 dicembre 1995, n. 549, è indeducibile dal reddito imponibile qualora il rapporto tra la consistenza media durante il periodo d'imposta dei finanziamenti di cui al comma 4 e la quota di patrimonio netto contabile di pertinenza del socio medesimo e delle sue parti correlate, aumentato degli apporti di capitale effettuati dallo stesso socio o da sue parti correlate in esecuzione dei contratti di cui all'articolo 109, comma 9, lettera b), sia superiore a quello di quattro a uno.*
2.Il comma 1 non si applica nel caso in cui:
a) l'ammontare complessivo dei finanziamenti di cui al comma 4 non eccede quattro volte il patrimonio netto contabile determinato con i criteri di cui alla lettera e) del comma 3;
b) il contribuente debitore fornisce la dimostrazione che l'ammontare dei finanziamenti di cui al comma 4 e' giustificato dalla propria esclusiva capacità di credito e che conseguentemente gli stessi sarebbero stati erogati anche da terzi indipendenti con la sola garanzia del patrimonio sociale.
3. Ai fini dell'applicazione del comma 1:
a) si considerano eccedenti i finanziamenti di cui al comma 4 per la parte della loro consistenza media eccedente il rapporto di cui al comma 1;
b) si considerano parti correlate al socio qualificato le società da questi controllate ai sensi dell'articolo 2359 del codice civile e se persona fisica anche i familiari di cui all'articolo 5, comma 5;
c) il socio e' qualificato quando:

244/2007. With the thin capitalization, as afore told, the shareholder of a company may support the company with a capital increase or new payments or with different funding. statutory terms are not identified as critical, in terms of fiscal shows a difference of taxation. Also the provision in question takes into account the thin group of companies. Certainly it had an anti avoidance character[88]. In fact, for those subjects described by such norm it was not possible deduct passive

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1) direttamente o indirettamente controlla ai sensi dell'articolo 2359 del codice civile il soggetto debitore;

2) partecipa al capitale sociale dello stesso debitore con una percentuale pari o superiore al 25 per cento, alla determinazione della quale concorrono le partecipazioni detenute da sue parti correlate. Non si considerano soci qualificati i soggetti di cui all'articolo 74;

d) ai finanziamenti erogati o garantiti dal socio qualificato si aggiungono quelli erogati o garantiti da sue parti correlate;

e) per il calcolo della quota di pertinenza del socio qualificato e di sue parti correlate si considera il patrimonio netto contabile, così come risultante dal bilancio relativo all'esercizio precedente, comprensivo dell'utile dello stesso esercizio non distribuito, rettificato in diminuzione per tenere conto:

1) dei crediti risultanti nell'attivo patrimoniale relativi ad obblighi di conferimento ancora non eseguiti;

2) del valore di libro delle azioni proprie in portafoglio;

3) delle perdite subite nella misura in cui entro la data di approvazione del bilancio relativo al secondo esercizio successivo a quello cui le stesse si riferiscono non avvenga la ricostituzione del patrimonio netto mediante l'accantonamento di utili o l'esecuzione di conferimenti in danaro o in natura;

4) del valore di libro o, se minore del relativo patrimonio netto contabile, delle partecipazioni in società controllate e collegate di cui all'articolo 73, comma 1, lettera a) e di cui all'articolo 5, diverse da quelle di cui al successivo comma 5;

f) la consistenza media dei finanziamenti di cui al comma 4 si determina sommando il relativo ammontare complessivo esistente al termine di ogni giornata del periodo d'imposta e dividendo tale somma per il numero dei giorni del periodo stesso. Non concorrono alla determinazione della consistenza i finanziamenti infruttiferi erogati o garantiti dai soci qualificati o da sue parti correlate a condizione che la remunerazione media di cui alla lettera g) non sia superiore al tasso ufficiale di riferimento maggiorato di un punto percentuale;

g) la remunerazione dei finanziamenti eccedenti e' calcolata applicando agli stessi il tasso che corrisponde al rapporto tra la remunerazione complessiva dei finanziamenti di cui al comma 4 maturata nel periodo d'imposta e la consistenza media degli stessi.

4. Ai fini della determinazione del rapporto di cui al comma 1 rilevano i finanziamenti erogati o garantiti dal socio qualificato o da sue parti correlate intendendo per tali quelli derivanti da mutui, da depositi di danaro e da ogni altro rapporto di natura finanziaria.

5. Ai fini della determinazione del rapporto di cui al comma 1 non rilevano i finanziamenti assunti nell'esercizio dell'attività bancaria o dell'attività svolta dai soggetti indicati nell'articolo 1 del decreto legislativo 27 gennaio 1992, n. 87, con esclusione delle società che esercitano in via esclusiva o prevalente l'attività di assunzione di partecipazioni.

6. Si intendono garantiti dal socio o da sue parti correlate i debiti assistiti da garanzie reali, personali e di fatto fornite da tali soggetti anche mediante comportamenti ed atti giuridici che, seppure non formalmente qualificandosi quali prestazioni di garanzia, ottengono lo stesso effetto economico.

7. Il presente articolo non si applica ai contribuenti il cui volume di ricavi non supera le soglie previste per l'applicazione degli studi settore. Si applica, in ogni caso, alle società che esercitano in via esclusiva o prevalente l'attività di assunzione di partecipazioni.

[88] S. CAPOLUPO, *Reddito di impresa*, EGEA, 2007, pp. 943-944.

interest[89]. This precedent disposition, conclusion is connection with transfer price in the international tax lax and Italian tax law[90].

After the modification in 2007, the art. 98 has been deleted and it has been introduced Art. 96 that regulates the passive interests. In fact, the passive interests and similar elements can be deducted by subject up to the amount of interest income and any surplus to the extent of 30% of the EBITDA[91].

6.3. APA

In the Italian tax system, with art. 8, D.L. n. 269/2003, converted with L. n. 326/2003, it is introduced the "*international ruling*". This institute represents a private instrument for the companies or multinational group that carry out with other company resident in the other country, conducting cross-border operations.

This represents a negotiated settlement with the tax authorities on preventive methods of distribution of profits, loss of interest and the criteria for determining transfer prices, the use of specific comparables.

The method aforesaid was introduced to avoid the conflict with tax authorities situated in different country where the multinational group where he carries out business. The instrument analyzed applies the non-discrimination principle and it does not impede business operations[92]. The *International ruling* has been influenced by the Advance Pricing Agreements (APA) that represent an instrument to avoid contrast with tax authorities and used to tax plannig of

[89] See Circular of Italian Tax Authority, 21.04.2009, n. 19 that tells:
"*In particolare, la thin capitalization rule (ex articolo 98 del TUIR) aveva l'obiettivo principale di contrastare la sottocapitalizzazione a fini fiscali delle imprese, rendendo indeducibili gli interessi passivi relativi ai finanziamenti erogati o garantiti da soci qualificati (direttamente o per il tramite di parti ad essi correlate), qualora tali finanziamenti risultassero di ammontare almeno quattro volte superiore alla quota di patrimonio netto contabile di pertinenza del socio medesimo e delle sue parti correlate*."

[90] A. STORCK, *The Financing of Multinational Companies and Taxes: An Overview of the Issues and Suggestions for Solutions and Improvements*, in *Bulletin for International Taxation* 2011, p. 28 et seq. "*The characterization of thin capitalization rules as safe harbour rules under the OECD Transfer Pricing Guidelines would, in the author's view, provide the basis for a harmonization of such rules and a common safe harbor may be the most obvious result. Consequently, Art. 9 of the OECD Model could be used for both as a barrier for excessive limitations, and a corresponding adjustment under Art. 9(2). This would also be in line with the understanding of the OECD Commentary to Art. 24(5) of the OECD Model that refers to these rules as part of the context under which thin capitalization rules are compatible with a non-discrimination clause.*"

[91] G. FALSITTA, cit., pp. 441-442.

[92] See G. FALSITTA, cit., pp. 520-521. See also A. FANTOZZI, cit., p. 606. See, P. VALENTE, cit., p. 343.

multinational group resident and operating in the other countries. Moreover, those agreements have been refined by International (OECD) and EC authority. In conclusion, the *International ruling* or APA are useful to contrast the economic double taxation, making the relationship with the authorities of the host was more certain

6.4. Penalties

In the precedent subparagraph, the analysis acted demonstrated the anti avoidance nature of the transfer pricing rules.

In this section, it is more important to analyze the penalties application in the Italian tax law.

Verification that denies a lower income declared by a company after the application of the rules on transfer pricing may also involve the application of administrative sanctions, according with general principles contained in D. Lgs. n. 471/1997. In particular, this norm considers income controlled after arm's length principle application as a hypothesis of misrepresentation of income.

But the transfer price rules is not considered strictly a violation because the transactions between the related parties, as multinational group, is different respect to the similar transactions with independent parties. Moreover, the presentation of *Masterfile* by company, that is required by international, European and Italian Tax Authorities exclude intend to circumvent or evade[93] the same rules.

To avoid the different treatment described, the Italian legislature has provided a cause of exclusion of administrative sanctions if company has submitted the required documents[94]. In this case, there is not the element subjective for application of sanctions (*intentio fraudandi*)[95].

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[93] About transfer price nature see G. LEONI, M. LEOTTA, M. MAZZETTI DI PIETRALATA, *La deducibilità dei costi derivanti da operazioni con soggetti "black list"*, in *Boll. Trib.*, n. 13, 2011, pp. 993-994. See also E. DELLA VALLE, cit., p. 133 and subseq. A. FANTOZZI, cit., pp. 603-604. See the judgment of Supreme Court n. 22023/2006.

[94] See art. 26, D.L. 78/2010 and the art. 1, par. 2-ter, D. Lgs n. 471/1997. For more information see P. VALENTE, cit., pp. 6-8.

[95] See E. DELLA VALLE, cit., p. 133, that affirms:

Another issue on application of penalty regards criminal law. In fact, in criminal law, the same violation aforementioned can be considered as criminal charge, according with of D. Lgs. n. 74/2000. This theme is different from administrative sanctions.

In accordance with recent Italian judgment[96], in general, the tax avoidance that has all elements required by D. Lgs. n. 74/2000 can be considered a crime of misrepresentation[97].

6.5. A specific internal transfer price rule

In the Italian Income Tax Code, it is provides a specific internal transfer price rule. In effect, as afore told, the transfer price rule, introduced in the art. 110, is referred only transactions between multinational related parties. There is not a general transfer price rule in the Italian fiscal System.

The art. 155 TUIR[98] provides a particular calculation basis method for company that shipping companies involved in trading in the national territory: this

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"*In presenza dell'elemento soggettivo e ove non ricorra alcuna delle cause di non punibilità di cui all'art. 6 del decreto legislativo n. 472/1997, il quale prevede, tra l'altro, che non danno luogo a violazioni punibili le valutazioni eseguite secondo corretti criteri di stima e che, in ogni caso, non si considerano colpose le violazioni conseguenti a valutazioni estimative se differiscono da quelle accertate in misura non eccedente il 5% , nulla osta, nel caso di violazione dell'art. 110, comma 7, del TUIR alla configurabilità dell'illecito amministrativo di infedele dichiarazione di cui all'art. 1, del decreto legislativo n. 471/1997. Ed invero tale disposizione individua la condotta sanzionata nel fatto di indicare in dichiarazione un reddito imponibile inferiore a quello accertato o, comunque, un'imposta inferiore a quella dovuta o un credito superiore a quello spettante laddove, appunto, la mancata applicazione della regola in questione si risolve nella indicazione in dichiarazione di un imponibile inferiore. Stante l'esistenza, all'interno dell'art. 6, comma 1, del decreto legislativo n. 472/1997, di specifiche esimenti relative alle valutazioni estimative nel caso di divergenza tra accertato e dichiarato in misura non eccedente il 5per cento, riterrei non applicabile la causa di non punibilità della cd. obiettiva incertezza di cui al comma 2, dello stesso art. 6 al caso di violazioni in oggetto che consistono, appunto in valutazioni estimative rivelatesi errate. L'unica disposizione penal – tributaria che può venire in considerazione in tema di trasfer price è, dunque, quella di cui all'art. 4 del decreto legislativo 74/2000, incentrata sull'indicazione in dichiarazione annuale di elementi attivi per un ammontare inferiore a quello effettivo o elementi passivi fittizi.*"

[96] See judgment of Supreme Court n. 7739/2012 commented by G. NEGRI, *Sanzione penale anche per l'elusione*, in *Il Sole 24 Ore*, 29.02.2012.

[97] See also I. CARACCIOLI, *Sull'inesistenza di reato di fronte alla contestazione del transfer pricing nei rapporti internazionali e dei prezzi di vendita in operazioni infragruppo*,in *Riv. Dir. Trib.*, n. 11, 2008, p. 140. See D. STEVANATO, *La rilevanza penale del Transfer pricing: una questione ancora aperta*, in *Dial. Trib.*, 2007, p. 471.

method is named "*Tonnage tax*". The different method is applied also for the dealings between the related parties in shipping area, as the art. 160 TUIR establishes that the dealings (goods or services) acted between companies are calculated with the arm's length principles[99]

With this article also for companies' group resident in Italian State it is applied the arm's length principle contained in art. 9 and 110 TUIR. As afore described, this case represents, in the Italian Tax System, internal transfer price rule.

6.6. Italian case law

Proceeding the analysis about the application of transfer pricing rules and consequent particular allocation of income between States, it is necessary to comment the approach adopted by the Italian Court.

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[98] This article affirms that:
"*1. Il reddito imponibile dei soggetti di cui all'articolo 73, comma 1, lettera a), derivante dall'utilizzo in traffico internazionale delle navi indicate nell'articolo 8-bis, comma 1, lettera a), del decreto del Presidente della Repubblica 26 ottobre 1972, n. 633, e successive modificazioni, iscritte nel registro internazionale di cui al decreto-legge 30 dicembre 1997, n. 457, convertito, con modificazioni, dalla legge 27 febbraio 1998, n. 30, e dagli stessi armate, nonché delle navi noleggiate il cui tonnellaggio non sia superiore al 50 per cento di quello complessivamente utilizzato, è determinato ai sensi della presente sezione qualora il contribuente comunichi un'opzione in tal senso all'Agenzia delle entrate entro tre mesi dall'inizio del periodo d'imposta a partire dal quale intende fruirne con le modalità di cui al decreto previsto dall'articolo 161 (1). L'opzione è irrevocabile per dieci esercizi sociali e può essere rinnovata. L'opzione di cui al comma 1 deve essere esercitata relativamente a tutte le navi aventi i requisiti indicati nel medesimo comma 1, gestite dallo stesso gruppo di imprese alla cui composizione concorrono la società controllante e le controllate ai sensi dell'articolo 2359 del codice civile.*
2. L'opzione consente la determinazione dell'imponibile secondo i criteri di cui all'articolo 156 delle navi di cui al comma 1 con un tonnellaggio superiore alle 100 tonnellate di stazza netta destinate all'attività di:
a) trasporto merci;
b) trasporto passeggeri;
c) soccorso, rimorchio, realizzazione e posa in opera di impianti ed altre attività di assistenza marittima da svolgersi in alto mare.
3. Sono altresì incluse nell'imponibile le attività direttamente connesse, strumentali e complementari a quelle indicate nelle lettere precedenti svolte dal medesimo soggetto e identificate dal decreto di cui all'articolo 161."

[99] This article affirms that: "*1. I soggetti che esercitano l'opzione di cui all'articolo 155 non possono esercitare quella di cui alle sezioni II e III del titolo II né in qualità di controllanti, né in qualità di controllati.*
2. Alle cessioni di beni ed alle prestazioni di servizi fra le società il cui reddito è determinato anche parzialmente ai sensi dell'articolo 156 e le altre imprese ((,anche se residenti nel territorio dello Stato,)) si applica, ricorrendone le altre condizioni, la disciplina del valore normale prevista dall'articolo 110, comma 7.".

The Italian judge, n. 6194/2007, underlined important notion of transfer price. In particular, it affirmed that to determinate income basis, derived by dealings between related parties, inherence principle application can be applied. In order to this principles, the Italian court drew some important judgments of the European Court, for example, C- 110/98, *Rè gie Dauphinoise* and some judgments of the Supreme Court on inherence notion, i.e. n. 4419/2003, n. 10491/2003.

In addition, the Supreme Court affirmed that, for this case, was relevant, besides the inherence principle, transfer price rule and the consequent arm's length principle. However, in the case examined the subjects did not belong to a group of multinational companies. Art. 110, par. 7, refers only multinational group.

The second judgment is n. 23634/2008 and the Italian Court claimed that the arm's length principle can be applied not only to transactions between multinational corporations, *external transfer price*, but also to the Italian companies, internal transfer price, because arm's length, contained in Art. 9 TUIR, is a general principle of Italian tax[100].

In other word, with judgment, accepted the argument can be applied also to the transfer pricing of operations resident society groups attributing to the arm's length character of the fundamental rule. But according to the provisions we have examined cannot be attributed to this general principle[101].

[100] See also judgment n. 10802/2002.

[101] See also E. DELLA VALLE, cit., who has analyzed the thought of Italian Court about internal transfer price and a general arm's length principle, J. n. 10802/2002 and subseq. and who affirmed that: "*Non risulta condivisibile quanto affermato dalla nota sentenza della corte di cassazione n. 10802/2002, secondo cui esisterebbe un principio generale desumibile dall'art. 9 del dpr 917/1986, in base al quale l'amministrazione è tenuta a valutare ai fini fiscali le varie prestazioni che costituiscono le componenti attive e passive del reddito secondo il valore di mercato. Tale principio non esiste; all'opposto, la valutazione a valore normale è regola che in taluni casi subentra in funzione derogatoria al principio di determinazione del reddito sulla base dei corrispettivi pattuiti*."

Chapter IV. The Common consolidated corporate tax base

1. Introduction

In 2011, European Community has proposed a draft directive for the establishment of a common tax base for corporate income. This text approved by EC in march 2011, is named Common consolidated corporate tax base.

The proposal aims to reduce the difference in tax rates, elimination of double taxation and to facilitate cross-border transactions between companies resident in the member states[102].

In particular, the general principles such as exemption of taxation for dividends and specific rules on corporate groups should implement the concept of tax neutrality, as the rules analyzed in the previous sections that, on the contrary, show the differences in taxation, and the differences between Italian[103] and international tax law.

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[102] See M. GIACONIA, *Proposta di Direttiva CCCTB: Prime reazioni di fonte italiana con le audizioni al Senato*, in *Fiscalità e commercio internazionale*, n. 9, 2011, who tells "*Con tale iniziativa, la Direttiva intende rimuovere i maggiori vincoli di natura fiscale che ostacolano l'espansione e l'operatività transfrontaliera delle imprese europee, determinati dalla interazione dei ventisette diversi regimi fiscali: il riferimento è in particolare ai fenomeni di doppia tassazione e ai costi di natura amministrativa di compliance alle discipline locali sul transfer pricing.*"

[103] M. GIACONIA, *cit.*, who affirms that:

"*Nelle loro relazioni, Assonime e Ministero delle Finanze evidenziano come il sistema proposto dalla Direttiva dia garanzia di stabilità alle regole di determinazione del reddito imponibile; per questo motivo, tale sistema dovrebbe essere particolarmente apprezzato dalle imprese italiane.*

In particolare, Assonime osserva come le Manovre fiscali annualmente realizzate dal nostro Legislatore per esigenze di gettito comportino sistematiche variazioni della base imponibile. Tale modalità di intervento - continua Assonime - è preferita alle Manovre che agiscono sulle aliquote d'imposta, per ragioni (anche) di "immagine" politica, nonostante queste siano di più facile gestione per i contribuenti.

La stessa riflessione è stata operata da altre associazioni di categoria in sede di audizione . A titolo esemplificativo, è stato citato l'ultimo intervento di riforma della disciplina IAS: è stato a questo riguardo sottolineato che il nostro Legislatore, dopo aver previsto l'applicazione del principio generale di derivazione per le imprese IAS, "ha voluto tutelarsi, mediante appositi decreti, dai riflessi negativi che dovessero derivare da modifiche alle regole contabili diramate dalle competenti autorità tecniche internazionali".

Si osserva che il disagio dei contribuenti di fronte a tale interventismo del Legislatore italiano in materia fiscale è aggravato dall'abitudine di disporre l'efficacia delle nuove disposizioni nell'esercizio in corso, in violazione dello Statuto dei contribuenti (art. 3 della Legge 27 luglio 2000, n. 212). Come esempio più recente, si possono citare le nuove disposizioni introdotte dalla Manovra 2011 (D.L. 6 luglio 2011 n. 98), relative ai finanziamenti conseguiti da società consociate europee attraverso l'emissione di titoli quotati (art. 23, comma 1 e ss.) e all'ammortamento dei beni gratuitamente devolvibili (art. 23, comma 10), applicabili dall'esercizio 2011. Nel panorama descritto, ogni riforma in grado di dare stabilità alle regole di determinazione del reddito imponibile si dimostra quanto mai opportuna."

This draft provides a common calculate income basis of company with a clear and simply rules. There is, for example, a section for the costs of company income: passive interest, research and development, lost etc.

The uniform taxation proposed by this common document has another purpose. The common taxation, in fact, limits the abuse of tax law or tax avoidance and tax evasion. With introduction a similar tax rates there is not tax haven in EC territory or States with a low taxation.

2. Comparison between CCCTB and PE's taxation and transfer price rules

The CCCTB introduced a common taxation of income for Permanent establishment[104]. This subject is considered as an entity separate and the income derived in the host country there taxed. This rule is similar to the permanent establishment taxation provided by articles 5 and 7 OECD Model.

The art. 73 CCCTB, called "*Switch-over clause*"affirms that:

"*Article 11(c), (d) or (e) shall not apply where the entity which made the profit distributions, the entity the shares in which are disposed of or the permanent establishment were subject, in the entity's country of residence or the country in which the permanent establishment is situated, to one of the following:*

(a) a tax on profits, under the general regime in that third country, at a statutory corporate tax rate lower than 40% of the average statutory corporate tax rate applicable in the Member States;

(b) a special regime in that third country that allows for a substantially lower level of taxation than the general regime.

The average statutory corporate tax rate applicable in the Member States shall be published by the Commission annually. It shall be calculated as an arithmetic average. For the purpose of this Article and Articles 81 and 82, amendments to the rate shall first apply to taxpayers in their tax year starting after the amendment."

Another aspect useful in this section is fiscal profile of transactions between related parties in the CCCTB. The art. 78 introduced the general and

[104] See art. 5 CCCTB that describes a PE's notion.

specific elements for the dealings between companies and the allocation of their income. The norm aforesaid tells:

"*If a taxpayer participates directly or indirectly in the management, control or capital of a non-taxpayer, or a taxpayer which is not in the same group, the two enterprises shall be regarded as associated enterprises.*

If the same persons participate, directly or indirectly, in the management, control or capital of a taxpayer and a non-taxpayer, or of taxpayers not in the same group, all the companies concerned shall be regarded as associated enterprises.

A taxpayer shall be regarded as an associated enterprise to its permanent establishment in a third country. A non-resident taxpayer shall be regarded as an associated enterprise to its permanent establishment in a Member State.

2. For the purposes of paragraph 1, the following rules shall apply:

(a) participation in control shall mean a holding exceeding 20% of the voting rights;

(b) participation in the capital shall mean a right of ownership exceeding 20% of the capital;

(c) participation in management shall mean being in a position to exercise a significant influence in the management of the associated enterprise.

(d) an individual, his spouse and his lineal ascendants or descendants shall be treated as a single person.

In indirect participations, the fulfilment of the requirements in points (a) and (b) shall be determined by multiplying the rates of holding through the successive tiers. A taxpayer holding more than 50% of the voting rights shall be deemed to hold 100%."

The subjective and objective elements provided, by this disposition, correspond with the concepts explained by OECD Model and domestic law. The rules analyzed shortly show a important draft that contains dispositions to simplify a tax corporate in EC Territory[105].

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[105] See P. VALENTE, *Vantaggi fiscali per le società nella proposta di direttiva UE sulla base imponibile comune*, in *Corr. Trib.*, n. 16, 2011, p.. 1359.

Moreover, the following article concerns a general transfer price rule with arm's length principle application. This provision, called "*Adjustment of pricing in relations between associated enterprises*", tells that:

"*Where conditions are made or imposed in relations between associated enterprises which differ from those that would be made between independent enterprises, then any income which would, but for those conditions, have accrued to the taxpayer, but, by reason of those conditions, has not so accrued, shall be included in the income of that taxpayer and taxed accordingly.*"

Art. 79 attributes equal treatment in order to calculate of dealings value between related parties and avoids the preventive use of mutual agreements procedure for companies resident in member States.

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Anti-abuse law

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092543

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PART 1

ANTI-ABUSE RULE

CHAPTER 1 – GENERAL ANTI-ABUSE RULE IN ITALIAN LEGISLATION

1. INTRODUCTION

The notion of "anti-abuse rules" covers a broad range of rules, measures and practices through which States seek to protect their (corporate and individual) tax bases. A State may apply a general concept of abuse based on legislation or developed in case law and/or more specific anti-abuse provisions, such as Controlled Foreign Corporation (CFC) and Thin Capitalization rules which aim to protect the tax base from particular types of erosion. Other types of specific anti-abuse provisions include, for instance, switch-over from exemption to credit method in certain cross-border situations and provisions explicitly targeted at passive investment in other countries.

Until the end of the eighties of last century, the legislator did not provide any general anti-avoidance provision; this situation had led to a fervent interest in the doctrine that raising the problem of how to counter the evasive behavior of taxpayers[1].

It was peaceful the distinction between tax evasion[2] and tax avoidance, but was more difficult to identify the dividing line between legitimate tax savings[3] and tax avoidance[4]. It was necessary to avoid, once identified a general principle

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[1] M. ANDRIOLA, *Ipotesi applicative di norma antielusive*, in *Rass. Trib.,*2006,6, p.1898 ss.
[2] It consists in violating the legal obligation to pay taxes.
[3]G. CHINELLATO, *Codificazione tributaria e abuso del diritto*, Padova, 2007, p. 164 – 174.
The taxpayer can make choosing from the various options offered by the legal system to help him/her minimizing the tax burden.
[4] F. TESAURO, *Istituzioni di diritto tributario. Parte generale*, Torino, 1998, p. 213. Juridical doctrine tried to extrapolate from the observation of the phenomenon the essential characteristics of tax avoidance. It was found out that there are always four aspects present in a tax avoidance case, which are: the abnormality of the transaction actually put in place, in confront of the type of transaction that would normally have been performed in those circumstances; the equality in the result obtainable through the abnormal transaction, in confront of the one obtainable through the transaction provided by the tax statute; the suitability of the abnormal transaction to get a decrease (or the nullity) of the tax burden; the exclusive (or prevalent) subjective intent of escaping from the tax burden provided by the avoided norm.

of prohibition of fraud in tax law, the attribution of an excess of power to Financial Administration so large as to result in a true union in business decisions taxpayers, in stark contrast with the principle enshrined in Art. 41 of the Constitution, which protecting the free private enterprise[5] .

In an attempt to locate a criteria to distinguish the two figures, Italian doctrine has often made reference to *Fraus Legis*. Art. 1344 c.c., titled "Fraus legis (of contracts)", clearly states that, *when a contract is used as an instrument to avoid the application of an imperative norm, its cause must be considered illicit. And when the cause is illicit, the contract is void* (art. 1418 c.c.)[6]. The crucial issue concerns the classification of imperative norms: if tax measure can be treated as an imperative norm that does not allow exceptions, to be directed to protect public interest [7].

In accordance with influential Doctrine, the possibility of invoking the law on fraud would cover the interstices of the system lack of specific protection and qualify as illegal behaviors that do not formally go beyond the letter of the law, but basically contradict the purpose. In order to verify the illicitness, it would be necessary the existence of an operation created with the actual scope of avoid the rising of taxing burden and, at the same time, to go round the application of a rule.

On the other hand, the main arguments for the irrelevance of fraud in tax law are about the failure in tax jurisdiction of a general anti abuse clause that allows tax authorities to set aside contracts. But it should be noted that, while in the past it was not interpreted in this way, recent judiciary developments seem to read Art. 53 of the Italian Constitution, which establish the "ability to pay principle" in its first paragraph, as an imperative norm that puts a limit to the exercise of private autonomy when the purpose is to obtain a lower tax burden without any valid economic reasons. On the contrary, the existence of specific anti

[5] M. ANDRIOLA, *Ipotesi applicative di norma antielusive,* cit., p. 1900. it seems that the taxpayer can save taxes when he/she chooses between two or more alternatives provided by the legal system. And this would be lawful tax saving. On the contrary, when the tax payer does not choose between licit alternatives but circumvent tax norms, then it will be tax avoidance.

[6] M. P. TABELLINI, *Libertà negoziale ed elusione d'imposta*, Padova, 1995, p. 46 ss.

[7] F. GALLO, *Brevi spunti in tema di elusione e frode alla legge (nel reddito d'impresa),* in *Rass.Trib.*, 1989, I, p. 17.

avoidance presumptions of law which would create a self sufficient system, repulsive of a general anti avoidance rule[8].

The main objection to the thesis of the applicability of Art.1344 of civil code moves from the consideration that a general principle would leave too much discretion for the interpreter and, therefore, would introduce uncertainty into a sector, such as tax law, where the requirements of certainty of law are substantive.

Secondly, the civil law remedy to *fraus legis* is the nullity of the contract. But this kind of sanction results quite excessive and insufficient at the same time in confront of the objectives of tax law[9]. It is excessive because it brings to the elimination of the contract, while it would be much better to simply make it unenforceable to the tax administration; in this way, the civil law validity of the contract would be safe but, at the same time, the tax administration would have the power to re-characterize it only for tax purposes. It is insufficient because it does not make the Italian revenue authority able to take back the amount of tax yield stolen through the use of tax avoidance contractual constructions.

Starting in the '70s, avoidance has become a disturbing phenomena because of its negative effects on internal revenue; it was evident that other measures have to be implemented in order to cover the spaces left unprotected by the absence of a general anti abuse rule.[10] After repeated attempts, the legislature adopted the Art.37-*bis*, which introduced an anti abuse clause collocated in a middle position between a general anti abuse clause and a specifical one.

1.2 ART.37- BIS INCOME TAX ASSESMENT CODE

Article 37-bis ITAC[11] represents a quasi-general anti-avoidance provision that is assuming a growing importance for business enterprises. It provides that acts, facts and negotia cannot be opposed to Financial Administration, if they are

[8]F. GALLO, *Brevi spunti in tema di elusione e frode alla legge (nel reddito d'impresa),* in *Rass.Trib.*, 1989, I, p. 12.
[9] Already in 1923, Hensel was saying that: "the scope of the attempts to stop tax avoidance is not the nullity of the contract, but the revenue from the tax avoided". A. HENSEL, *Zur Dogmatik des Begriffes "steuerumgehng"*, in *Bonner Festgabe für Zitelman*, 1923, p. 119.
[10] M. P TABELLINI, *L'elusione della norma tributaria*, Torino, 2007, p. 129.
[11] Presidential Decree n. 600, 29 September 1973.

lack of economical reasons[12], *to bypass duties or prohibitions* stated by juridical order, *to get tax cut or repayment undeserved*"[13].

In presence of tax benefits derived from this transactions, Financial Administration has the power and the duty of rejecting themselves, applying the ordinary taxation.[14]; in other words, there is an intention of taxpayer to obtain an advantage by artificially creating the conditions for obtaining it.

In summary, the rule provides that three criteria must be fulfilled in order to determine the existence of a tax-avoidance transaction:

(a) the lack of business purpose;

(b) the circumvention of obligations/prohibitions;

(c) the result of obtaining tax reductions/refunds otherwise not due[15].

The first one is the *business purpose test*. The transaction must have a real and substantial economic motivation (*economic substance*) and its purpose (*business purpose*) shall achieve an economic benefit regardless of the tax saving. Furthermore, the advantage statement must be actual and not potential (profit potential), in compliance with tax planning normally permitted[16]. Economic substance must be assessed on a case by case basis trough a comprehensive review of the factual situation, in particular, looking to the economic reason of the transaction, the extent of any tax advantage, the congruence with respect to the legal instrument used with regard to economic interests pursued.[17] In fact, we deal with acts and behaviors that allow to reach a certain economic result at a tax cost lower than it should have been born if the taxpayer had acted according to ordinary legal model[18].

Circumvention of obligations or prohibitions underlines also the importance of identifying a contraposition between two different paths that bring

[12]C. GARBARINO, *Manuale di Tassazione internazionale*, Milano 2008, p.741 ss. It should be noted that a fiscal reason is not an economical one. We needs only think to business purpose test.

[16] It consists of three fundamental elements which must characterized every fiscal operation all together.

[14] The taxation it would be applied if the taxpayer does not have realized the tax benefits.

[15] As a further clarification, the Ministry of Finance (*Circular n. 320, of 19 December 1997*) pointed out that the tax savings are illegitimate when they are contrary to the ability to pay principle (Art. 53 of the Italian Constitution)

[16] R. LUPI*, Disorientamenti sull'elusione, salvo che per le sanzioni,* in *GT*., 2007, 7, p. 622.

[17]M. P. TABELLINI, *L'elusione della norma tributaria,* cit., p. 244 ss.

[18] P. RUSSO*, Brevi note in tema di disposizioni antielusive*, in *Rass. Trib*., 1999, I, p.75.

to the same economic and juridical effect. One, the tax avoidance behavior, profitable from a tax point of view; the other, the rightful behavior avoided, brings to the same result more directly and rapidly, but is also more expensive in terms of tax burden.

With the expression *tax reductions or refunds*, the legislator meant any kind of tax advantage. Therefore, it may consist in a reduction of the amount of taxes to be paid, or in a lower tax, or in any other way profitable from a tax point of view.

The rule in its formulation is applied only to transactions listed therein[19]. They seem to represent at least the major ways in which taxes can be avoided. In this perspective, Art 37-*bis* may be qualified as "almost-quasi-general" provision. The rule punishes pathological tax advantages; it shall not affect taxpayers' behavior to choose the transaction that leads to the lowest taxation[20].

The 3 rd paragraph of Article 37-*bis* has a very wide scope, mainly due to subsidies granted by the doctrine that has come to between them cover the majority of the operations that a company business is able to put in place. The idea of expanding the scope of provision cannot be, however, irrespective of the fact that the list exists and that with it we always have to confront. In fact, the legislature could have adopted a general clause, but did not fact, preferring to insert a listing wide and capable of being dilated using a unique action on the part of the disposal, without changing the general structure[21].

But the truly qualification passes by the evolution of the Supreme Court of Cassation which has granted a constitutional basis to the rule.

[19] The catalogue of transactions are indicated to Art.37-bis, c3 from lett. A) to let. B).
(a) transformations, mergers, divisions, voluntary liquidations and distributions to the shareholders other than profit distributions; (b) contributions to the capital of companies and transactions concerning branches of activities; (c) transfers of credits; (d) transfers of excess tax credits; (e) operations carried out under the legislation implementing the Merger Directive; (f) operations concerning transfers and valuations of participations, transfers of securities, foreign currencies and precious metals and transactions on derivative instruments.

[20] R. LUPI, *Elusione e legittimo risparmio d'imposta nella nuova normativ*a, in *Rass. trib*., 1997, p.1100.

[21] M. BEGHIN, *L'elusione fiscale tra presupposti applicativi, esimenti, abuso del diritto ed "esercizi di stile",* in *Rass. Trib*., 2008, 5, p. 334 ss.

1.3 THE OPINION OF THE SUPREME COURT OF CASSATION

Less than the ten years since the introduction of Art. 37-*bis*, emerging interest in a institution already used in anti-avoidance key by the Court of Justice as well as from other European systems, in particular the German: the so called "Abuse of the law." Before reaching mature evaluation, the Supreme Court followed a long evolutionary path.

In a first phase the court adopts a *positive legal theory*:[22] tax avoidance is linked to explicit rule of law; the court stated that only those behaviors that are defined by a statute, in force at the time when the facts came to existence, can be considered as an attempt to avoid taxes, and therefore of no effect. At this stage, treating the problem of dividend washing, the Court noted the absence of a prohibition that denied the power to transmigrate through an act the ownership of an asset, allowing the movement on the part of subject most favored from tax point of view; consistent with this approach, tax authorities had no power to redevelop contracts placed by the parties, to subject them to less favorable tax treatment than the treatment would otherwise be applicable.

In judgment 20816/2005 the Court asserted that, if the only interest pursed by parties is to save taxes, their transaction should be considered void because it defects of the cause of contract. In such way, the Court of Cassation applied private law concepts to tax law, stating that the *fraus legis* concept is applicable also in tax law.

Later time, the Court of Cassation[23] asserts that the lack of a reasonable economical purpose which was sufficient to justify two linked agreements, (purchase agreement and selling one)[24], or the constitution of legal right of usufruct[25] it would have lead to absolute void[26]*;* if the only interest pursed by the parties is to save taxes, their transaction should be considered void because it defects in the cause of the contract[27]. The defect in the cause that invests in its

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[22] Cass., 3 April 2000, n. 3979; Cass., 3 September 2001, n. 11351; Cass., 7 March 2002, n. 3345.
[23] Cass., 21 October 2005,n. 20398 ; Cass.,14 November, n. 22932.
[24] This operation is generally called " *Dividend Washing*".
[25] This operation is generally called "*Dividend Stripping*".
[26] Art.1325-1418 c.c. for a lack of "cause ", ex art.1418 c.c., or fraus legis, *ex* art 1344 c.c.
[27] The purchaser of shares from a mutual investment fund, after having received the dividends, sales those shares again to the same fund in order to permit the circumvention of the tax regime

essence the linked contracts, as the Court of Cassation pointed out, implies their non effectiveness in front of the tax administration. The National Judges found that the concept of abuse of law, while Art. 37-bis ITAC was not operative yet in the Italian legal system at the time of the facts object of the judgment, should had had a central role in the application of domestic law. The Court supported the direct applicability in the Italian legal system of Abuse of Law as developed by ECJ[28]. In judgment 22932 (first time in which the Court had to deal with a case of dividend stripping) underlined the presence of a general principle elaborated by ECJ by virtue of it is not possible to benefit from transactions enforced for the sole purpose of elusion. The existence of this European principle must push the interpreter in the search of appropriate ways within National system to counter the abuse of law. This had been the first time that the Court of Cassation expressly supported the direct applicability in the Italian legal system of the principle of abuse (of Community) law as developed by the European Court of Justice[29].

In 2006, European Court of Justice with Halifax and Cadbury Schweppes[30] leading cases elaborates a more general conception of "abuse of law" as a general principle of European system[31]. The first important definition of abuse of right by the Court of Justice have been designed with Halifax, C-255/02,21 February 2006,

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provided for by art. 9 of statue n. 77 of 1983 on the income from equity investments held by mutual funds, the application of that principle is reflected in a defect in the cause which gives rise to the nullity of the linked contracts for the purchase and resale of the shares, since the parties would nt take from them any other advantage than tax savings.

[28] A. LOVISOLO, *Il principio di matrice comunitaria dell'<abuso> del diritto entra nell'ordinamento giuridico italiano: norma antielusiva di chiusura o clausola generale antielusiva? L'evoluzione della giurisprudenza della Suprema Corte,* in *Dir.Prat. Trib*., 2007, II, p. 738.

[29] European Court of Justice, judgments n. 125/76, of 11 October 1977, (Cremer case); n. C-8/92, of 3 March 1993, (General Milk Products case); n. C-206/94, 2 May 1996, (Palletta case); n. C-367/96, of 12 May 1998, (Kefalas case); n. C-110/99, of 14 December 2000, (Emsland Stárke case); n. C-167/01, of 30 September 2003 (Diamantis case).

[30] In Cadbury Schweppes the Court asserted that: *" Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host Member State and carries on genuine economic activities there."*

[31]Cass., 17 October 2008, n. 25374.

considered as a true leading case on abuse of law. Judges have applied for the first time the abuse of law relating on VAT discipline[32]. The Halifax had a crucial importance for the development of Supreme Court that until a few months before (C.Cass. nn. 20398, 20816, 22932 of 2005)was limited to mentioning the principle of abuse. However, in the judgment of the Supreme Court of September 29, 2006 n. 21221, the situation changes considerably because Judges claims that the application of the principle of abuse of right is required for its European background. It implies that the prohibition of abuse should be regarded as a rule will apply not only to harmonized tax but also to all sectors of the tax order.

In the same year the Court , trough subsequent decisions[33], has partially rejected such position; the ECJ conception of abuse of tax law evidences a longer approach: it's not sufficient a tax advantage but it is necessary that this one aims at circumventing the application of the legislation. The Supreme Court has clearly stated that the abuse of law must be qualified as a canon of interpretation. It is an additional criterion to counter tax avoidance. When the judges say that the doctrine of abuse of law is a canon of interpretation regulator of ordering, planning to introduce a kind of interpretive evaluation, on the one hand, with reference to the elusive business realized, allowing the interpreter to look ahead in the formal aspect, considering instead the content and the substantive effect of the transaction .It is important to determine what is the relation of abuse of law principle and other juridical criterion governed by our legislation. Accordance with a first approach, the anti-abuse principle could represent a rule to contrast elusive activities which are not punishable by analytical anti-avoidance clauses or by quasi general anti-avoidance rule Art.37-*bis*. In its decisions n.30055 and 30057 dated December, 23st 2008, the Court - dealing once again with dividend washing and dividend stripping cases - qualifies the principle as a General Anti Avoidance Rule which has a *constitutional ground in principle stated in Art.53* of Constitutional Law[34]; it was stated (in both judgments) that: “the source of that [general anti-avoidance] principle, in the case of non harmonized taxes, such as direct taxes, it is to be searched not in EU case law but rather in those

[32] ECJ have confirmed the existence of a general principle that prohibits individuals to take advantage or make transactions with the sole purpose to obtain benefits otherwise undue.
[33]Cass., 29 September 2006, n. 21221.
[34] Art.53 Cost states the “ability to pay” of taxpayers.

constitutional principles that are the base of the Italian tax system. In fact, the principles of contributive capacity (Art. 53, first paragraph, of the Constitution) and progressive taxation (Art. 53, second paragraph of the Constitution) are the base both of tax norms in a strict sense and norms that give any kind of benefit to the taxpayer, being those norms finalized evidently to a better effectiveness of those principles". The judgment identifies 2 elements which must characterize juridical operation:

- the behavior of taxpayer
- the aim or purpose under the behavior.

The first one reflects an irrational and extraordinary use of juridical instruments with the only purpose of obtaining a *fiscal benefit,* so the aim of a tax advantage in the principle aim of the transaction.

The second one leads to the purpose of fiscal benefit in *the lack of reasonable economical porpoise.*

In other words, by virtue of Art.53 Cost. the basis of taxation is the liability of taxpayers to contribute to public expenditure whatever the existence of special tax law that this liability taxes[35].

The transactions aimed at circumventing the application of the legislation and at gaining a tax advantage as the principal aim of transaction are lack of any effects. If a commercial purpose is achievable by one or more instruments which all expresses economical initiative, equality arising from common of purposes would be violated; the presence of more economical reasons than tax saving makes it justified the difference in tax burden[36].

An important clarification moves from judgment n.1372 of 2011[37] by which the application of the principle must be guided by a particular caution, as need to find the right line between tax planning overly aggressive and freedom of choice of legal forms, especially when it comes from business activities; it must be said that the elusive characterization must be excluded when it is possible to

[35]S. FIORENTINO, O. LOMBARDI, *L'abuso del Diritto nella giurisprudenza tributaria della cassazione:da nomofilachia a nomogenesi,* in *Obbl. e Contr*., 2011.
[36] This position is confirmed in Cass. 25 May 2009, n. 12042 and in Cass. ord. 2 November 2011 "As reiterated in Halifax, the behavior of taxpayer consists in the fact that, unlike the assumption of fraud ", the subject has entered into real transactions, corresponding to legal model.
[37] Cass. 21 January 2011, n. 1372.

identify the existence of extra tax reasons that do not necessarily identify in immediate profitability of the operation but may be also purely consist in organizational, structural and functional reasons.

Anti-abusive interpretation expresses a general clause of justice in the allocation of taxes between taxpayers; it becomes the expression of a constitutional equality and, at a lower level it reveals its attitude of general fiscal rule able to orient the interpretation of fiscal system[38]; furthermore, it has a preventive and deterrent force. The taxpayer is free to carry out his operations, but it is bound to remain within what is allowed.

Doctrine has criticized this position [39]; in the lack of a general anti abuse rule the jurisprudential creation seems to be contrary to Italian tax law system, in absence of any legal provision. On the other hand, it must be pointed out that an anti-avoidance clause limits the distorting phenomena of tax planning, without affecting the legal certainty , which would be affected if the contrast to avoidance was passed through general unwritten clauses (and, before that, through declarations of nullity of contracts or simulation)[40].

1.3.1 A BRIEF OVERVIEW ABOUT CRIMINAL RELEVANCE OF TAX AVOIDANCE

It is even more controversial whether tax avoidance should have criminal relevance. Also in this case, in the absence of any relevant case law, the doctrine has often debated on different positions. Some scholars[41] found the argument

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[38] The ratio behind the clause can be simplified: it's supposed that the realization of economical aim of a transaction must be taxed on X (taxpayer). X has realized the aim trough the use of A (transaction). The same juridical treatment must be reserved to everyone uses that same juridical transaction aimed to the realization to the same economical aim if, to obtain it, Y(taxpayer) has used linked transaction, different from the A one which are taxed with a lower tax rate.

[39] S. DE MITA, *L'antielusione trova una base in Costituzione*,in *Il Sole-24 Ore*,2 gennaio 2009; G. ZOPPINI, Da *mihi factum,dabo tibi ius:note laterali sulle recenti sentenze delle Sezioni Unite in tema di abuso del diritto*, in *Riv.dir. Trib* , 2009, I, 607 ss.

[40] S. FIORENTINO, *L'elusione tributaria scelte di metodo e questioni terminologiche*, Napoli,1996, p.165 ss.

[41] G. BARTOLINI, *Sulla progettata penalizzazione delle condotte elusive*, in *Il Fisco*, 1998, p. 5496; O. CUCUZZA, *L'art. 37-bis del D.P.R. n. 600/1973 e la riforma del sistema penal-tributario*, in *Il Fisco*, 1998, p. 3715; M. DI SIENA., *Brevi considerazioni sulla criminalizzazione dell'elusione fiscale,* in *Il Fisco*, 2003, p.3316. Different judgments led to the same considerations:

criminal irrelevance on the basis of two arguments: the presence of the necessary psychological element and procedural nature of Article 37a. The formulation of specific intent "to evade" *expressis verbis* excludes the criminal relevance of tax avoidance. The procedural nature of the anti-avoidance rule led to state that the taxpayer is free to choose the scheme deemed adequate to the operation; in parallel, Fiscal Administration may disapply tax effects of the scheme chosen by the taxpayer. Other scholars[42], in a minority position, argue for the criminalization stating that tax avoidance is not that dissimilar from a fiscal fraud. Therefore, they see no reason why also tax avoidance schemes should not be punished with criminal sanctions, as in the case of the fiscal fraud. Such attitude would make Legislative Decree n. 74 of 2000 perfectly applicable also to tax avoidance, if the aim of legislator is to protect the correct perception of levy, you do not se why all those activities which are suitable to compress tax basis should go free from punishment. Recently, the problem seems to be partly explained in the light of a decision of Court of Cassation[43] . From an investigation carried out on a disposal of brands to Luxembourg company for an amount that tax authorities assumed to to be less than the market value, for the purpose of avoiding tax in Italy, may also derive a criminal penalty (Cass., Sec. II, 28.02.2012, n. 7739). The judges of the Supreme Court have ruled that the behavior of the elusive taxpayer cannot be considered criminally when it leads to committing the offenses of no declaration or misrepresentation despite the lack of an express criminal sanctions in the abuse of law. The scope of the rules may incriminate those activities that are likely to result in a reduction or exclusion of the tax base. It should be noted that in Halifax case, ECJ states that "the discovery of a tax avoidance behavior should not bring any kind of sanctions, for which it is necessary a clear and univocal normative

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CTP Milano, sez. XVI, n. 278 del 13.12.2006; CTR Lombardia, sez. XVII, n. 2 del 14.01.2008; CTR Toscana, n. 26 del 1.4.2009; Cass., section. V, n. 12042, 25.5.2009.

[42] F. GALLO, *Rilevanza penale dell'elusione*, in *Rass. trib.*, 2001, p. 321; A. TOPPAN, *Elusione fiscale e sanzioni penali*, in *Rass. trib.*, 1994, p. 206; S. GOLINO, *Le verifiche fiscali e le nuove sanzioni penali*, in *Il Fisco*, 2000, p. 6569; G. BERSANI, *Elusione fiscale e dichiarazione infedele*, in *Il Fisco*, 2002, p. 7678. P. ADONNINO, *Parere del Ministero delle finanze e del Comitato Consultivo per l'applicazione delle norme antielusive e rilevanza penale dell'elusione*, in *Riv. dir. trib*., 2001, I, p. 244.

[43] G. NEGRI, "*L'elusione fiscale diventa un reato: sanzioni penali per chi sceglie i paradisi fiscali"*, in Il Sole 24 Ore, 2012.

base, but simply an obligation to repay in part (or all) the taxes unfairly not paid." However, the debate on the point is still in progress.

1.4 TAX HAVEN, BLACK AND WHITE LIST: A METHOD TO COUNTERACT THE EROSION OF TAX BASIS

The vast majority of European countries, including Italy, adopt enforcement measures to protect tax base from tax erosion and endure competition from preferential tax regime countries. The identification of these states is essentially based on two criterion: low tax rates (or the adoption of a zero level of taxation) and the absence of a comprehensive and effective exchange of information[44]. The legislator proceeded to suppress the "black list"[45] and replace them with "white list"[46]. Exchange of information is recognized as a crucial tool

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[44] In accordance with OECD Model, the criterion of exchange of information and transparency was progressively increasing its prominence to qualify a tax haven.

[45] In its first formulation, *Art 76, comma 7-bis,TUIR (introduced by Lg.413/1991)* qualified as "favorable" the tax regime which excluded from income tax or subjected income to a lower taxation (the half one than the taxation applied in Italy).

With *Art.1,comma 2,lett b), Lg 342/2000* the criteria were modified; *D.M. 21 November 2001* had implemented the legislation.

- Art 1 identifies "pure" tax haven.
- Art 2 identifies four countries and denies them the deductibility linked to transactions between these countries and other companies
- Art 3 identifies "no preferential tax regime".

D.M 24 January 2002 identifies countries covered by Art.110 comma 10, 11, 12 TUIR are applied. It's composed of three articles:

- Art 1 identifies laxative black list: states, which are deemed, by implication of law, states or territories with preferential tax regime, on the grounds that they enjoy almost total exemption responding, therefore, the requirement of taxation appreciably less than that applied in Italy.
- Countries doesn't include in exhaustive black list with the exclusion of some countries (such as United Emirate Arab, excluded company operating in the oil sector)
- Countries doesn't include exhaustive black list with the inclusion of some countries (such as Switzerland-companies does not subject to cantonal taxation; South Korea-companies that benefits of Tax Incentives Limitation Law.

Comma 2 of Art.3 includes, therefore, blacklisted actors and activities established in the countries referred comma 1 of that article, which benefit from tax reliefs "substantially similar" to those given in the same paragraph one, under agreements or provisions of the Tax Administration of the same countries. This rule allows the taxation only in relation to the countries listed in black list exhaustively, to include schemes that are not established by law, but under administrative acts or practices. On this point, some clarifications were provided by the Financial Administration; it is necessary to verify the actual tax treatment of income relating to specific provisions under negotiation or administrative, not being dictated determining the general statutory provisions for the corporate category. *Assonime* noted that, in this case, would be a burden on the resident also has the honor of this next check.

[46] By Lg.244/2007.

for combating tax evasion; so it was decided to reformulate Italian anti-avoidance rules by eliminating the criterion of reduced taxation and adopting white lists, one of which is based solely on the criterion of the exchange of information.

In practice, while currently the recipient countries of penalties are expressly mentioned in a "black list", according to new method they will be identified "by exclusion", as not falling within any list of virtuous States. The elimination of black list is aimed to overcome the problem - several times Italian Tax Administration disputed - of the existence of explicit discrimination against foreign sovereign countries. As regards the black list, these primarily concern the relationship between preferential tax regime companies and company localized in Italy. The suppression of the black list is intended to avoid that domestic companies are competitively disadvantaged in a global market, in particular referring to *merger & acquisition* market, by which a company reorganize its assets, inheriting the participations of companies resident in tax havens. The new list will contain States and territories that ensure an adequate and effective exchange of information, but this likely to reverberate its effects against states with whom, even if there is a bilateral convention, the mechanism of exchange of information does not satisfy adequacy this criterion. The closest reference is to the Swiss Convention(it should be noted for the special relationship with Italy) which provides a "close" system of exchange of information, i.e. a system limited to cases in which a taxpayer resident in one of two contractors States have asked the application of Convention, but significant effects may occur about European States in respect of which there remain significant restrictions on access to bank information by Italian Financial Administration[47].

Lg.244/2007 proceeded to introduce, trough *Art. 168-bis* (entitled "countries or territories that allow an adequate exchange of information"). It provides the suppression of the black list and replacing them with a white list.

Under the new policy outlined by Art.168-bis,the preferential tax regime countries will be those countries "not included" in special white list to be issued with Ministerial Decree.

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[47] AA.VV. *edit by* G. FRANSONI, *Quaderni nella rivista di diritto tributario-Finanziaria 2008*, Milano, 2008, p.217-218.
E. LO PRESTI VENTURA, *Le «black» e «white lists» nella normativa fiscale italiana: un quadro aggiornato delle diverse discipline*., in *Fisc. int*., 2007, 5, p. 406.

- Two white lists for entities other than individuals.

  -white list exchange, containing the countries with which it's feasible the exchange of information.

  -white list “preferential tax regime countries”, containing the countries where the level of taxation is not significantly lower than that applied in Italy

A white list for individuals. If the exchange of information is the main objective aimed by tax ordinary jurisdictions, at the same time, legal systems were concerned to tighten their rules in order to discourage the migration of tax basis to tax favorable jurisdictions.

The implications of the existence of non-cooperative jurisdictions, including "tax havens", were addressed during the G20 summit in London on April 2, 2009; in the discussion on measures to strengthen the financial system, governments have committed themselves to taking actions against tax havens and sanctions to protect their public finances. The OECD published a report on the progress made by individual countries in the implementation of an effective exchange of tax information. With the Progress Report developed in preparation for the G20 OECD has definitely passed the approach of report” *Harmful Tax Competition*” which distinguished between tax havens[48] and Harmful preferential tax regime[49]. In this regard, the original text (April 2 2009) the report identified three groups of countries: the first group (so-called list of "white") of 40 states and territories had not only joined the standard on exchange of information, but had also actually implemented; the second group (so-called "gray" list) included 38 countries who had joined the exchange of information, but that they had implemented very slightly, by entering into a limited number of agreements or no agreement, the group consisted of 30 tax havens identified in 2000 on the basis of the criteria on Harmful Tax Competition and 8 other countries based of international financial centers; the third group (list "black") was formed of 4 countries (Costa Rica, Malaysia, Philippines and Uruguay) that had not acceded even formally to exchange information.

[48] Countries with low level of taxation and characterized by lack of effective exchange of information; lack of transparency; no substantial activities).

[49] Preferential tax regimes adopted by countries to ordinary taxation, which accorded (and agree) exemptions or very small application of tax to certain entities (holding companies, coordination centers) or objective in relation to certain types of income, banking, financial, insurance.

CHAPTER 2-ABUSE OF LAW IN INTERNATIONAL CONVENTIONS

2.1 HOW TO TACKLE ABUSE OF LAW

OECD Tax Treaty Model does not provide for an explicit definition of improper use or abuse of the treaty itself, nevertheless some specific provisions against those kind of operations are present (e.g. concept of *beneficial ownership* in Art. 10, 11 and 12); it becomes necessary to refer to the Commentary to the OECD Model which -at Par.7 states that- "*the purpose of the conventions against double taxation is to promote, by eliminating international double taxation, the exchange of goods and services, the movement of people and capital";* however, these agreements won't facilitate the tax avoidance and tax evasion.

According to Commentary , taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries' laws.

The OECD Committee on Fiscal Affairs, in that regard, expressed concern about the misuse of international conventions indicating the case of a natural person or legal entity which act trough an entity created in a State for the sole purpose of obtaining benefits under the Treaty, otherwise enjoyable. An hypothesis of indirect violation of the treaty is implemented by the method of "*Treaty shopping"* which consists in the use of the treaty by a person who does not fall within the scope of the same, through the configuration of an international trade transaction, which includes the participation of a person (or entity) resident in a Contracting State, so enjoy the preferential treatment provided for in the Treaty in favor of persons (natural or legal) resident in that State. For example, if the state A grants an exemption on interest paid by its residents to residents of State B, as does the advantage granted to B can lead to a return for A which presumably limits its tax yield in the expectation of capital flows from B, attracted by the favorable regime provided for the interest. if the resident of country C, which does not use a similar conventional scheme with A, puts a subsidiary in country B in order to fund operators of country A, certainly violates the spirit of the Treaty. In fact, the country receives an advantage, without giving

anything in return and country A suffer a loss of revenue without offering a suitable condition to C to inject capital in A[50]. In such circumstances, the principle of reciprocity is violated because the balance of commitments under the treaty is altered.

Another form of abusive tax structure is constituted by "*Rule Shopping*"; this phenomenon is different from treaty shopping because it does not involve the creation or substitution of entities but concerns the attempt to modify the nature of the income and the tax payable. The purpose is to exploit the application of DTC articles that attribute exclusive taxation rights to Resident State instead of articles that provide for a division of those rights. In this way it is possible to avoid Source State withholding taxes. The most important rule shopping cases concern dividends[51]: taxpayers attempt to substitute the dividends conventional clause with the one on interests (thin capitalization) or capital gains (dividend washing). So in thin capitalization operations the objective is to turn dividends into interests[52]. Then, the loan capital remuneration can be calculated on the basis of market price according to arm's length principle or on the basis of the company business profit. In both cases there is no tax neutrality between loan capital and risk capital, but when the arm's length principle is applied it is quite difficult to stop the abusive rule shopping behavior. On the other hand when the remuneration changes on the basis of company profits, a sort of profit sharing element is identifiable allowing for a classification of those loans as hybrid financial instruments[53]. For this reason, the OECD Model added the art. 11.par.6[54]

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[50] V. UCKMAR, *I trattati internazionali in materia Tributaria*, in *Diritto Tributario Internazionale* coordinated by V. Uckmar, Padova, 2005, p.132 ss.

[51] It is important to keep in mind Article 10 of OECD model about dividend taxation which limits Source State taxation rights at: "*a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends; b) 15 per cent of the gross amount of the dividends in all other cases.*"

[52] The general rule in Article 11 of OECD model provides for a maximum withholding tax of 10% on the gross amount: "*However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.*" Moreover, several DTCs grant even complete exemption.

[53] P. PISTONE, *L'abuso nel diritto tributario internazionale*, in *Diritto Tributario Internazionale*, V. Uckmar, Padova, 2005.

[54] Article 11 paragraph 6 of OECD model convention: "*Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount*

Which limits the application of the Article regime as far as it is in accordance with the conditions following by the application of arm's length principle. It is important to notice that, in the meantime, Art. 10 par. 3 excludes the qualification of dividends as income originated by a debt-claim[55]. However, par. 25 of the Commentary to Art.10 allows the application of the dividend regime, provided by the national legislation, for that part of the income that exceeds the amount calculated according to arm's length principle.

In the second case of rule shopping ,the so called *dividend stripping*, the aim is to realize the value of the dividend through its alienation, transforming it in capital gains. In this way the shareholder is able to immediately convert into cash the accrued dividends in the shape of capital gains. Moreover it is interesting to note that dividend washing can be characterized by treaty shopping aspects whenever shares are sold to a subject benefiting from more advantageous conventional tax regime to which the seller wouldn't have the right to benefit from. The effects in terms of tax base erosion can be better appreciated if it is imagined the situation of a participation controlled through an investment company located in a State with tax exemption regime for capital gains but in the meantime supplied with a good conventional net[56]. (*See par.3.10, part II on Tax arbitrage on dividends*)

The most appropriate method to combat the phenomenon of abuse is to enter detailed rules which pursue this goal. The OECD Model does not contain any general anti-abuse rule but, as highlighted in the commentary, some articles of the model contain appropriate provisions to prevent misuse of treaties[57].

The Conduit Company Report of the Committee on Fiscal operator stress indicates some provision could be included in bilateral treaties against double taxation. The approach suggested are the following:

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which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention."

[55] Article 10 paragraph 3 OECD model: "*The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident*".

[56] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p.844 ss.

[57] In particular, the art. 10, 11, 12 require the identity between the recipient and the beneficial owner from dividends, interest, royalties, in order to be entitled to the limitation of the withholding tax.

(i) *The exclusion approach*, which excludes exempt or near exempt companies or incomes from the treaty benefits because they benefit of specific provision by virtue of internal dispositions.

Convention Italy-Luxemburg (firmed 3 June 1981) provides that the convention isn't applicable to financial companies resident in Luxemburg which enjoyed benefits by L.31.luglio 1929[58].

(ii) The *look trough approach,* which seeks to ensure that treaty benefits are not conferred to a company that is owned by a third country resident[59].

OECD commentary suggests introducing some limitation to the examined approaches in order "*to ensure that treaty benefits will be granted in bona fide cases*" and whenever no treaty abuse is concerned. The Commentary makes a list of five different clauses:

• General bona fide provision: conventional benefits are granted if the income is originated by operations "*motivated by sound business reasons and thus do not have as primary purpose the obtaining of any benefits*".

OCSE approach recommends the use of *Bona fide clause*. It was adopted by U.S.A-Italy convention and Switzerland-Italy (1951), where the less tax rate on dividends is recognized to the condition that Helvetica company haven't been created with the only purpose of enjoying this benefit.

• Activity provision: grants conventional benefits to sources of revenue other than passive incomes.

• Amount of tax provision: conventional benefits are granted by the source State if the "*reduction of tax claimed is not greater than the tax actually imposed by the contracting State of which the company is a resident*". This provision, more than an anti-abuse clause, seems to be a limit to the resident State possibility of lowering its tax rates.

• Stock exchange provision: assumes the effectiveness of the conduit company to be guaranteed by market rules.

• Alternative relief provision: residents of a third country can benefit from the

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[58] The so-called holding which doesn't pay taxes also if income derives from interests, dividends. Dividends distributed by holding are exempt from withholding tax.

[59] It's opportune referring to the beneficial owner(substancial aspect).

convention if the source State negotiated a not less favorable convention with the third State at issue.

The best known example of this approach is the inclusion of the "*clause of limitation-on-benefits*" in Italy-U.S.A Treaty. Convention Italy-Switzerland provides at Art.4. par.4 that "*It is not considered resident of a contracting state a person that, although owns requirements of paragraphs 1,2,3,is merely beneficiary of incomes"* (for a more detailed analysis of the subject, see Chapter 4, section 4.3 of this work. *see Part II of this work, par.4.3.)*

(iii) The *subject to tax approach*, trough which State of source grants treaty benefits if the income is subject to tax in the State of residence. This approach seems to be more operative than the other one because it covers also treaty shopping's phenomena than lead to a tax exemption whose source is a ruling, an agreement between company and financial administration to provide a convincing tax regime for both part. However, even this formula has the drawback of not being able to hit the stepping stone structures, where the company is actually subject to taxation, but erode its tax base through the incurrence of an amount of costs and expenses, such as payment of interest to another conduit company that benefits from an exemption of such income.

(iv) *Channel approach* trough which residents of a contracting state can't benefit of treaty favorite conditions if they make payments in favor of non residents in a contracting state to erode tax basis. This type of clause is provided in Swiss convention and U.S.A. convention with Italy.

CHAPTER 3- SPECIFICAL ANTIABUSE RULES

3.1 RESIDENCE OF COMPANIES AND REQUALIFICATION OF CORPORATE RESIDENCE: INTRODUCTION

The requalification of corporate residence has been subject of considerable attention by the national legislator in order to prevent the permanent removal of business components to taxation in the State in which the company was formerly resident. To this end it is necessary to clarify the concept of residence for income tax in order to better understand specific anti abuse rules.

3.2 RESIDENCE: ART.73 CITA

Prerequisite for the application of income tax is the existence of a link with our legal system. The concept of residence in Italy is spitted in two categories: the residence of legal persons and the residence of natural persons, under certain conditions. It is important to underline that the integration of one of these conditions is enough to consider a natural or legal person as resident. Both rules require that these conditions should be fulfilled for the major part of the tax period.

The residence of company [60]is fixed by virtue of three criteria:

- place of incorporation[61]
- place of management[62]

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[60] G. MELIS, *La residenza fiscale de soggetti ires e l'inversione dell'onere probatorio di cui all'art 73,commi 5-bis e 5 ter tuir* ,in *Dir.prat.trib*., 2007, p. 782 ss.

[61] It's a formal seat criterion.

[62] Where direction and control of economic activities are effectively held, *i.e.* the place where directors usually meet in order to fix guidelines for enterprise's activities, assessed irrespective of directors' domicile, nationality or fiscal residence and of coincidence with the place where these guidelines are implemented. It's an effective seat criterion. This criterion essentially coincides whit the concepts of effective management defined by the OECD Model Convention. So if a company has only its headquarters in Italy it is considered resident for tax purposes. C. GARBARINO, *Manuale di Tassazione Internazionale,* Milano,2005, p.551; G. MAISTO, *Brevi riflessioni sul concetto di residenza fiscale di società ed enti nel diritto interno e convenzionale* , in *Dir.prat.trib*., 1988, I, p .1364; G. CORASANITI- P. DE'CAPITANI, *La nuova presunzione di residenza fiscale dei soggetti Ires*, in *Dir .prat .trib*., 2007, p.102.

Jurisprudence of : Cass., 24 February 2004, n.3620; Cass., 14 January 1991, n. 2515 fiscal residence is localized where president, general director and personnel department are situated.

- main business purpose[63]

Place of incorporation must be sought as it results from the enterprise's articles of incorporation; this criterion constitutes a *iuris et de iure* presumption: the registration is a sufficient condition to levy a tax even if it is possible to demonstrate that the registered person is not really resident. This purely formal criterion, however, seems to doctrine unsuitable to ground worldwide taxation nor, if strictly scrutinized, orthodox by a constitutional point of view, as art. 53 of Italian Constitution obliges "everybody" to concur to public expenditure according to their capacity to pay, but also clearly infers an effective and lasting link between the person and the territory of the State.

Effective direction is localized where takes place the administration of company by virtue of *place of effective management* [64]; the place where the main and substantial activity of entity is carried out. In this place it is determined the fate of the business, hence the uniqueness of site; this criterion essentially coincides with the concepts of effective management defined by the OECD Model Convention. So if a company has only its headquarters in Italy it is considered resident for tax purposes. A problem emerged referring to group of companies. It's difficult to identify administrative seat of group independent from holding's one. The point is whether or not subsidiaries' administrative board can be deprived from theirs decisional functions without determining the attraction of fiscal residence on holding company.[65] In this case, the concept of permanent

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Cass., 10 February 2005, n. 2671 points out the place of general direction instead of place of general meetings.

[63] We can refer to quantitative parameter, such as, gross billing, number of employers in each state or qualitative one if the object is complex. It's important to distinguish between the place in which activity is localized and the market in which output is sells. Finally, this criterion express the juridical and economical localization of incomes in state's territory. G. MELIS, *La residenza fiscale dei soggetti ires e l'inversione dell'onere probatorio di cui all'art 73,commi 5-bis e 5-ter tuir*, cit., p.806 ss.

[64] B.A VAN DER MERWE, *Residence of a Company-The meaning of Effective Management*, in S. A Mercantile Law Journal, 2002, vol.14, n.1.

G. MARINO, *La residenza nel diritto tributario*, Cedam, 1999,121 ss. Points out that a fictitious element may be constituted by a sole director who is a local practitioner. In fact, also if the place of activity of board, of residence of employers who are responsible for day by day administration is localized abroad, juridical effects of this acts are closely linked to guidelines of stakeholders.

This position is confirmed in case law: C.Cass.,16 July 1984,n.3604;C.Cass.28 July 2000 n.9978;C.Cass.13 April 2004,n.7037;C.Cass.

[65] G. MELIS, *Trasferimento della residenza fiscale e imposizione sui redditi*, Rome, 2008, p.231.

establishment is involved. A subject may transfer its fiscal residence in a foreign country, maintaining a permanent establishment in State's territory[66].

Such difficulties may emerge in the relation between object of product activity and property owned. For example, the transferring of Italian company 's residence in a foreign country may lead to a permanent establishment in Italy but also if in the foreign country company carries on a main productive activity.

Secondly, problem may emerge referring to the case where there is no authentical activity as it happens for the mere enjoyment of company where the line between activity and main item is labile.

For *natural persons*, resident ones are subjected to worldwide income taxation principle: all incomes whatever their source. Non-resident persons are able to product incomes subjected to taxation in Italy if there are materially or economically linked to state's territory.

There are three different types of link:

- *Fiscal residence*: the registration in civil registry is a formal test necessary for an efficient activity of tax administration, but in its actual formulation it is considered inappropriate and even unconstitutional by many scholars. In fact, this criterion constitutes a *iuris et de iure* presumption: the registration is a sufficient condition to levy a tax even if it is possible to demonstrate that the registered person is not really resident. So we should hope that this rule will become a relative presumption and make proving otherwise possible[67].
- *Domicile*: place where a person has established the main seat of business and interests.
- *Residence*: place where a person has his habitual abode.

Art.10 L.n.448/1998 integrate the criterion trough the introduction of co.2 bis which asserts that: unless evidence is given to the contrary, Italian citizens erased

[66] G. MELIS, *Trasferimento della residenza fiscale e imposizione sui redditi*, cit., p.238.
The problem is radically solved in CFC rules by which company control lets the attraction of subsidiary's income on the holding by virtue of transparency principle.

[67] G. MELIS, *Trasferimento della residenza fiscale e imposizione sui redditi*, cit., p.137. Illegitimacy can be recognized in the taxation of incomes regardless of effective residence or domicile in State's territory. This can be verified, such as, if the taxpayer emigrates abroad forgetting the cancelling from tax register.

from tax register and emigrate in state or territory that can be qualified as tax havens are considered resident in Italy. The legislator fixed an inversion of burden of proof: normally, Financial Administration has to prove the fictitious transfer; in this case the burden of proof is on the taxpayer who has to proof the effectiveness of transfer.

3.3 EXIT TAX: ART. 166 CITA

In line with international practice, Italy applies a rule of closure which aims to contrast the phenomenon of tax evasion and, on the other hand, to ensure the coherence of its tax system. The Italian tax law provides no specific exit tax related to the transfer of residence of natural persons not engaged in business activity. Exit tax rule consists in imposing the latent appreciation of the assets of a company that transfers its tax residence abroad. The rationale behind this provision reflects the intention of not losing the ability to tax capital gains, which although not yet realized at the time of transfer, however, are matured within the Italian legal system. In other words, if these values were not taxed it would lose its tax revenue. The description of the rationale also explains the exception to the rule, so where the assets remain subject to Italian tax authority, flowing Italian permanent establishment, the levy is not implemented. It is quite clear that the rule has dual nature: a structural nature and an anti avoidance one.

About first aspect, the rule preserves the consistency of internal taxation system in accordance with the general principle of corporate income taxation which provides the taxation of latent capital gains if estates exit from the system of enterprise.[68] By contrast, it is stressed that estates does not necessarily exit from the activity of enterprise, continuing to live in chief to a person resident abroad for tax purposes. So, the personal connection of the subject and - if it relocates the business- the territorial connection with the Italian tax system fall away.[69] Secondly, indeed a taxpayer could transfer his residence in an another State with the sole purpose of selling his assets and taking advantage of the

[68]L. MIELE, V. RUSSO, *Exit tax e coerenza del sistema dei beni d'impresa*, in *Corr. trib.*, 8, 2010, p.630.
[69]G. MELIS, *Trasferimento della residenza fiscale nell' imposizione sui redditi*,cit., p.502 ss.

allocation of taxation rights fixed by the negotiating States in the DTC. In this case the new residence State will be chosen basing on the lower taxes levied on capital gains and it must be noticed that some States grant even the exemption; moreover, according to the DTC allocation of taxation rights, the State of origin cannot levy taxes[70].

Therefore, in accordance with Art 166 [71] taxation of the latent capital gains on company assets is excluded, when those goods are transferred to a permanent establishment in the State of origin. Otherwise, as a general rule, when a subject undertaking a business enterprise moves his residence abroad, assets must be estimated at their normal value[72]. This provision clearly links the taxation of unrealized enterprise gains to the continuity of application of the fiscal regime for businesses. As a result it provides that the unrealized gains of the permanent establishment abroad are considered to be realized, since, after the transfer of residence abroad, there is no way to provide for any kind of continuity. The element that determines taxation is the removal of the business from application of the fiscal regime for business due to the loss of fiscal residence, whereas in order to avoid such a consequence it is sufficient to set up a permanent establishment in Italy to which the assets of the enterprise can be assigned. In the latter case it will only be possible to avoid taxation of assets that are assigned to the permanent establishment and only as long as these assets remain with the permanent establishment[73].

In the case of requalification of corporate residence to other European countries, the discipline seems to be incompatible with the European principle of

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[70] Indeed according to paragraph 5 of Art. 13 of the OECD model convention: "*Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.*"

[71] Introduced with D.L. 23 February 1995, n. 41. By virtue of this rule: *The transfer of residence abroad of commercial enterprises which involves the loss of residence for fiscal purpose lead to the realization at normal value of assets, except for that they are not merged into a permanent establishment situated in State's territory. The same provision shall be applied if the components-later merged in state's territory-will be distracted.* MELIS G.,*Trasferimento della residenza fiscale nell' imposizione sui redditi*, cit., p.504 ss. It's considered an exit tax provided to avoid abuse generated by common change of residence in order to subtract incomes to the taxation. The fundamental element is constituted by the loss of link with state's territory.

[72] As defined by Article 9 paragraph 3 CITA: *price averagely applied for goods and services of the same kind or similar in a free market condition and at the same commercialization level, in the place and at the time when those goods or services have been purchased*.

[73] T. TASSANI, *Trasferimento di residenza ed exit tax nel diritto comunitario: esperienza Italiana*, in *Studi Tributari Europei*, I, 2009.

freedom of establishment; payment of exit taxes does not consider the real purposes of the transfer and does not provide for a case by case analysis, consequently damaging also operations with no tax avoidance intentions; but it is important to underline that this provision was introduced not solely in relation to the transfer of residence abroad, as it embodies a general principle applicable to all persons in every case where there is objectively no application of the business tax regime[74], even though there is no transfer of residence[75].

However, it may be said that, even though Art. 166 CITA was regarded as incompatible with the freedom of establishment on the basis of a broad definition of restriction, the above-mentioned incompatibility could be justified, relying on ECJ case law, on the grounds of "coherence of the tax system[76]". As already argued by distinguished authors, the justification of "coherence of tax system" is noteworthy as taxation based on Art. 166 originates from "a structural systematic requirement", not from anti-avoidance or anti-evasion purposes.

Finally, the solution protects national jurisdictions on the basis of the principle of territoriality as recently explained by ECJ judgments; according to the principle of territoriality, taxation can be considered to be balanced and proportional. This fiscal effect represents the consequence of a general imposition that does not exist in the cases decided by the ECJ judgments concerning exit taxation[77].

The position expressed in the doctrine is not in accordance with the latest positions taken by the ECJ[78]. Firstly, ECJ clarifies that the application of taxation at the time of transfer does not seem (in principle) to conflict with Art.49 EU

[74] ROMANO, *Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell'Unione Europea,* in *Rass.trib.*, 2004, p. 1291;V. FICARI, *Trasferimento della sede all'estero, continuità della destinazione imprenditoriale e contrarietà al trattato CE dell'"exit tax" sulle plusvalenze. latenti*, in *Rass.trib.,* 2004, p.2146 ss.

[75] Accordingly, wherever an entrepreneur terminates the entrepreneurial activity without realizing all the assets, or a company is transformed into a non-commercial entity, the entrepreneur or company are taxed on unrealized gains, since their assets are to be assigned to a purpose other than the original purpose; the same conditions apply to assets of entities moving abroad if they do not assign these assets to a permanent establishment in Italy.

[76] ECJ 11 March 2004, C-9/02 de *Lasteyrie du Saillant;* ECJ 7 September 2006, C-470/04 N.

[77]T. TASSANI, *Trasferimento di residenza ed exit tax nel diritto comunitario: esperienza Italiana*,cit.

[78] C-371/10 del 29 November 2011; ECJ provided that the legitimacy of exit tax is tied to the moment of realization of surplus value.

Treaty, as it implements the objective of ensuring balanced allocation of taxing powers between Member States of origin and destination of operator's site.

However, this power must be exercised within proportionality principle. For this reason, the Court concludes that the taxation cannot be immediately but it should be deferred by suspending the effects up to the effective realization of a taxable item.

Outlined the regulatory framework, it should be noted that the Italian Government in the context of "liberalization decree. D.L 24 January 2012,n.1." has resulted in a significant change of the discipline, acknowledging judgment of ECJ. The rule clearly states that "*Subjects who transfer their residence in States belonging to the European Union or to the European Economic Area with which Italy has signed agreement on mutual assistance in collection of tax claims may require the suspension n accordance with the principles enshrined in the Case National Grid Indus BV"*. So, if at the time of requalification of corporate residence in a European Member State or a Member of Economic European Area (included in national white list, with which Italy has signed an agreement on mutual assistance in collection of tax claims) , the subject does not maintain a permanent establishment in Italy, he may request that the tax -the evaluation at the normal value on the transferring of assets -is suspended until the actual realizations of the same. It is important to note that the decree transposes into the body of the rule reference to the judgment of the Court of Justice in which the ECJ asserted that "*Article 49 TFEU must be interpreted as: not precluding legislation of a Member State under which the amount of tax on unrealized capital gains relating to a company's assets is fixed definitively, without taking account of decreases or increases in value which may occur subsequently, at the time when the company, because of the transfer of its place of effective management to another Member State, ceases to obtain profits taxable in the former Member State; it makes no difference that the unrealized capital gains that are taxed relate to exchange rate gains which cannot be reflected in the host Member State under the tax system in force there; precluding legislation of a Member State which prescribes the immediate recovery of tax on unrealized capital gains relating to*

assets of a company transferring its place of effective management to another Member State at the very time of that transfer."

3.4 REQUALIFICATION OF CORPORATE RESIDENCE: ART 73.5-*bis* e 5-*ter* CITA

The rule at issue is always designed with a view to protect tax revenue in cases of migration of corporations. A group of company may have convenience in establishing the holding company in a state other than the country of the place of effective management; in other words, this figure is characterized by the localization of a fictitious residence of a company in a preferential tax regime, so that the same might benefit from a favorable tax regime.

A foreign company which holds participation of control (ex Art.2359) into a resident company is considered [79]resident in Italy if:

- is controlled, also indirectly, by resident individuals[80].
- is administered by a control board or equivalent management body composed predominantly by resident members.

The control is linked to the majority of the voting rights in annual general meetings(control by law) or sufficient votes to exercise a dominant influence (control de facto [81]).

In the case of congruence between resident and non-resident administrators, the application of presumption must be excluded: it's applied only if there is a prevalence of resident administrators.

In relation to the residence of directors (and, broadly, of physical persons), Art. 2 CITA follows the rule that the resident is a person who, for greater part of tax year, is registered in general register's office or has in Italy domicile or residence in as these notions are pointed in the Italian Civil Code.

[79] Through a relative presumption (*iuris tantum*).

[80] If the administrators are natural persons we will refer to Art.2 CITA.

[81] Circ. *Assonime*. N.67/2007:Control can be derived from different elements such as absenteeism of members, the pulverization of the share capital.

The main consequence of this anti-avoidance provision is that foreign holdings, when falling in one of the two categories, are taxed in Italy according to worldwide income principle.

The taxpayer has the burden of proof. He may prove that the company has the residence abroad[82] .The ability to sterilize the presumption passes through Art. 37-bis, last comma, d.p.r.29 September 1973, 600[83].

Circ.n.28/E 4 August 2006,par.8.3 clarifies that the taxpayer has to demonstrate trough adequate and convincing arguments that the effective place of management is abroad[84].

Financial Administration highlights the attention to Resolution n.312/E,5 November 2007 in which it is asserted that the evidence can refer "not only to formal documents, but also to concrete elements from which appears the place of effective and strategic decisions , stipulation of agreements and financial and banking operations". A veritable handbook was provided by Financial Administration during an infringement procedure against Italy[85].

In response to European Commission[86], Financial Administration stresses that the evidence must show:

- Effective ownership and concrete exercise of decisional power by local administrators.
- Effective local development of operational management of company abroad. Financial Administration points out the functional autonomy of

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[82]E. M BAGAROTTO, *Presunzione di Residenza Fiscale delle società estero vestite*, Wolters Kluwer Italia , 2008, p.2 e ss; V. PEZZUTO-SCREPANTI, *La verifica fiscale*, Milano, 2004, p.359 e ss. To support the place of effective residence, Financial Administration can use various ways such as sending of missives or fax, attendance note, documents.

[83]The provision recognizes the taxpayer's right to present its case before the tax authorities to obtain the anti-avoidance provision set aside.

[84] Another issue is an itinerant board of directors. In this case it's reasonable to consider company's residence in the state in which meetings of board are habitually conducted or the place in which the company has the strongest bond.
G. MARONGIU,La *nuova presunzione di Residenza Fiscale dei soggetti ires*, in *Dir.prat.trib.*, p.103.

[85]M. PIAZZA, *Presunzione di Esterovestizione, prova contraria senza limiti*,in *Il Quotidiano Ipsoa*, Wolters Kluwer Italia, 2011.

[86] The occasion was a compliant filed in 2009 by "*Commissione Conformità Comunitaria dell'Associazione Italiana Dottori Commercialist*i" that gave rise to an infringement procedure against Italy. European Commission has closed the case with a letter of 4 June 2010 and a subsequent one of 11 January 2001, but did so further once Financial Administration provided adequate responses to a series of question on the distribution of burden of proof between the parties.

controlled company from financial, organizational and accounting point of view, the autonomy of country managers referred to organization of dependents, spending decisions, conclusion of agreements. Indicators can be constituted by negotiations of country managers. In this way it is demonstrated that function of coordination performed by holding company must be distinguished by concrete administration acts.

Coming to the effect that the provision implies, we must distinguish those in the hands of the foreign holding from those of Italian subsidiary. The main effect concerns tax treatment capital gains realized on investments that will contribute to the taxable income, subject to the partial taxation in the event that the conditions for the application of the exemption scheme participation will occur. As for dividends, they must contribute to income to the extent of 5% of their amount or, if they come from tax havens, in full measure, unless it is proved that at least 75% of the income of the company is located in a state other than those considered tax havens. With regard to the Italian subsidiary and the Italian parent company, the effects are those related to the hypotheses of relationships with a resident rather than nonresident. So, for example, the discipline ex Art 167 CITA regarding controlled foreign companies will not apply.

3.5 CONTROLLED FOREIGN COMPANIES: ART.167-168 CITA

The extensive use of tax haven entities by residents lead to provide some measures to ensure domestic amount of levy tax. CFC legislation becomes one of the unilateral defense measures against tax evasion. The main purpose of CFC rules is to prevent resident companies from avoiding domestic tax by diverting income to subsidiaries in low tax countries[87].

By virtue of this rule, incomes gained by these companies, located in tax havens, are taxed transparently and directly in the hands of resident holdings, irrespective of the effective distribution of dividends or other incomes.

Different requirements are necessary:

[87] S. GARUFI, *La nuova disciplina delle CFC*, in *Rass. Trib.*, 2010, III, p.619 ss.

- Italian Resident taxpayer [88]controls foreign company. if an Italian resident directly or indirectly (also through fiduciary companies or by a nominee) controls[89]an enterprise, a company or a body, resident in a tax haven, incomes gained by this last are taxed in the hand of the Italian resident and proportionally to the shares possessed, beginning from the end of foreign person's commercial period. This applies as well to participations in non resident persons when incomes comes from their P.E.s located in tax havens. This rule covers Italian resident's direct or indirect participation, not lower than 20 per cent, to profits gained by an enterprise, a company or a body residing or located in a tax haven; this percentage is decreased to 10 per cent if the company works in the Stock-Exchange.

In case of direct control, both "by law" (possess of majority in shareholders' meeting) and "de facto" (possess of sufficient votes to dominantly influence the shareholders' meeting), CFC incomes are pro quota taxed in the hands of the Italian resident direct holder. In case of indirect control (votes of controlled companies, fiduciary companies and nominees are taken in account), both by law and de facto, if the resident holding performs such control through other residents, CFC incomes are taxed pro quota to them; on the other side, if control is exercised through non residents, CFC incomes are pro quota and by transparency attributed to the resident. Finally, in case of "external" control (dominant influence by means of contracts or agreements), CFC incomes are attributed to the resident shareholder in relation to its participation to profits.

- Controlled foreign company must be situated in a State different from States included in white-list[90]. Pending enactment of white list, the

[88]Art.167.1 is applied to individuals, partnership, corporations, non profit-organizations.In particular, Art.5 and 73, comma 1, lett a), b), c) CITA. identifies taxpayers subjected to CFC legislation.

[89] According to Art.2359 c.c., an entity controls another company if:
-possesses more than 50 % of voting rights (in ordinary shareholder meetings)
-has a sufficient voting rights to exercise a dominant influence at the ordinary general meeting of the foreign entity or
-has influence on the foreign company because of contractual arrangements.

[90] D.M. 21 November 2001, 429 introduced black list for CFC Legislation. Territories are listed by a decree of Ministry of Finance, in reason of a taxation slightly lower than the Italian one or lack of adequate exchange of information or equivalent criteria. By LG. 24 December 2001, 244 new criterion were introduced to identify preferential tax regime countries; in particular, it was provided that Ministerial Decree would have positively identified territories in reason of a taxation no lower than the Italian one and with ad adequate exchange of information or equivalent criteria

discipline is referred to countries included in black list ex D.M. 21 November 2001.

By Decree 78st June 2009, the Italian Government has exacerbated anti-avoidance legislation, extending the scope of application also to companies no localized in black listed jurisdictions [91]; CFC legislation will apply if the follow conditions occur:

-Company or non- resident entity are taxed less than half of taxation that would have been applied if they had been resident in Italy.

-They have achieved revenues for more than 50% from management, from holding or investment in securities, investments, loans or other financial assets, sale or lease of intangible rights[92] as well as the provision of services to subjects who directly or indirectly controls the company or nonresident entity, are controlled or supervised by the same company that controls non-resident company or entity, including financial services[93].

The changes introduced by legislature intended to give body to fight tax havens initiated by the G20 summit on "Financial Markets and the World Economy" held in London April 2, 2009. (*For a brief overview, see par.1.4, chapter I of this work*). CFC discipline is also extended to companies controlled by residents not only in the black listed countries, but also in all countries with a slight tax (tax friendly); this should close the loop on combating tax arbitrage.

Therefore, this change seems to bring our country to transactional approach; to clarify this statement is worth pointing out that national rules are inspired by two alternative approach: the jurisdictional approach and the transnational one[94]. In its first formulation CFC legislation follows the jurisdictional approach, referring to the location of CFC in countries or tax havens and in the absence of any reference to the nature of incomes produced

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[91]E. M. BAGAROTTO, *La compatibilità con l'ordinamento comunitario della disciplina in materia di controlled foreign companies alla luce delle modifiche apportate dal decreto anti-crisi*, in *Giustizia Tributaria*, 2010.

[92] The rule seems to presume that company that brings , for more than 50% of total income above ,are routinely "wholly artificial arrangements" that do not carry on genuine economic activities in State of residence.

[93] However, the recurrence of this condition renders inapplicable the extenuating circumstance provided by law ex Art. 167. Par.5.

[94] Trough Jurisdictional Approach, income subject to taxation is determined on the basis of nature; in particular, we are referring to certain types of high-risk income, such as base company income)

by the controlled foreign company. The system just introduced in Italy grows, however, according to a different structure; pending the enactment of the white list, the CFC legislation will always apply to black listed countries and non black listed if the first condition occur. Since the adoption of the white list, the legislation will apply to preferential tax regime countries and those identified in white list if the tax level is below to the threshold. In order to avoid the application of CFC to no blacklisted countries, some adjustments are provided; taxpayer can prove the existence of a motivation other than to obtaining tax advantages by locating investments in tax haven. The decree introduces a safeguard clause that allows to avoid the charge of the taxation of foreign residents for transparency. The taxpayer is permitted to prove that the settlement abroad is not an artificial arrangement designed to achieve an unfair tax advantage.[95] It represents an obvious transposition of the judgment of ECJ in Cadbury Schweppes and represents a special safeguard clause, callable only when the transparent taxation is a consequence of the use of the two conditions mentioned above. The identification of a wholly artificial arrangement corresponds, in fact, to an analysis based on the criterion of substance over form according to objective criteria, such as the seat of effective management and tangible presence of the company as well as the commercial risk taken. *Cir. 51 / E* provides a non-exhaustive list of conditions to characterize the settlement as artificial; in particular, the lack of economic or commercial reasons that can justify the localization of company abroad, the absence of a proportion between activities apparently carried out by CFC and the availability of premises, staff, equipment, the non-resident company is overcapitalized, the taxpayer has entered into transactions devoid of economic reality, or that may be contrary to general business interests.

To complete the analysis, it should be noted that the system provides two derogations to CFC regime: taxpayer is allowed to demonstrate that CFC pursues an effective industrial or commercial activity market settlement or that the participation in CFC is not aimed to allocate incomes in tax havens[96]. About first condition, Financial Administration in Circ. 51/E states that it occurs when the

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[95] Art.167, par. 8-bis CITA.

[96] Art.167, par. 5 CITA.

controlled foreign company has a autonomy and appropriate structure in order to carries on productive activity and demonstrates the "rooting" of its activities to the country of settlement; it should be proved by many evidences such as bookkeeping entries, description of the organizational structure and operating procedures by which the subsidiary operates, lease agreements that leases which show the possession of branches and offices. The reference to market settlement is to be understood as “economic link of CFC with foreign country”; more generally, it is an "area of influence" which includes the countries with which there are closer economic, social and political links. About second condition, it aims to counter those elusive phenomena of relocation of passive income to preferential tax regime countries by the creation of “companies without business” it refers to those situations in which the productive elements of income are allocated to formally autonomous entities whose sole purpose is the economic exploitation of the assets and not the actual performance of a trade or business.

3.6 LIMITS ON INTERESTS DEDUCTIBILITY: ART. 96 CITA

The theoretical issue that arose is whether interest expense deductibility in business income must first be examined in the light of general principles governing such category of income. Also such item should be subject to the criteria set out by Art.109 CITA. In particular to: the accrual principle (taxation of interest in the year which it accrued), the prior accounting in the P&L and to the inherence principle (inherence of interest expense to the business carried out)[97].

The Supreme Court of Cassation in some decisions stated the non applicability of such principle[98], while in others, it deemed that Art.109 excludes interest expenses only from the need of checking their relation with profits, but not also in relation to the business activity. *L. n.244,24 December 2007* introduced the current rule; it grants to taxpayer, in each tax period, the full deductibility of interest expenses and similar charges up to the amount of interest income and

[97]F. MARCHETTI, F. RASI, *Raccolta di capitale di rischio e di capitale di debito: la disciplina italiana*,in *Studi Tributari Europei* I, 2010.
[98] Cass.21 November 2001, n.14702; Cass.2 February 2005, n.2114; Cass. 4 June 2007, n.12990.

similar one[99]. Interest expenses which exceed the interest income of the year may be deducted for tax purposes in the limit of 30 % of R.O.L, to be determined by the difference between the production value and costs, excluding depreciations of tangible and intangible assets and of the rents paid for assets under financial lease[100] .Interest expenses and similar financial burdens that cannot be deducted in the tax year, since they exceed the above threshold, can be carried forward without time limits may be deducted in the following years without any time limit whenever in such years the conditions for their deductibility are met. The use of interest expenses is however conditional to the fact that in such subsequent years the amount of interest expenses and of similar charges is lower than 30% of the relevant year R.O.L[101].

The provision has, indeed, excluded from its scope of application banks and other financial entities (SGR, SIM, financial intermediaries, SICAV, insurance companies as well as holding companies of banking and insurance groups); this exclusion comes from the main importance of debt for these companies, in

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[99] Art. 96.1 CITA expressly excludes from its scope of application interest expenses and similar charges included in the cost of goods pursuant to art. 10.1, lett. *b)*, CITA. The deductibility rules set forth by art. 96 will apply to interest whether or not included in the cost of the goods.
Pursuant to art. 96.3, attention shall be paid not only to interest incomes and expenses originated by contractual relationships having a financial aim (loan, lease, issuance of bonds and similar securities, notional cash pooling). Therefore, the relevant interest (incomes and expenses) for such purposes do not include both delayed interest payments and interest payments due for the omitted payment of taxes, since they both do not have a voluntary financial aim. Pursuant to a specific provision, implicit interest arising from commercial debts do not fall within the determination of interest expenses, whilst interest income arising from the same source fall within the determination of interest income. It is possible to determine also virtual interest income due for delayed payments by the public administration and they are determined at the official discount rate plus one base point.

[100] R.O.L is defined by art. 96. 2 CITA, as the difference between the value and costs of productions (as per letters A) and B) of art. 2425, of the Italian civil code) as resulting from the profit and loss account, with the exclusion of the following negative items of income:
1) depreciation of tangible and intangibles assets listed in lett. B), n. 10), points a) and b), of the profit and loss account;
2) assets lease rents included in lett. B), n. 8), of the profit and loss account.
In its determination reference shall be only made to the accounting data *"as resulting from the yearly profit and loss account"*; and for entities drafting the accounts pursuant to IAS/IFRS, the determination of the relevant amount is made *"pursuant to the corresponding items of the profit and loss account".*

[101] In other words, while the thin capitalization rules and the *pro rata* rules required to determine the amount of interest expenses which qualified as finally not deductible, the current system exclusively provides for a temporary non deductibility of interest expense.

relation to which the fund-raising activities imply, as an ordinary burden, the payment of interest and similar charges[102].

The current system differs from the former ones since it significantly simplified the tax deduction regime, grounding the assessment of the adequacy of the debt's level and, consequently, the deduction of interest expenses from the business income on a criterion (R.O.L) which is not linked to the taxpayers dimensions or to the holding of stock eligible for the participation exemption regime. Moreover, it positively directs businesses towards their capitalization or a debt restructuring to the extent that it allows to carry forward interest expenses which are not deductible in a single tax year without any time limitation. On the contrary, the former tax regimes set out a final impossibility, although limited, to deduct interest expense which was not eligible for deduction in a single tax year.

Various approaches have been taken during the years[103] to contrast the thin capitalization. The most relevant action against the thin capitalization of companies was adopted by the legislator through the so-called "Dual Income Tax" (DIT)[104].

The DIT was based on the assumption of dividing business income into two components to subject to a different tax regime: a first one subject to a reduced tax rate of 19% and a second one subject to the then ordinary tax rate of 37%, provided that the overall tax burden was not, according to the original version of the provision35, on average, lower than 27%[105].

The opportunity to amend the DIT regime occurred enacting the "Corporate Income Tax Reform through (by T.U.I.R.)" which the approach to the taxation of interest was once more changed. Financing a company by means of equity

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[102] Art. 96.5-bis now states that the interest expenses are deducted from the corporate income tax base of these entities within 96% of their amount.

[103] In order to provide support to growth trough a reduction of taxation on income arising from the financing of risk capital and to reduce the unbalance in tax treatment between companies which, recourse to venture capital or debt and therefore, to enforce capital structure of Italian productive system, D.L 6 December 2011 n. 201 (the so called- Monti decree) allows the deduction of an amount equal to the notional yield of new equity, according to the provisions of comma 2 to 8.For companies and commercial entities-Art.73.1 lett d), the provision of this article shall be applied with regards to permanent establishments in the State.

[104] D.lgs n. 466 /1997.

[105] Through this taxation mechanism the legislator addressed the issue of the neutrality of the forms of business financing by way of adopting a logic of rewards: the behaviors held by taxpayers and deemed to be virtuous (i.e. the use of equity rather than debt financing) were favored by a reduce tax burden which arose from the reduction of the applicable tax rate.

normally results in a distribution of profits to the shareholder in the form of dividends, but only after taxation of such profits at the level of the subsidiary. Debt financing, in turn, will result in a payment of interest to the creditors (who can also be the shareholders), but such payments generally reduce the taxable profits of the subsidiary. Dividend and interest may also attract different withholding tax consequences. As the source State's taxing rights on interest are generally more limited than on dividends, debt financing can lead to the erosion of the tax base in the state of the subsidiary. To counter this problem, many Member State have introduced specific thin capitalization provisions dealing with structured debt financing schemes. Typically these limit the deductibility of interest paid on loans taken with (or otherwise arranged by) shareholders to the extent that the subsidiary is considered to be excessively "thinly" capitalized.

Art. 97 CITA (*pro rata patrimoniale*) was intended to prevent the deductibility of that part of interest expenses remunerating loans obtained to finance the acquisition of participations that, if transferred, would enjoy the newly introduced tax exemption regime (so-called Participation Exemption Regime) Art. 98 CITA sets out the non-deductibility of interest expense related to loans granted and/or secured by qualified shareholders and/or by its related parties, regardless of their residence, whenever the total amount of loans granted and/or secured by said qualified shareholders and/or by their related parties exceeds by at least 4 times the overall share of net assets attributable to said shareholders or to their related parties[106].

Italian rules on thin capitalization has taken German rules as a reference model[107].

The complains made by ECJ lead Italian Legislator to take into account the effect of European judgment; the rule is applied, in principle, to all shareholders regardless of the declaration of taxable income in Italy in which channeled the

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[106] The thin capitalization rule was not applicable only when the borrower (i.e. taxpayer owing the interest) could prove that the loans granted or secured by the qualified shareholders were justified on the basis of the borrower's own debt capacity and thus the loans would also have been granted by a third party with the only independent guarantee of the borrower's assets.

[107] Reference is made to the decision dated 12 December 2002 on Case C-324/00, *Lankhorst-Hohorst GmbH v/ Finanzamt Steinfurt* and the decision dated 18 September 2003 on Case C-168/01, *Bosal*, in which ECJ expressed a principle of law according to which conditioning the enforcement of anti-thin capitalization rules to the fact that the interest expenses deducted are taxed in the same country is in breach of EU law.

financial costs involved, as well regardless of stakeholder's residence in Italy, or in another European union member state or in a third state[108].

3.7 LIMITS ON COSTS DEDUCTIBILITY: ART. 110.10 CITA

The necessary requirements of contraction in production costs and the gradual shift in balance towards certain commercial areas of the world have led many national actors to work more often with firms located in territories outside the EU and to plan the use of international tax planning techniques based on use of companies domiciled in jurisdictions characterized by low incidence of taxation, in order to reduce their costs[109].

Art.110.10 CITA provides that expenses and other negative components[110] arising from transactions with residents or companies located in States or Territories, other than those specified in Article 168[111], are not deductible. This deduction is allowed for transactions with residents or businesses located in States of the European Union or European Economic Area.

The generic reference to "other negative components" makes subject to the non deductibility regime all elements suitable to reduce the domestic payer's tax base. From a subjective point of view the framework is applied to resident operators in business activity[112]. *Circ 207 / E*, 16 November 2000, clarifies that the anti-avoidance measure will apply to all business relationships with companies located in countries and territories with preferential tax regime, regardless of the existence of any control relationship. The rule also applies with respect to services rendered by professionals who are domiciled in blacklisted States or territories.

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[108] A. COMELLI, *Sul contrasto all'utilizzo della sottocapitalizzazione*, in *Dir.prat.trib.*, 2004,I p.275 ss.

[109] F. BRIGHENTI, *Deducibilità di costi black list dopo la Finanziaria 2007:disciplina attuale e strategie difensive*, in *il Fisco*, 2007,10, p. 1407.

[110] It is a very broad reference that allows to include any negative component arising from transactions with suppliers located in tax havens.

[111] D.M.23 January 2002 is relevant. (*See above on this work*).

[112] In this regard, the concept must be intended by a broad interpretation. Circ 16 November 2000, n.207 /E par 1.1.1. clarifies the entity of this anti abuse rule*;" it should apply to all business relations with enterprises located in countries and territories with preferential tax regime, regardless of the existence of any way of control , also to foreign permanent establishments located in tax havens."*

The purpose is to contrast transferring taxable income to low tax states with whom there is an adequate exchange of information. The rule aims to achieve two purposes:

- avoid tax base erosion using artificial transactions with companies localized in low tax regime
- avoid that, trough the interposition of foreign companies localized in low tax countries, taxpayers may transfer some assets abroad subtracting the income to tax (*tax deferral*)[113].

To this end, legislator have introduced a relative presumption whereby transaction are marred by potential elusiveness. It follows the inversion of burden of proof: in order to enjoy the deductibility, taxpayer must demonstrate:

- the *commercial credibility of foreign supplier* or, alternatively,
- the *economic convenience of transactions*.

In light of some insights offered by the court, it would seem necessary to show that the foreign company carries on its core business for the local market; it follows that whenever its demonstrated that the activity is carried out mainly on markets different from localization ones, it is not integrated the requirement of stable and continuous participation in economic life of foreign state and thus, it is denied the chance to set aside the presumption in question.

This approach seems to be overcome by *Circ. N. 51/E* , 6 October 2010 which provides, in relation to the CFC, some indications of the evidence needed to demonstrate that foreign companies mainly carry out commercial activity. The taxpayer must demonstrate commercial nature of foreign enterprise's activity ; in particular he must show that it is the main activity and its effectiveness. In order to demonstrate this, he must produce some documents[114] or explain the reasons for the failure to produce them.

The Supreme Court has substantially modified the approach based on the actual conduct of a trade by the foreign operator[115]: no longer satisfied with the

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[113]G. MAISTO, *Il regime tributario delle operazioni intercorrenti tra imprese residenti e società estere soggette a regime fiscale privilegiato*,in *Riv.dir.trib*., 1991, I, p.757 ss.

[114] Financial statements of foreign company, operating procedures of the foreign company, prospectus with the composition of the administrative body of the foreign company.

[115]F. RASI, *I costi black list tra diritto interno e diritto convenzionale: prime sviste giurisprudenziali*, in *Dir. Prat. Trib. Intern*., 2010, p.1537 e ss.

demonstration of the effectiveness of the foreign entity, but requires that foreign entity is able to effectively carry out that particular activity; it is thus further narrowed the scope of the standard[116].

The Court has asserted that availability of business premises, dependents, the use of provisions, are adapted to prove the existence of foreign entity but business activity must be valued they referring to in the transaction that gave rise to costs. This position is likely to exclude the exercise of an effective business leader in those companies within international groups act as a platform for purchases (so called, *royalties companies*)[117].

These conclusions are not consistent with the anti-avoidance nature of this rule; the anti-avoidance purpose is evident from the fact that the legislator assumed that the taxpayer come into contact with a non-existent subject, or carries on non-existent transactions; in order to overcome that presumption, legislator allow taxpayer to demonstrate the existence of commercial counterpart or the transaction. The Court seems to question the real anti avoidance nature of the rule; judges to win the presumption no longer satisfied by proof that the transaction is real but require the demonstration of commercial credibility and effectiveness of the foreign supplier located in preferential tax regime countries.

In particular, the Agency had objected to an Italian company the non-deductibility under art. CITA 110.10 Income Tax Code) of costs for the purchase of assets from a related company in a Country to taxation privileged (in Switzerland), for the fact that this, in turn, purchased the same goods from another company resident in Belgium. The Agency believed that the latter company was the actual producer of goods and therefore believed that the Swiss company merely interposed. the Italian company was asking quashed the judgment n. of 78/01/07 Lombardy Regional Tax Commission, which upheld the Agency positions as: a) the applicant had provided adequate evidence to the contrary about the absence of factual conditions for applying Article. 110.10 CITA.; b) the appellate decision was issued in violation of Article. 25 of the DTC between the Italian Republic and the Swiss Confederation, ratified by Law December 23 1978, n. 943. The Supreme Court was first asked to verify the suitability of the facts alleged by the applicant company to exclude the application of the provisions of art. 110.10, CITA. In detail, the Italian company had not demonstrated that the availability of large rooms, the existence of several officers, the availability of various utilities, the "use of various supplies" like "contracts in intercompany distribution "(under which ..." was appointed sole distributor of [certain specific] products ... for Europe "). She had been given full evidence of the effectiveness of the Swiss company. The Supreme Court has not agreed with Court of Appeal: It has considered the company as a "*purely paper*". In other words, the judges of legitimacy have not considered suitable for rebut the presumption of Article. 110, paragraph 10. The evidence offered by the Italian company about the existence of the Swiss. these were the elements which can be given value only "formal" and, therefore, consistent with the "paper function" of that company.

[116] Cass. n. 4272,23 February 2010.

[117]F. RASI, *I costi black list tra diritto interno e diritto convenzionale: prime sviste giurisprudenziali,* cit., p. 1538. These companies do not necessarily produce goods; however, their income is necessary so that other people use these assets.

About second point, the valuation must take into account all the facts and circumstances of a concrete case, such as transaction price, the opportunity to acquire the same product from other suppliers, the existence of commercial link with black list supplier (the presence of objective economic benefits, such as the presence of a central purchasing group level from which all subsidiaries stock up, the substantial equality between the price paid to the foreign company and the normal value, that the transaction has been performed by bringing customs documentations, bills and evidence of official financial flows[118].

It should be noted that Art. 110, par. 10 does not operate if Italy and "black listed" country enclose in their Convention to avoid double taxation a provision similar to art. 24, par. 4 OECD[119]. This means that if an Italian company pays interest or royalties to a company located in a privileged tax regime with which had concluded with Italy a bilateral agreement, the predicted negative component should be considered deductible from the income of the Italian independently from the effectiveness of the anti-avoidance rules in question.

A further point is represented by the relationship between this rule and CFC one; Art. 110. par.12 clarifies that where the conditions for the application of CFC rules occurs, it applies priority. It means to say that it is accorded the full deduction of the income where the income of foreign company are already taxed in Italy. If the taxpayer gets the disapplication of CFC legislation demonstrating that CFC pursues an effective industrial or commercial activity, the disapplication exerts its positive effects in relation to Art.110 par.10. The only case where the limitation on deduction of costs may be applicable is the case in which the parent company disapplies the CFC legislation by showing that the possession of foreign investment in the blacklisted company does not achieve effect of locating incomes

[118] F. ARAMINI, *Spese derivanti da operazioni con soggetti residenti in Stati o territori a regime fiscale privilegiato*, in *Riv.dir.trib.,* 2001, p. 112 ss.
There is always a real economic interest when the company carry on transactions which produce profits; the reference is to Comm. trib. prov. Roma.sez LIII, n. 454, 13 November 2009.

[119] Art 24 par. 4 OECD Model provides that " *Interests, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise , be deductible under the same conditions as if they had been paid to a resident of the first- mentioned state. Similarly, any debts of an enterprise of a Contracting State shall, for the purpose of determining the taxable Capital of such enterprise be deductible under the same conditions as if they had been contracted at a resident of the first mentioned State."*

in preferential tax regime countries; In fact, in such cases may even be required to demonstrate that transactions respond to a real economic interest[120].

3.8 MERGERS AND ACQUISITIONS (M & A): ART. 172.7 CITA

On 23 July 1990 the Council adopted Directive 90/434/EEC on a common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (the Merger Directive). The objective of the Merger Directive is to *remove fiscal obstacles to cross-border reorganizations* involving companies situated in two or more Member States. The Directive includes a list of the legal forms to which it applies. The companies must be subject to corporate tax, without being exempted, and resident for tax purposes in a Member State. The transposition of the Directive, which occurred with *D. Lgs. 30 December 1992, n. 544* recognized the opportunity to make contributions in tax neutrality regime. Rules have been included in Consolidate Income Tax Act. The principle of neutrality might be the structural scheme of the whole category. Indeed, the translation into national legislation is not unique and it is referred to a different formula, generally emphasizing the absence of a hypothesis of realization of capital gains[121]. The ECJ stated that Art 11 of the Directive [122]must be interpreted in the sense that, in

[120] M. PIAZZA, *Guida alla fiscalità internazionale*, Milano, 2004, p.1323.
[121] For example, transformations, mergers and divisions the formulation of the principle is similar: "*do not constitute capital gains and losses*." For exchanges of shares is significantly different, more comprehensive because it provides that "the transaction does not give rise to" *components positive and negative of income tax*."
[122] Art 11 of Directive 90/434 EEC: "A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Titles II, III and IV where it appears that the merger, division, transfer of assets or exchange of shares: (a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that one of the operations referred to in Article 1 is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives; (b) results in a company, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements which were in force prior to that operation. Paragraph 1 (b) shall apply as long as and to the extent that no Community law provisions containing equivalent rules on representation of employees on company organs are applicable to the companies covered by this Directive."

determining whether the operation has the main objective of avoidance or evasion of tax, National Authorities must carry out an examination entirety. Therefore, Member States can provide that, if the transaction is not carried out for valid economic reasons, the same constitutes a presumption of fraud and tax evasion. In other words, the neutrality tax regime induces companies to realize mergers and acquisitions operations only to obtain fiscal benefit[123]. In Kofoed[124], the Court stated that the transposition of a directive into domestic law does not necessarily require legislative action, it being sufficient for a regulatory environment. In other words, implementing the judgment of ECJ, the directive will be interpreted in the light of Art.37-bis acting as a quasi-general anti avoidance provision and jurisprudence of the Court of Cassation. This is the reason why the Supreme Court after the judgment Kofoed, returning to the problem of tax avoidance perceived need to find some general principles in domestic tax regulatory system that prohibits the abuse of right on income tax. It is telling, in fact, that the United Chambers of the Supreme Court have emphasized "*... that the source of this principle, in terms of non-harmonized taxes, such as direct taxes, is not found in case law but rather in the same constitutional principles that inform the Italian tax system* "(C. Cass., 23.12.2008 n. 30057) (*see above,par.1.2, Chapter I, part I*). It should be noted that the opportunity to realize elusive operations has been limited by the introduction of specific anti-avoidance provisions such as the limitation to carry forward losses and interest expense. Art 172.7 CITA states that the carry forward of losses - attributable to one of the companies involved in an mergers and acquisitions- is permitted where certain indicative conditions occur; we refer to the economic vitality of the subject is satisfied and provided that a quantitative parameter related extent of its net assets. About first requirement, it is necessary that the amount of total revenue (and other incomes) and personnel

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[123]S. CAPOLUPO, *Carattere elusivo delle operazioni straordinarie*, in *Il regime fiscale delle operazioni straordinarie*, edit by E. della Valle, V. Ficari, G. Marini, Torino, 2009.

[124] C-321/05: The 'Kofoed' case discusses the application of Article 11(1)(a) of the Merger Directive in a situation where Article 11(1)(a) is not implemented into national provisions of a Member State. However, this case does not assist in determining the borderline between *Article 11(1)(a) of [the Merger Directive] reflects the general Community law principle that abuse of rights is prohibited. Individuals must not improperly or fraudulently take advantage of provisions of Community law. The application of Community legislation cannot be extended to cover abusive practices that is to say, transactions carried out not in the context of normal commercial operations but solely for the purpose of wrongfully obtaining advantages provided for by Community law'*

costs referred to year preceding the deliberations of the operation is greater than 40% of the average amount recorded in the two years preceding; it is evident that the provision aims to prevent the company that owns losses is an empty box, only created in order to simulate the existence of an actual business enterprise. About second requirement, losses of the companies participating in the operation may be deducted from income of the company resulting from the merger or division for the part of any amount not exceeding the amount of their equity. Doctrine emphasizes how tying the amount of losses carried forward amount of shareholders' equity, which reflects the value of the enterprise, the rule intended to preclude a loss of movement dissociated by a movement of economic values, it is clear the anti-avoidance spirit of this provision[125].

A last aspect concerns the possibility of applying rules on domestic mergers and acquisitions including transactions that involve companies established in State that does not belong to the European community. In order to support this position, doctrine has emphasized that internal rules do not provide some specific textual restrictions to non-residents. These conclusions are supported by Financial Administration[126] even if a condition is laid down: the discipline of foreign state is similarly regulated to what happens in Italy; in other words the operation is regarded as a universal succession (a continuation of legal relations that precede and succeed the moment in which transaction takes place).

In *Resolution 3 December 2008, n. 470/E*, Financial Administration highlights two additional profiles: subjects involved have a legal form homologous to that provided for the Italian companies, the operation takes effect in Italy on the tax bill, at least one of those involved.

3.9 INBOUNDS DIVIDENDS FROM TAX HAVENS

A dividend is a profit distribution based on a shareholder relationship. The ordinary dividends regulation is partial exemption accordance with participation

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[125]P. L. CARDELLA, *Disciplina delle perdite nelle operazioni straordinarie*, in *Il regime Fiscale delle Operazioni Straordinarie*, cit., p.503.
[126] Resolution 21 February 2000, n. 8996.

exemption regime. Dividends from preferential tax regime territories are taxed on Italian percipient and are subjected to a system of taxation more burdensome than that it is usually applied to dividend from foreign sources; in the absence of adequate taxation does not occur behind the phenomena of double taxation. However, the taxpayer has the opportunity to overcome that presumption and access to the exemption by demonstrating that ordinary profits in question serving a fair taxation compared to the level of taxation in force as long as it is demonstrated that from participation has not been achieved, since the beginning of the holding period, the effect of locating the income in black-list countries[127]. An essential element is the linking that must exist between the foreign company - granting the dividend- and black-listed country. The legislation refers to the criterion of residence, excluding from the exemption dividends deriving from companies resident in blacklisted countries. The D.L 223/2006 has also brought back to full taxation *indirect profits*; that objective was explicitly stated in the explanatory report to the measure where it is emphasized how through the corporate chain of intermediate links were possible to escape the full taxation for dividends from blacklisted countries. The novel legislation is a real special anti-avoidance clause. The purpose is to counteract operations which aim to circumvent the system of full taxation of profits from subsidiaries located in non-privileged tax regime countries. The current rules also apply to profits and revenues that come to the Italian parent company via conduit companies[128].The Financial Administration in particular has stressed that the inspection approach should not be based on simple quantifications of the tax burden suffered by the profits received by the Italian parent, but on the fact that participation in the subject localized in tax havens is not owned by subsidiary in order to artificially avoid a fair taxation. The interpretation is completely in line with Cadbury Schweppes judgment in which ECJ had recognized the possibility for nation legislators of providing domestic anti-abuse rules in order to avoid evasive behaviors by purely artificial structures.

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[127] It should be noted that this is the same test required under CFC. Therefore, with reference to the content of the proof apply the instructions provided by Financial Administration. (*See above*).
[128] Circ. 51/E reads that the examination of flow of dividends betwenn Italian parent and foreign subsidiary cannot be limited to to the application of general criteria but must be based o a case by case analysis.

Two hypotheses may be envisaged: Holding localized in black listed country with participations in white list countries and dividends, distributed by white listed holding, which came from subsidiary companies localized in different countries(black or white listed ones). About first point, the Italian shareholder, who perceive dividends by holding company localized in black listed country, should exclude from taxation the income already taxed by virtue of CFC rules.

About second point Financial Administration in Circ.51/E has determined that the conduit company must document the source of the distributed profits in this way, only profits from preferential tax regime countries will be subjected to full taxation, while others profits will be taxed only partially[129].

3.10. TAX ARBITRAGE ON DIVIDENDS

The discipline of contrast to dividend washing operations and dividend stripping was introduced to counter tax arbitrage between the exemption of capital gains and deduction of loss for the purchaser-dealer, where gain and loss can be correlated respectively to production and distribution of exempt dividends for the beneficiary. To this end, the discipline sterilizes the tax effect of realized capital losses realized on investments for an amount corresponding to the component of exempt dividends received. It is just the dividend stripping operations to provide a starting point for that evolution of the jurisprudence of the Supreme Court which, as explained above, the figure has come to bring the abuse of rights under constitutional principles. With a view to a summary reconstruction of the story seems to be interesting, bring the case covered by the judgment. (*For a brief definition of Dividend Stripping operations see above, par.2.1,chapter 2 of this work.*)

A U.S. company, with no permanent establishment in Italy, gave way to an Italian company (M) the usufruct, for about two years, with the right of withdrawal of control shares (90%) of an Italian Spa, upon payment of an amount equal to the total dividends that presumably the Italian company would have

[129] M. BARGAGLI, M. THIONE, *Tassabilità dei dividendi provenienti indirettamente da "black list": problematiche applicative*, in *Il Fisco*, 2011, 25, p. 1- 3656.

distributed during the period. After a year, M company ceded its right of usufruct to R company. The conclusion of Financial Administration placed emphasis on the fact that the company set up the operation in order to achieve tax benefits represented-for foreign company-by the non-payment of withholding tax provided by Italian legislation and- for M company- by the use of tax credit and deduction of the purchase cost of usufruct. If we wanted to provide a general definition, the transaction, thus classified as a Dividend Stripping, consisted in the purchase of shares just before a dividend is paid and the sale of those that shares after payment. When part of a tax avoidance scheme, it is used to distribute company profits to its owners as a capital sum, instead of as a dividend. The purpose generally being that capital gains are subject to lower taxes[130].

Just dividend washing and stripping operations provide the Supreme Court the opportunity to take stock of the treatment of transactions potentially elusive. From positive legal theory, passing through fraus legis, judges reach the elaboration of a general principle to recognize the origin of abuse in the Constitution(*see above, par.1.3,part I of this work titled "The opinion of the Supreme Court of Cassation".)*

In 2005 the legislator , in order to combat tax arbitrage, has introduced Art. 109.3bis. The goal is to fight the phenomenon of arbitrage between the capital gain exemption in respect of the originator and the capital loss deduction for the purchaser-dealer, where gain and loss, respectively, were related to the production and distribution exempted profits for the beneficiary.

The rule states that capital losses on shares or financial instruments (which do not meet the requirements established by law to enjoy the participation exemption regime) does not reveal up to the amount of taxable dividends. The deduction limit is applied whenever shares: have been purchased in the 36 months before their sale, satisfy the conditions of letters c) and d) Art 87[131]CITA and

[130] R. LUNELLI, *Dividend washing e dividend stripping nella giurisprudenza della Corte di Cassazione:tra validità, nullità radicale, invalidità relativa ed inopponibilità. Alcune riflessioni sulla "specialità" delle regole tributarie,* in *Il Fisco*, 2006, 25, p.3810.

[131] This provision requires for a minimum holding period of 18 months before the sale and has a clear anti-tax avoidance aim because it avoids participation transfers motivated by the sole purpose of benefiting from the participation exemption. The company issuing stock and shares should be resident in a different State from those included in the black-list enacted with Ministry of Finance decree of November 21th 2001 (i.e. so-called tax havens). The residence in those other States must

produced dividends in the precedent 36 months before their sale. Capital losses must be realized through the sale or assignment of shares to shareholders or to extra business purposes.

The issue about the ability to sanction Dividend stripping operations is part of a more general problem about the criminalization of avoidance. In the Italian legal system, it is neither very clear whether tax avoidance should be sanctioned or not. The situation is, however, changed with the D. Lgs. 74/00, which introduced a new crime ("*unfaithful declaration* "- Dichiarazione Infedele : art. 4), consisting in the mere concealment of positive components of income (above certain thresholds) , also by indicating fictitious negative components. In this last case, the problem is that the Decree deals explicitly with tax evasion but not with tax avoidance. However, it is even more controversial whether tax avoidance should have criminal relevance. Also in this case, in the absence of any relevant case law, the doctrine has often debated on different positions. *(For a brief overview about the problem of criminal relevance of Tax Avoidance see subpar. 1.3.1, chapter I of this work.)*

be kept uninterruptedly for 3 years before the sale of the relative participation. If the company has been in existence for less than 3 years, the residence in a “white list” country must be maintained for more than half the length of time of the period between the incorporation act and the receiving of the capital gain. However, the taxpayer can still benefit from tax exemption as long as he can show that the result of localizing incomes in those States had not being pursued from the start of the operation. The former condition is consistent with the anti-tax avoidance ratio of the discipline: in tax havens the profit would not be taxed and so it would no longer be necessary to avoid economic double taxation. Finally, the company issuing stock and shares must carry on a commercial activity. There is “absolute presumption” with an anti-elusive aim: there is no commercial activity (and then no participation exemption) whenever the patrimony of the participated company is predominantly formed of immovable properties other than those which are object of the production and sale activity of the company, its plants and the buildings directly used in the undertaking activity.

CHAPTER 4-INTERNATIONAL ASPECTS, SPECIFIC PROVISIONS

4.1 THE BENEFICIAL OWNERSHIP CLAUSE in DTCs CONCLUDED BY ITALY.

The beneficial owner clause, dealing with treaty shopping and subjective interposition operations, is contained in Art. 10, 11 and 12 of OECD Model respectively concerning dividends, interests and royalties.

The concept of beneficial owner has its roots in common law systems; the clause was firstly introduced in the OECD of 1977[132]. The limited taxation in the state of the source was subject to the condition that the recipient will also be the beneficial owner of income flows and this engendered the suspicion that, in case of mismatch between the recipient and the actual beneficiary, the benefit could not be granted formal. In 2003 important paragraphs have been added to the Commentary; it was stressed that the concept of beneficial owner is not used in Convention with a technical and restrictive meaning but it results from the context and the Convention purposes, especially international double taxation elimination and tax evasion and avoidance prevention.

In the majority of DTCs concluded by Italy, the benefit of the limitation of taxation in the state of source is acknowledged, provided that the taxpayer, resident in the Contracting State who receives the income, was the true beneficiary[133]; the limitation of the source State taxation requires that the recipient, resident of the other contracting State, is the beneficial owner, according to the formula provided by the Model Convention of 1977. After the Model revision in 1995 is now certain that the benefit is also granted whenever an interposed subject is involved but the beneficial owner resides in the same State

[132] At the time the Commentary only specified on the subject that the limitation of source State taxation rights was not applicable whenever interposed agent or a nominee were concerned (i.e. between the payer and the beneficial owner). Conduit companies were included only later by the OECD report on "*Double taxation convention and the use of conduit companies*". In the report it is stressed that a company, even if is the formal owner of the income, it is not the beneficial owner whenever it has such limited powers to be considered as a trustee or an administrator on behalf of another subject. In paragraph 61 of OECD report on "*The application of the OECD model tax convention to partnership*" of 1999 it is further specified that the beneficial owner is the subject to whom the income is referable to, according to the national legislation of the contracting State.

[133] A. BALLANCIN, *La nozione di "beneficiario effettivo"nelle Convenzioni internazionali e nell'ordinamento tributario italiano,* in *Rass. trib*., 2006, I, p.209.

(i.e. the other contracting State)[134]. As regards the definition of "*beneficial owner*" in DTC concluded by Italy, the first Protocol of the treaty concluded with Germany, 18 October 1989, should be noted; it establishes that *" The recipient of the dividends, interest and royalties is the beneficial owner within the meaning of Articles 10, 11 and 12 if he is entitled to the right upon which the payments are based and the income derived there from is attributable to him under the tax laws of both States."*

A similar concept has been adopted by few Italian Ministry of Finance acts. In Ministry of Finance *Circ. December 23 of 1996, n. 306/E*, concerning the regime of Legislative Decree April 1 1996, n. 239 (dealing with interests and other forms of income from bond and similar titles) the beneficial owner is identified in the subject to whom the income is referable, according to Italian tax laws; moreover it is specified that the condition is not fulfilled if there is an interposed subject such as an agent or a nominee[135]. The same position is confirmed in the *Resolution of the Ministry of Finance May 6th 1997, n. 104/E* which states that the right to conventional benefits is reserved to those persons having the status of beneficial owners, understood to be those where the income is tax due[136].

A slight change of direction seems to follow from the Circular. 47 / E, 2 November 2005, adopted in Italy to review the implementation of Directive 2003/49/EC where you can read "*in view of anti abusive purpose of the rule, the company is the beneficial owner when has the ownership and availability of income receive* ". It clarifies that, in order to consider a company as the final beneficiary of the interest or royalties, it is necessary that the company- receiving the interest or royalties - derives a direct "*personal economic benefit*" from the income arising from the transaction, considering that the function of the

[134] OECD Model Convention was amended in 1995 and Par. 12.2 of the current Commentary to article 10 of the OECD Model Convention makes clear that treaty benefits remain available when an agent or nominee is interposed between the beneficial owner and the payer of the income, but the beneficial owner is a resident of the contracting state. The Commentary acknowledges that this has been the consistent position of all member states.

[135] It is clear the reference to the OECD commentary in support of the proposition that the requirement is not satisfied when an intermediary – such as an agent or nominee – is interposed between the debtor and the income final beneficiary.

[136] It stated that the beneficial owners of the dividends pursuant to tax treaties with UK, the Netherlands and France are those who are treated as the owners of the dividends and are taxed on the dividends in their state of residence.

requirement is to prevent the use of an intermediary for the sole purpose of benefiting from the exemption. The Circular states that, considering the anti-abuse purpose of the beneficial ownership clause, a company shall be treated as beneficial owner of the income if it has *the power of realization and disposition* of the income. The jurisprudence of the Court of Cassation seems to confirm this orientation, highlighting that the key point is made by checking the subjugation of income to the taxing power of the country where the beneficial owner is resident regardless of the actual tax payment[137].

The only other definition of beneficial owner is found in the Protocol of Treaty signed with Turkey 27 July 1990, where it is determined that the clause of the beneficial owner must be interpreted in the sense that "*to a resident of a third country are not recognized tax benefits under the agreement with regard to dividends, interest and royalties, but that this limitation is not under any circumstances limitation is not in any case applied to residents of a state contractor*."

There are few conventions which expressly provides that benefits are recognized in favor of the resident who is the beneficial owner rather than the recipient beneficial owner. These are the agreements with Australia, Belgium, and the United States. In some conventions the formulation is limited to certain cases; the case of agreements with Malta (dividends and royalties), Sri Lanka (dividends), Bulgaria and United Arab Emirates (interests). In other agreements the references are very limited: in conventions concluded with Cyprus, Japan, Tanzania, Hungary, Thailand, the figure of the beneficial owner appears only on the presence of a permanent establishment in the state of the source. In some cases it provided the total exclusion from taxation of income in the state of the source(Conventions concluded with Russia, Macedonia, Austria, Bulgaria.)

Other conventions adopted a different formulation from the one indicated in the OECD Model. In DTC concluded with France, is provided, in terms of interest and royalties, that beneficial owner enjoys a limitation of taxation in the

[137] Cass., 29 January 2001, n. 1231; Cass. 5 February 2001, n.1583; Cass. 17 February 2001,n.2344; Cass. 21 February 2001, n.2532. In the past, the Court required proof of the perception of incomes and the fulfillment of tax obligations in recipient's state of residence. Cass.29 March 2000, n.3861; Cass. 11 April 2000, n.4560.

State of Source[138]. In DTC concluded with United Kingdom, the rule in terms of interests, as previously shown for France, guarantees effective limitation or exclusion from tax in the State of Source under certain conditions[139]. Finally, In DTC concluded with Switzerland, the application of the Convention and its benefits are entirely excluded to the apparent recipient[140].

4.2 THE ABSENCE OF A STATUTORY DEFINITION

Moving to a more careful analysis of the clause in domestic law it should be noted that the term "beneficial owner" is not defined by any rules of domestic tax law, or similar clauses; in other words that term is defined and used in other specific areas of Italian tax law and the way in which it is defined in those areas may affect the interpretation of the same term as it applies in the treaty context.

Some clauses are introduced by Community Tax within the implementation of Community directives n.2003/48/CE[141] (Legislative Decree 18

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[138] DTC Italy-France, Art 11. Par.3 : *"Interests is taxable only in the state of which it is the person receiving the interest, whether that person is the beneficial owner of the interest and they are paid in connection with the sale on credit of industrial, commercial or scientific equipment, or in connection with the sale on credit of any merchandise by one enterprise to another company."*

[139] DTC Italy-UK, Art 11.Par. 3 and 4: *"person who receives the interest is a resident, if that person is the beneficial owner of the interest and:(a) the payer of the interest is the first Contracting State referred to in paragraph (1) of this Article or one of its political or administrative subdivisions or local authorities (in the case of Italy) or one of its local authorities or agencies or instrumentalities of the Government or a local authority (in the case of the United Kingdom); or (b) the interest is paid in consideration of a loan made, guaranteed or insured by the second Contracting State referred to in paragraph (1) of this Article ("the second Contracting State"), including the Export Credits Insurance Company (Societá di Assicurazione ai Crediti per l'Esportazione), or one of its political or administrative subdivisions or local authorities (in the case of Italy) or one of its local authorities or by the United Kingdom Export Credits Guarantee Department (in the case of the United Kingdom) or a public establishment of the second Contracting State."*

[140] DTC Italy-Switzerland, Art. 4 Par.5 : *"The following shall be deemed not to be resident in a Contracting State within the meaning of this Article: a) a person who, while fulfilling the conditions laid down in paragraphs 1 to 3 is merely the seeming recipient of the income in question whereas the person who actually receives the income -- either directly or indirectly through other individuals or legal entities -- is not deemed to be a resident of that State within the meaning of this Article. b) an individual who in the Contracting State in which he would be resident in accordance with the preceding provisions, is not subject under the tax law of that State to the taxes generally levied on all the income from the other Contracting State which is generally liable to tax."*

[141] EC Savings Directive: It provides for an automatic exchange of information system to make sure that saving income in form of interest earned by a resident of a member state from sources in another member state is taxed in the recipient's state of residence.

April 2005, n.84) and n. 2003/49/EC[142] (Legislative Decree no. May 30, 2005, n. 143), which added *Art. 26-quarter* in Decree 600/1973[143]; paragraph 4 let. c) of the decree substantially received the directive definition which distinguishes between companies and PEs. identifying beneficial owner as "*A company of a Member State […] if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person.*" *"A permanent establishment […]:(a) if the debt-claim, right or use of information in respect of which interest or royalty payments arise is effectively connected with that permanent establishment; and (b) if the interest or royalty payments represent income in respect of which that permanent establishment is subject in the Member State in which it is situated to one of the taxes mentioned in Article 3."* However, the expression "*its own benefit*" might implicate a more substance-over-form analysis directed at investigating whether the company, in addition of being the legal owner of the income, has also sufficient powers of enjoyment or disposition over the income and has an economic return from the income, so that it can be considered the actual economic owner of the income concerned. The purpose of the beneficial ownership provision in the EU interest and royalties directive is very similar to the purpose of the beneficial ownership clause in tax treaties. In both cases, the term is used to avoid abuses consisting in the use of conduit or legal artificial structures to benefit from a tax exemption or reduction afforded by the law which otherwise would not apply. Therefore, the definition of the term "beneficial owner" contained in the EU interest and royalties directive is likely to play an important role for the interpretation of the

[142] Directive 2003/49/EC is aimed to solve problems of double taxation between associated companies resident in two Member States: exclusive taxation rights on intra communitarian interests and royalties are attributed to the residence State while an exemption must be granted by the source State.

[143] Interest and royalties Directive: This provision gives the grounds for the introduction of the limitation of the exemption of paragraph 5 of Art. 26-*quater*: whenever the interests or royalties payer is directly on indirectly controlled by the beneficial owner or both of them are directly or indirectly controlled by a third subject, the exemption is limited up to the interests or royalties amount calculated according to arm's length principle. This rule excludes from the exemption benefit, those operations which, although exceeding the arm's length condition, on the other hand does not exceed the debt/equity ratio necessary for the applicability of the thin capitalization regime. To conclude letter f-*ter*) was added to paragraph 3 of Art 37-*bis* of DPR 600/1973. This provision allows tax administration to ignore tax benefits provided by Art 26-*quarter* whenever interests and royalties are paid to persons other than individuals, directly or indirectly controlled by one or more non EU resident subjects. Indeed in those cases the beneficial owners of the payments are outside EU but they use interposed subjects to obtain the exemption benefit.

same term used and applied for purposes of tax treaties. In implementing the directive, Italy has adopted the position that beneficial ownership requires the power of disposal of the income, which the taxpayer must receive for his own benefit, and taxation of the income in the taxpayer's residence state. That interpretation is consistent with the definition of the term "beneficial ownership" provided in Italy-Germany tax treaty (the only one of the seventy seven Italian tax treaties in force that contains a definition of that term).

In the implementation of EC Savings Directive, the term "Beneficial owner" is defined as any individual receiving the payment for his own benefit and as final beneficiary of the income; *Circ. 55/E, December 30, 2005*, which provides guidance on the application of the legislation implementing the directive, confirms that the "beneficial owner" is a person who receives the payment for his own benefit.

It is also true that there are some rules that seems to adopt the "*look trough approach*". We refer to Art. 27-*bis*, paragraph 5 of D.P.R. 600/1973 by which the application of the discipline is excluded for companies which, even fulfilling the foreseen subjective and objective conditions, are directly or indirectly controlled by extra-EU subjects. However, those companies can still benefit from the directive if they are able to prove that they have not been incorporated with the sole or main purpose to benefit from the regime at issue. This provision is aimed to contrast abusive treaty shopping operations and correctly proceeds with a case by case analysis based on a *bona fide* clause.

4.3 LIMITATION OF BENEFITS CLAUSE

The extent of the limitation on benefits clause characterizes most of agreements concluded by the United States. It should be noted that this anti-abuse measure has considerably evolved over the years; in its current form is certainly an effective tool in the repression of abuse of International Conventions, a fact

that prompted the OECD [144] to recommend the use of anti-abuse tools available that restrict access to the benefits granted by Conventions[145]. It may be useful to reconstruct the features of the limitation of benefits clause retracing the evolution, starting from different types of approach to abuse.

According to the American Law Institute, US Conventions have three different approaches to treaty abuse:

- *Special measures approach*: it excludes specific categories of subjects from benefiting from the convention.
- *Principal purpose approach*: it excludes the application of the convention whenever the control relationship between two companies has principally a tax avoidance purpose.
- *Comprehensive approach*: it is now the most diffused and it limits the application of the conventions according to subjective and objective conditions referring to the undertaken activity and the type of international income.

"Limitation on benefits" clauses are advanced instruments conceived against treaty shopping abuses by U.S[146].

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[144] Recommendation n.9 (OECD, *Harmful Tax Competition. An Emerging Global Issue*, cit.p.47) establishes that: "*countries consider including in their tax conventions provisions aimed at restricting the entitlement to treaty benefits for entities and income covered by measures constituting harmful tax practices and consider how the existing provisions of their tax conventions can be applied for the same purpose; that Model Tax Convention be modified to include such provisions or clarifications as are needed in that respect.*"

[145] P. PISTONE, *L'abuso nel diritto tributario internazionale*, in *Diritto Tributario Internazionale*, cit. p.861.

[146] The 1985 Convention provided for a LOBC with a more limited scope. art. 2 of enclosed protocol, aimed to "clarifying and supplementing the Convention for the avoidance of double taxation with respect to taxes on income and the prevention of fraud or fiscal evasion" and signed simultaneously to the Convention.

This provision reads: "*A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to benefits provided in Articles 7 (Business profits), 10 (Dividends), 11 (Interest), 12 (Royalties), 13 (Capital gains) or 22 (Other income) unless: (a) more than 50% of the beneficial ownership of such person (or in the case of a company, more than 50% of the number of shares of each class of the company's shares) is owned, directly or indirectly, by any combination of one or more of: (i) individuals who are residents of the United States; (ii) citizens of the United States; (iii) individuals who are residents of Italy; (iv) companies as described in subparagraph (b); or (v) the Contracting States; or (b) it is a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange. Paragraph 1 shall not apply unless the competent authority of the other Contracting State determines that either the establishment, acquisition or maintenance of such person or the conduct of its operations had as a principal purpose obtaining benefits under the Convention. For the purpose of subparagraph (1)(b), the term "a recognized stock exchange" means: (a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock*

On January 1, 2010 came into force the new DTC signed by Italy and the U.S. on August 25, 1999. Art. 2 of the New Protocol to the Convention provides a comprehensive LOBC which aims at preventing that non-residents of either Contracting State must establish structures or underinvestment in one of the two Contracting States, in order to benefit from conventional rules (Treaty Shopping phenomena, following the look through approach). This objective is achieved by excluding from the application of some or all of the benefits of the Convention subjects who are not able to overcome at least one of the tests designed to ensure that the residence has not been established in one of the Contracting States for the sole purpose of obtaining conventional benefits. With the introduction of such tests, the U.S. Authorities believe that they can derive the subjective intention of the abuse and, at the same time, limit the restrictive impact in the application of the Convention[147].

By virtue of U.S. Tax Authority, the application of the clause is supplementary to the anti-abuse provisions provided by individual national laws. The clause is based on the principle of "*bona fide business purpose*" directly linked to that of "*substance over form*"; it follows the look-through approach (*For a definition of "bona fide" and different approach suggested by OECD see above, par.2.1,chapter 2 of this work.*)

Conventional benefits are granted to the satisfaction, at least, of one of the six tests contained in the second Par. of Art.2. In particular, a resident of a Contracting State[148] is entitled to enjoy the conventional benefits if it is: a natural

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exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934. (b) any stock exchange constituted and organized according to Italian laws; and (c) any other stock exchange agreed upon by the competent authorities of the Contracting States."

[147] P. PISTONE, *L'abuso nel diritto tributario internazionale*, cit., p.863.

[148] Art 2.par.1: "*A resident of a Contracting State shall be entitled to all the benefits of the Convention if the resident is: (a) an individual;(b) a qualified governmental entity; (c) a company, if: (i) all the shares in the class or classes of shares representing more than 50 percent of the voting power and value of the company are regularly traded on a recognized stock exchange, or (ii) at least 50 percent of each class of shares in the company is owned directly or indirectly by five or fewer companies entitled to benefits under clause (i), provided that in the case of indirect ownership, each intermediate owner is a person entitled to benefits of the Convention under this paragraph; (d) described in subparagraph 5(a)(i) of Article 1 of this Protocol; (e) described in subparagraph 5(a)(ii) of Article 1 of this Protocol, provided that more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State; or (f) a person other than an individual, if:(i) on at least half the days of the taxable year persons described in subparagraphs (a), (b),(c), (d) or (e) own, directly or indirectly (through a*

person, a government recognized, a company that satisfies the "*publicly traded test*" or "*subsidiary of publicly testing*", organization defined in Article 1, Protocol par.5, a pension fund, a person, other than a natural person who satisfies both tests: '"*ownership test*" and "*base erosion test*".

"*Publicly traded test*" provides that shares that represent more than 50% of the voting rights and value of companies, are subject to a regular trading[149] on a securities exchange.

Under the "*Subsidiary of publicly traded test*[150]", it is provided that a company is controlled by other listed of resident companies (in one of the two Contracting States) whose shares are traded on Stock Exchanges. More precisely, at least 50% of each class of shares must be owned, directly or indirectly, by no more than five companies standing to benefit from the agreements under the "publicly traded test".

The "*Ownership test*" requires that, at least for half of the tax year, individuals who meet one of the tests, possess directly or indirectly at least 50% of each class of shares or other rights.; instead, "*Base erosion test*" provides that a percentage less than 50 % of gross income earned by the person ,directly or indirectly, is paid to people who are not residents of one of the Contracting States, in the form of payments deductible for income tax purposes in the state of residence of that person.

Residually, where none of the tests are satisfied, *"active trade or business test*" is applied; by virtue of this test, a resident of one of the Contracting States may invoke the provisions related to the individual categories of income, if the following conditions cumulatively occur: the resident actually manages a trade or business in the state of residence and this trade or business is substantial in relation to the activity from which the income derives and exercised in the other

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chain of ownership in which each person is entitled to benefits of the Convention under this paragraph), at least 50 percent of each class of shares or other beneficial interests in the person, and (ii) less than 50 percent of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State (unless the payment is attributable to a permanent establishment situated in either State), in the form of payments that are deductible for income tax purposes in the person's State of residence."

[149] The term "regularly traded" is not defined in the Convention. In accordance with paragraph 2 of Article 3 (General Definitions), this term will be defined by reference to the domestic tax laws of the State from which treaty benefits are sought, generally the source State.

[150] The test is applicable only in cases where the intermediate participants in the resident company are resident in one of the Contracting States and meet at least one Lobc test.

State[151]. Par.4 provides that a resident of one of the States that is not otherwise entitled to benefits of the Convention may be granted benefits by a discretionary provision[152]. One last though is a must: the application of the Convention in cases

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[151] Art.2 par.3.of Technical explanation to the Protocol: Ownership/Base Erosion; it established that*:" Subparagraph 2(f) provides a two-part test, the so-called ownership and base erosion test. This test applies to any form of legal entity that is a resident of a Contracting State. Both prongs of the test must be satisfied for the resident to be entitled to benefits under subparagraph 2(f). The ownership prong of the test, under clause (i), requires that 50 percent or more of each class of beneficial interests in the person (in the case of a corporation, 50 percent or more of each class of its shares) be owned on at least half the days of the person's taxable year by persons who are themselves entitled to benefits under the other tests of paragraph 2 (i.e., subparagraphs (a), (b), (c), (d), or (e)). The ownership may be indirect through other persons themselves entitled to benefits under paragraph 2. Trusts may be entitled to benefits under this provision if they are treated as residents under Article 4 (Resident) of the Convention and they otherwise satisfy the requirements of this subparagraph. For purposes of this subparagraph, the beneficial interests in a trust will be considered to be owned by its beneficiaries in proportion to each beneficiary's actuarial interest in the trust. The interest of a remainder beneficiary will be equal to 100 percent less the aggregate percentages held by income beneficiaries. A beneficiary's interest in a trust will not be considered to be owned by a person entitled to benefits under the other provisions of paragraph 2 if it is not possible to determine the beneficiary's actuarial interest. Consequently, if it is not possible to determine the actuarial interest of any beneficiaries in a trust, the ownership test under clause (i) cannot be satisfied, unless all beneficiaries are persons entitled to benefits under the other subparagraphs of paragraph 2. The base erosion prong of the test under subparagraph 2(f) requires that less than 50 percent of the person's gross income for the taxable year be paid or accrued, directly or indirectly, to non-residents of either State (unless income is attributable to a permanent establishment located in either Contracting State), in the form of payments that are deductible for tax purposes in the entity's State of residence. To the extent they are deductible from the taxable base, trust distributions would be considered deductible payments. Depreciation and amortization deductions, which are not "payments," are disregarded for this purpose. This provision differs in some respects from analogous provisions in other treaties. Its purpose is to determine whether the income derived from the source State is in fact subject to the tax regime of either State. Consequently, payments to any resident of either State, as well as payments that are attributable to permanent establishments in either State, are not considered base eroding payments for this purpose (to the extent that these recipients do not themselves base erode to non-residents. The term "gross income" is not defined in the Convention. Thus, in accordance with paragraph 2 of Article 3 (General Definitions) of the Convention, in determining whether a person deriving income from United States sources is entitled to the benefits of the Convention, the United States will ascribe the meaning to the term that it has in the United States. In such cases, "gross income" will be defined as gross receipts less cost of goods sold. It is intended that the provisions of paragraph 2 will be self-executing. Unlike the provisions of paragraph 4, discussed below, claiming benefits under paragraph 2 does not require advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed."*

[152] Art.2.par.4 of Technical explanation to the Protocol: "*This discretionary provision is included in recognition of the fact that, with the increasing scope and diversity of international economic relations, there may be cases where significant participation by third country residents in an enterprise of a Contracting State is warranted by sound business practice or long-standing business structures and does not necessarily indicate a motive of attempting to derive unintended Convention benefits. The competent authority of a State will base a determination under this paragraph on whether the establishment, acquisition, or maintenance of the person seeking benefits under the Convention, or the conduct of such person's operations, has or had as one of its principal purposes the obtaining of benefits under the Convention. Thus, persons that establish operations in one of the States with the principal purpose of obtaining the benefits of the Convention ordinarily will not be granted relief under paragraph 4. The competent authority may determine to grant all benefits of the Convention, or it may determine to grant only certain*

of control by non-residents in the two Contracting States continues to be precluded. It is true that the activity clause restricts the situations of impossibility to invoke the benefits only to those cases which do not give evidence of a business income, but it seems that the limitation is not sufficient to make these provisions consistent with the Community Treaty and the EU freedoms[153].

Another LOB clause is included in Art. 23 of the DTC concluded between Italy and Switzerland. Art. 23 deals with Convention's benefits on dividends, interests and royalties. The latter are not granted to legal entities "*resident of a Contracting State, and in which persons who are not residents of that State have, directly or indirectly, a substantial interest in the form of a participation, or otherwise*", unless they fulfill several conditions: "*The interest-bearing debts to persons who are not residents of the first-mentioned State are not higher than six times the equity capital and reserves*". This condition is a rule against thin capitalization abuses, as it can be noted from the debt/equity ratio. "*The interest paid on loans contracted with such persons is not paid at a higher rate than the normal interest rate*". Also this provision is aimed to contrast rule shopping operations. Indeed, this condition includes also those interests which, even if not exceeding the, previously examined, debt/equity ratio, on the other hand, exceed "*the normal interest rate*". The latter, in Italy, is "*the legal rate of interest plus three percentage points.* "*not more than 50 percent of the relevant income from sources in the other Contracting State is used to satisfy claims (interest, royalties, development, advertising, initial and travel expenses, depreciation on any kind of*

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benefits. For instance, it may determine to grant benefits only with respect to a particular item of income in a manner similar to paragraph 3. Further, the competent authority may set time limits on the duration of any relief granted. It is assumed that, for purposes of implementing paragraph 4, a taxpayer will not be required to wait until the tax authorities of one of the States have determined that benefits are denied before he will be permitted to seek a determination under this paragraph. In these circumstances, it is also expected that if the competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure in question, whichever is later. Finally, there may be cases in which a resident of a Contracting State may apply for discretionary relief to the competent authority of his State of residence. For instance, a resident of a State could apply to the competent authority of his State of residence in a case in which he had been denied a treaty-based credit under Article 23 on the grounds that he was not entitled to benefits of the article under Article 2 of the Protocol."

[153] P. PISTONE, *La compatibilità con le libertà comunitarie fondamentali delle convenzioni internazionali contro la doppia imposizione con i Paesi terzi*, in *Riv.dir.trib.*, 2004, III, p.108-122; J. MALHERBE, O. DELATTRE, *Compatibility of Limitation of Benefits Provisions with EC Law, European Taxation,* 1996, p.199.

business asset including intangible assets, processes, etc.) by persons not resident in the first-mentioned State".“*Expenses connected with the relevant income derived from sources in the other Contracting State are met exclusively from such income*[154]". Moreover, when the same entities receive interests and royalties from Italy, a further condition needs to be fulfilled: these interests and royalties must be “*subject, in the canton in which such legal entity has its seat, to the cantonal tax on income in the same or similar way as is provided in relation to the Federal Defence Tax*". Finally a property and base erosion clause is provided for family foundation resident in Switzerland[155]. Rules concerning the application of this provision are contained in paragraph 3: “*The supervision, investigation and corroboration necessitated by the application of paragraphs 1 and 2 shall be carried out by the competent authorities of the Contracting State in which the recipient of the relevant income is resident. If the competent authority of the other Contracting State, from which the income originates, has reasonable grounds to cast doubt on the declarations made by the recipient of such income in his efforts to obtain a tax reduction, and the information contained in those declarations is confirmed by the competent authorities of the first State, then it shall communicate those grounds to the competent authority of the first State; this authority shall then undertake a new investigation and inform the competent authority of the other State of the conclusions reached. In case of disagreement between the competent authorities of the two States, Article 26 shall apply. No reduction will be given until agreement is reached.*"

It should be noted that, under those clauses, the scope of Treaties- normally extended to all residents of two contracting states- qualifies a further positive element: the presence of a genuine link between the resident and states' territory. This additional requirement does not exclude that the Convention can be applied many times in which the establishment of a society in a state has the pure

[154] It is interesting to note that the former list of conditions is open. Indeed, according to paragraph 1 letter e of Art. 23, “*Additional measures already taken, or to be taken by one of the Contracting States, against abuse of the use of tax relief relating to tax withheld at source in the other Contracting State, shall not be prejudiced hereby.*"

[155] Art 23 paragraph 2: “*[...] A family foundation resident in Switzerland may not claim the benefit of the reductions of tax imposed by Italy on dividends, interest and royalties if the founder, or the majority of the beneficiaries, are not residents of Switzerland, and more than one third of the relevant income is not, or will not be, paid to residents of Switzerland.*"

scope of benefit from the network of international conventions concluded by the same, according to the scheme of "treaty shopping"[156].

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[156]SOZZI C., *Corte di Giustizia e clausole convenzionali di limitazione dei benefici*, in *Rass.trib*, 2007, III, p.1022 ss. C-374/04(*Test Claimants in Class IV of the Act Group Litigation v Commissioners of Inland Revenue*) and C-446/04 (*Test Claimants in the FII Group Litigation v Commisioners of Inland revenue*) two main issues are involved: the refusal to grant a tax credit for dividends paid to non-resident companies with subsidiaries in the United Kingdom, this tax credit being for the corporation tax paid by their resident subsidiaries; the situation of companies resident in the United Kingdom that were paid dividends from subsidiaries resident in another Member State. The Court first pointed out that although direct taxation falls within the competence of the Member States, they must none the less exercise their competence in accordance with Community law. Freedom of establishment aims to guarantee the benefit of national treatment for companies established in the Community which wish to pursue their activities in another Member State by prohibiting any discrimination based on the place in which companies have their registered office. Applying different rules to comparable situations or the same rule to different situations constitutes such discrimination. The Court considers two scenarios. In the first scenario, involving dividends paid to a non-resident company, a Member State acts in its capacity as the State of residence of the shareholder when it grants a tax credit to resident shareholders. When the company making the distribution and the shareholder receiving the dividend are not resident in the same Member State, the Member State of residence of the distributing company is not in the same position regarding double taxation as the Member State of residence of the recipient shareholder. In this situation the Court held that it is compatible with Community law, when a resident company distributes dividends, for the Member State of residence of that company to grant tax credits only to resident recipient companies and not to nonresident recipient companies which are not taxable in that Member State. In the second scenario, involving dividends originating in another Member State paid to resident companies, the Court found that where a Member State has a system for preventing or mitigating a series of charges to tax or economic double taxation for dividends paid by resident companies, it must treat dividends paid by non-resident companies in the same way. In this context, the fact that nationally-sourced dividends are subject to an exemption system and foreign-sourced dividends are subject to an imputation system does not contravene the principles of freedom of establishment and the free movement of capital, provided that the tax rate applied to foreign-sourced dividends is not higher than the rate applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the tax charged in the Member State of the company receiving the dividends.

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FROM NATIONAL TAX SYSTEMS TOWARDS GLOBAL TAX SYSTEMS

"taxation of transnational transactions of financial institutions and financial instruments"

Dr. Riccardo Carboni

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Chapter One

General Income Taxation of Financial Institution: The Italian Perspective.

1.1 Introduction: A definition of financial institution for tax purpose.

In a global financial market like the one we are living, we have to consider how the tax system are working together to reach the goals of semplification and to create a market which the capital can freely go from a country to another whitout limitation based on taxation model choose by a State (this is also one of the principles of the UE treaty of Lisbona).

To start a perspective from the point of view of italian tax system. The italian national tax law describes the financial institutions not expressly but we can rescue a definition analyzing what he prescribe at art. 96 sec. 5 TUIR[1], or if we prefer broaden the horizons we have to watch over the Consolidated Bank Law (Testo Unico Bancario, TUB) or The Consolidated Financial Law (Testo Unico della Finanza, TUF). In all this case we haven't a definition but we have a list of the financial institution. So the best thing is to itemize them: Financial institution for tax law are: Bank, saving management companies (L. 23 march 1983, n. 77), banking holding companies, Sim (investiment securities company), companies of wich at title V, V-bis, V-ter, of TUB (financial intermediaries, investiment bank; financial companies like consumer credit company; electronic money institution; payment institution), and at art 59, sez 1,b of the same law (subject under consolidated supervision of Italy central bank).

So we can observe that for italian law every society with a connection with the financial world is considered like a financial institution, but if we want to give a definition good for an economic view we have to consider also the central bank, the insurance company, and the deposit and loan fund.

A general definition could be : " the term Financial institution include over the central bank, the Bank, the investiment securities fund and the other resident financial institution, whose activity is to receive deposit or financial instrument and to give loans or achieve investiment in financial instrument or other assets for

[1] Testo Unico Imposte sui Redditi (Consolidated Income Tax Law).

their own".

1.2) The accounting rules for banks: Differences in calculating the taxable amount and special disposition for the taxation of banks

The definition of financial institution assumes relevance (for the purpose of this work) because this subject have different accounting rules, following the Italian decision of the application for obligatory rules of accounting standards IAS / IFRS, and different accounting rules for balance sheet means different rules, compared to those for other subjects IRES, for determining the tax base. This choice, made by Italian Lawmaker, is explained by considering the importance of the international banking network in the present period.

In fact these subjects, together with listed companies, companies with financial instruments widely distributed among the public ex Article 116 Tuf[2], financial intermediaries subject to supervision by the Bank of Italy, insurance companies, must prepare, according to the framework provided by Legislative Decree 38/2005 (execution of the powers provided by law n. 306/2003), its financial statements in accordance with the model IAS / IFRS (international accounting standards/ international financial reporting standards) della Iasb (international accounting standard board).

This choice made by the Italian legislator follows the ratio of "safety value".

In fact the financial statements prepared according to IAS / IFRS should be a document that has as main characteristics that can be summed in the expression fair value. This term encompasses what may be termed the philosophy of international accounting standards by which corporate assets must be represented according to the current value of the company [3].

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[2] Consolidated Act of Finance (Testo Unico della Finanza)

[3] In relation to civil and fiscal issues related to the introduction of international accounting standards, see also I*AS-IFRS, la modernizzazione del diritto contabile*, in AA.VV., *Quaderni di Giur. comm.*, 2007, 308

In particular, the IAS / IFRS is inspired by the principle of representation of the assets based on its real" value" revolt, specifically, to the market and investors[4].

The balance sheet prepared in accordance with international accounting standards must meet the needs of those who "use" the documents itself. In particular, it is directed, first and foremost, to investors, and secondly to employees, lenders, suppliers and other trade creditors, customers, governments and public institutions and, finally, to the general public[5].

The balance sheet document must then provide to its users "information" about the financial position, economic trends and changes in time in financial position.

In contrast, the national accounting standards are based on criteria that privilege the needs of protection of corporate assets: then, in the first place, the interests of creditors, third parties and shareholders. The general criterion of representation of the assets according to national accounting standards is therefore related to cd historical cost basis and not at fair value[6].

The balance sheet prepared under IAS / IFRS (as explained in the guidelines of the Framework for the preparation and presentation of financial

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[4] This is the principle of substance over form. We find it yet in the reform "Vietti" to civil code. In Art. 2423-bis, n. 1, c.c., concerning the valuation of balance sheet items, provides that" we must also take into account the economic function of assets and liabilities". However, the principle of substance over form is not so incisive was argued in the articles of the Civil Code, with the exception of deferred tax assets and off balance sheet transactions, which instead have found a specific and precise set of rules; Alessandro Vicini Ronchetti, Prime riflessioni sulle nuove regole di determinazione del reddito di impresa per i soggetti tenuti al bilancio IAS /IFRS, Giurisprudenza commentata, 2008, 05, 999;
Italian Revenue Agency, Circ-7e-28-02-11 "the Framework, paragraph 35, merely states that transactions and other events must be "recognized and presented in accordance with their substance and reality" economic and not only according to their legal form "as a result, the IAS / IFRS privilege the economic substance over form in legal cases in which these two aspects are put in contrast".

[5] Especially for investors to safeguard the freedom of choice, having the best and most appropriate information as possible, in the investment to be made. Falsitta, G. FALSITTA, *breviaria iuris,* Tomo I, Padova, 2010, pag. 408.

[6] As rightly pointed out by the doctrine of the previous note, the accounting changes introduced by IAS / IFRS are not only those related to the valuation at fair value, this case also dealt with extensively by d. lgs. No. 38/2005 and therefore already addressed the specific legislative provision, but also about the different criterion for inclusion of components of income. See in this regard VACCA, *Gli IAS/IFRS e il principio della prevalenza della sostanza sulla forma: effetti sul bilancio e sul principio di derivazione nella determinazione del reddito di impresa*, in *Riv. dir. trib.*, 2006, 10, 757 ss

statements), must follow the criteria of reliability, ensured by surveying the business phenomena "according to their economic substance and not only according to the legal form".

Therefore we have to overcome the traditional approach linked to historical cost as the limit of the evaluations from balance sheet saying, as mentioned, the setting of a patrimony measured by fair value ("price at which an asset could be exchanged or a liability settled in an arm's length transaction between the parties").

The differences from the previous year, resulting from the assessment with the criterion of fair value are recognized in income or an equity reserve, giving the consistency of capital volatility and instability from year to year[7].

What has been said really matter in relation to the principle laid down by the provision of Article 2, n. 16 of Law No delegation. 825/1971, for the determination of the tax base, dependence, or derived from the result of the income statement prepared in accordance with the Civil Code[8].

For subjects that instead prepare financial statements according to IAS / IFRS principles, it is initially prepared in term of the Legislative Decree 38/2005, a different pattern characterized on the principle of neutrality in the determination of the tax base in order to avoid that different subjects in homogeneous economic situations were subjected to differential treatments depending on the accounting

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[7] Note that if there is an active market, think of derivative financial instruments, which operate at replacement cost valuations will need to have regard to an assessment that takes account of recent transactions involving similar property, considering the reasonably market expectations and risk factors for quotas. See also Portalupi, Corriere Tributario 08, 3163; Laghi, Quagli, Corriere Tributario 08,3173).

[8] For non-Ias the taxable income is determined in the annual return of income, contributing to the profit or loss of income statement increases or decrease, made pursuant to the provisions of the Income Tax Consolidation Act, sec. I, Chapter II, Title II). The increases are positive components of income not charged to the income statement based on civil law, or of negative items charged to the income statement but, according to fiscal discipline, not allowed as deductions from income or deduction which is deferred to future years . The changes are related to decreased negative items deductible from income for tax purposes but not present between the costs of the income statement or charged in previous years, namely on the amendment of the active components allocated in the budget as revenues but not relevant for tax purposes. To be noted here, especially with respect to the period of first adoption of the regulation of IAS / IFRS, See Also Circular of Italian Revenue Agency 28 February 2011, n. 7/E.

systems adopted, and to avoid a reverse dependence on the choice by the taxpayer's accounting system to be adopted[9].

The subsequent measures by the legislature, aware of the obvious problems inherent in the approach described, as by the same stated: “d. lgs.n. 38/2005 proved to be the light of experience Gained In These early years, not enough to address in an organic matter left enhaving unchanged, even subjects for IAS, most of the rules governing the transformation of the original date (budget results) in the derivative (income tax) without Adapting Them to new criteria for the preparation of balance sheet.”[10], has had with the law n. 244/2007 (Finance Act 2008), which as noted by the best doctrine, the nature of stability and the rule allocates to a wide audience of individuals increasingly, also in view of the planned implementation of the EU Directive 51/2003 EC on innovation of the national laws relating to accounting, aimed at a growing rapprochement of these international accounting standards[11]. This law leads to a amendment to art 83 Tuir for IAS entities adopter that provides, notwithstanding other provisions of the Consolidated Law, the traditional principles for determining taxation leave the step to qualification criteria, time allocation, classification, already adopted in the preparation of financial statements in accordance with the international accounting standards. This means that any of the phenomenon of management relevance accounting, qualified, classified into budget or temporally allocated under IAS, scales effortlessly these civil determinations also during the identification of the tax base, excluding those values for any changes in the tax declaration , (so-called principle of **derivation strengthened[12]**) that had raised so many doubts in the validity of the old Law 38/2005. The obvious benefit arising for companies is to keep the representations already adopted in the budget will be guided to the

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[9] Therefore we adopted a system to had the aim of neutralizing the determinations of IAS-compliant financial statements of entities that would have affected the tax base, thereby achieving the same result of the application of national accounting standards / traditional. This approach, cumbersome and complicated, it was later passed by the legislature. See the results for the period 2005/2007 considered by the Circular 7 / E of the Revenue Agency.

[10] Finance Act 2008, Technical report about IRES subject.

[11] Vacca, Rassegna diritto tributario, 07, 757; Falsitta op. cit. pag 411.

[12] As said, i can affirme that the principe of this provision, assuming relevance to qualifications of the budget made with Ias rules (substance over form) instead of the traditional rule reference to the contractual underlying. See also A. Vicini Ronchetti, op. cit., pag. 999.

economic-material (fair value) is by removing the "perilous" corrections imposed by Tuir into reclassification of phenomena according to formal legal criteria for the national accounting[13]. That to which now must have regard is the difficulty of applying the rule above. As noted by the doctrine "The distinction of accounting policies from those obtained by Tuir applicable to the detection of the tax base is not clear, referring to categories from the uncertain and indefinite margins and generic".In general, the amenability of a transaction or event of property to a legal category (**qualification[14]**), is a logical antecedent to the choice of which set it off against statutory category in the budget (**budget classification[15]**), as well as the

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[13] The choice of the the legislator was establishedin the first place, the need to simplify the behavior of companies and financial administration, avoiding the complicated preparation and maintenance of the reconciliation between the statutory findings and findings of fiscal. In 2007, in particular, there were many cases which, according to the legislation then in force, had resulted in complicated solution interpretation - even by the same Internal Revenue Service in connection with specific opinions as - which further reinforced the need to make less difficult the determination of business income. For example, include: R.M. No. 100 / E, May 16, 2007; R.M. No. 216 / E, 9 August 2007; R.M. No. 217 / E, 9 August 2007; R.M. No. 221 / E, 10 August 2007; R.M. No. 289 / E of 12 October 2007; R.M. No. 319 / E, 7 November 2007; R.M. No. 10 / E of 14 January 2008, see also in this case the circular 7 / E, Revenue Agency.

[14] It considers in particular that the qualification process is entailed, beyond the individual specifications of accounting, in a broad and generalized application of the principle of substance over form, which as we have already seen, exceeds the legal formalism of which are founded the national accounting standards and rules of the Income Tax Consolidated Act, applicable to non-IAS adopters. It is important to reiterate that this principle, as the whole setup IAS, has no concern for profit nor for those aspects of organizational-regulators expressed in the Civil Code, but is mainly oriented to describe economic activity as a function of the potential investor.
Commentators have pointed out some critical points in considering the qualifications of IAS balance sheet also relevant for tax purposes. We read for example: "what effects it may have a clearly established illegality of certain qualifications adopted in the financial statements? You may have a consequence in terms of" undermining" taxable income related to it? An affirmative answer to the provocative question above is perhaps not been assessed during the preparation of the Finance Act 2008. The new Art. 83 DPR No. 917/1986 provides relevance taxation not only the quantum of income statements, but also the classification adopted in accordance with the adoption of IAS / IFRS. In this case, perhaps, may be less than" screen" among criteria for the preparation of financial statements and income tax that was" guaranteed" by the previous wording of Article. 83 DPR No. 917/1986. ". A. Vinicio Rocchetti op. cit.
Here we want to agree with the author just quoted as saying the reference to" correct" accounting principles should be accompanied by a systematic framework, since the provision is triggered in the delicate relationship between the statutory and income tax. See also LUPI, *Nuove prospettive di raccordo tra valutazioni civilistiche e reddito fiscale*, in *Corriere tributario*, 2008, 14, 1097 ss.
Note that, however, tend to continue to operate all the qualifications that have a purely taxation, such as for example art. 87, which qualifies the exempt capital gains (in hindsight this rule is a rule of quantification and qualification not only), Art. 88 that qualifying period income, the art. 44 paragraph 2 (mentioned by art. 89) which defines the remuneration and other income to capital gains.

[15] The classification is a result of the qualification. For example, after having characterized the financial leasing transaction as a purchase of goods on credit will need to provide for the classification of the asset on the balance sheet between the plant and equipment (resulting in an

timing of the purchases in which this phenomenon relevance due (**allocation time**[16]). As part of the IAS standards are not clear definitions of specific qualification processes of concrete situations accounting relevant.

Assists in this sense, the general principle that impression around the IAS system, the prevalence of substantial economic nature of the phenomena of the formal legal system of national accounting. With this is highlighted the business activities by marked economic effects, rather than by the forms and the legal effects of acts of negotiation. Therefore the typical qualifications, as well as the temporal arrangement of the facts from which you generate significant tax case, not likely to coincide with that resulting from application of IAS standards, causing a substantial misalignment of the data collected[17]".An example of what is

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allocation to income statement of annual depreciation). Please note that both schemes IAS balance sheet both income statement of those, have strong differences compared to those provided by the Civil Code. The the legislator has already spoken to joint schemes with the rules of IAS Income Tax Consolidated Act classifications that refer to civil, as in the case of Art. 87 of the Income Tax Consolidated Act, which expressly refers to the classification of the equity stake long-term investments during the first period of ownership. To this end we note the specific utility of the distinction contained in Article. 85, paragraph 3 bis, which qualifies for tax-term investments for subjects IAS adopters, providing that financial assets are considered financial instruments other than held for trading.

[16] Charging time: even the charge time is a direct consequence of the qualification process. The report accompanying the implementing regulation establishes the prevalence for 'temporal charges resulting from the different qualifications IAS ". For example, for "mixed income" (income agreed in the face of the promise of future performance, eg. Points a thousand miles, sweepstakes, prizes to customers, etc..) Apply the criteria for allocation of time established by IAS 18, which prevail over rules Article. 109. The same goes for the competition against income tax for income from services, for which it should no longer expect the completion of the services. As will be seen better later on, in fact, today do not apply to the subjects IAS adopters the provisions of Article. 109, paragraphs 1 and 2.

It should be noted that this criterion does not derogate in any way within the domestic jurisdiction, ie on the recognition of material income evaluations and quantifications as part of their heritage. In this breast see Decree 48/2009, which considered "intangible criteria, specifically in Income Tax Consolidated Act content, assessment, determination of charges, as well as the distribution of values over time such as annual depreciation.". See also Falsitta op. cit. pag 412

[17] Falsitta. op. cit. pag. 412: The author also shows how this finding is consistent with that contained in the Explanatory Memorandum to the Decree n. 48/2009 derogating for the IAS-compliant subjects, applying the general rule contained in Art. Section 109. Of about 1.2 Income Tax Consolidated Act certainty and determinable criteria for the classification of income components, and to the results and negotiating the acquisition of ownership of assets. This is because under the statutory references are to the IAS and determinable criteria of certainty that they would overlap with the fiscal forecasts. Similarly to the results of negotiation.
In this regard it is noted that the exceptions to the policy of allocation time as provided in accordance with international accounting standards, applies only to the allocation of costs and revenues pursuant to art. 109, 1 ° and 2 ° paragraph, DPR No. 917/1986 and not for the time charges relating to the evaluations of activities (such as depreciation, amortization, etc..) - Emerges

said can be done by taking into account the transfer of property which, we qualified, assignment or as a lease or loan, depending on the occurrence of the transfer of significant risks and rewards of the asset transferred, as required by IAS 18 (Revenues) and IAS 39 (specific for the financial instrument) .

In light of the provision no tax effect is recognized to differential by rivalutation model under IAS 16[18], as well as those resulting from the adoption of fair value for capital assets in IAS 40, nor to those resulting from the application of the impairment test[19] provided by IAS 36 on impairment of assets.

Turns out to be important for banks provisions of the Decree 48 (Ministry of Economy and Finance) about the limits of the assessments referred to art. 106, sec. 1.3 Income Tax Consolidated Act. In fact, it was expected that the initial recognition of loans at a value which does not coincide with the nominal one (resulting from the legal model) is not expressive, according to IAS, of an evaluation criterion, but a qualitative representation of discounting cash flows based on the effective interest rate. Thus the phenomenon acquires the characteristics of the qualification which retains its relevance, even for the purposes for fiscal determination, overriding the provisions of art. 106 Income Tax Consolidated Act[20].

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from other additional changes introduced by the Finance Act 2008. See also: A. Vicini Rocchetti op. cit. pagg. 999 ss.

This Furthermore relevance limited to the exclusive jurisdiction outside may be seen as the legislature has provided for the conservation of assessments and provisions that, for purely taxation reasons, deviate from the budget prepared by the national criteria and that, therefore, continue to pose similar exemptions also the financial statements with IAS. Examples are the provisions providing for the allocation of positive and negative cash rather than accrual (directors' fees, dividends, etc..) And those that do not allow or restrict the deduction of costs as they are not inherent or providing for the taxation of income components divided in time for reasons of expediency taxation (apportioned pro rata as the imposition of certain capital gains). Se also S. Fiorentino, IAS e neutralità fiscale nell'esercizio d'impresa , Rivista di dirirtto Tributario, 2009, 10, pag.833.

[18] Property, plant and equipment.

[19] See about the irrelevance for (plus) and losses arising from impairment tests that are fiscally neutral in the absence of an ad hoc provision which sanctions the tax effect, as happened to the fair value of the shares and similar instruments that do not fixed assets (Article 110, paragraph 1 bis, letter. b). Another example is represented by the provision for severance pay that may not exceed the limits of art. 105 of the Income Tax Consolidated Act.

[20] Therefore, being valid for subjects with different rules about IAS adopters Impairment of loans and provisions for loan losses.

Issue to note is that concerning which provisions of Income Tax Consolidated Act continuous application on Competence, having regard to the principle of imputation time. As previously stated (see nt 16) the scope of the IAS is limited to so-called external competence, therefore, applicable to cases involving solely to transactions with third parties parties, not derogating beyond the general rules laid down in Article 109, sec. 1.2 Income Tax Consolidated Act, thereby remaining applicable and waived all other provisions of special character of Income Tax Consolidated Act for specific components of income that establish special criteria for allocating time, as a function of specific interest tax[21].

Compared to the previous legislation of Legislative Decree 38/2005, the Finance Act of 2008 led to the repeal of the provisions on the integration of the base with the only changes made to equity pursuant to the criteria of IAS. The repeal, however, has not affected the determination of tax, since the present arrangement, under Art. 109, sec 3 Income Tax Consolidated Act, provides that "revenues, other income of any kind, and inventories in its taxable income even if they are not recognized in income.". As well as provided to the par-4 of same article, "The costs and other negative components are not allowed as a deduction if and to the extent that they are charged to income statement relating to the exercise of jurisdiction. Are considered expensed components recognized directly in equity as a result of international accounting standards."[22].

Then in the determinations of balance sheet adopted by the IAS-compliant subjects, the charges made directly in equity bound to have implications in determining the tax base are only those with fiscal relevance by their nature, highlighted by the operations of changes made in tax declaration.

The problem is identifying which of these fiscal charges assumes relevance. The solution lies in looking at the above mentioned qualification and

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[21] Cfr Lupi, Corriere tributario, 08, 3168; Beghin Corriere tributario, 08, 3168; Cfr nt 17

[22] Note, however, as the law provides that "a) are expensed in a prior period, and if the deduction 'was postponed in accordance' with the previous standards this section who have, or allow the court;
b) those who, though not chargeable to income statement, are deductible according to law. The costs and expenses specifically related revenues and other income, which although not resulting expensed in its taxable income, are allowed as deductions if and to the extent that certain elements are accurate. "

subsequent classification made in accordance to IAS standards in preparing balance sheet. This means that the phenomenon becomes relevant for tax if its expression accounting in the indictment directly to equity, depend on the significance attributed according to IAS and from that expressed by the provisions of Income Tax Consolidated Act. Only if the nature of the phenomenon is classified as economic, even if you speak with it directly to equity, this value assumes significance in the determination of fiscal income[23]. Just think of IAS no. 32 Section 331[24] which provides that "the fee paid or received is recognized directly in equity" that since the operation is seen as a reduction of risk capital. Any differential between the prices of sale and purchase of the securities is relevant only for the increase or decrease in equity. So here we are facing an economic phenomenon that is relevant to the subject only for the purposes of IAS compliant change in equity.

In continuation with what we just noted, that in deference to the primary purpose of simplifying and bringing values civil accounting to those fiscal (plus the inevitable finality of revenue), may be indicated for completeness also the recent legislation that promotes the values from realignments civil values and fiscal (IRES both that IRAP)[25].

Is finally noted that the purpose of carrying forward of losses should look at, pursuant to Article 84 Income Tax Consolidated Act the same rules that apply to the determination of total income under Article 83 Income Tax Consolidated

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[23] "The contest for tax base of the positive and negative components for tax relevant under the provisions of Income Tax Consolidated Act, recognized directly in equity through the application of the aforementioned international accounting standards. The same deletion of Article. 83 of the relevance of earnings components recognized in equity is not a substantial change from the past: it was a mere "adjustment" as a formal, positive components recognized directly in equity under IAS, if they occur autonomously , still remain peacefully taxed: first under of general principle of derivation accentuated (as seen in the technical report cited in the Decree 48) and in any case, though always under the relevant provisions of the Income Tax Consolidated Act, by virtue of the prediction residual , to be considered confirmatory of a general system, contained in art. 109, paragraph 3. In other words, the positive components of income, if relevant to the Income Tax Consolidated Act in the tax year, are taxable even if not charged to income as a specific foreclosure in this sense can be obtained only for the expenses and other negative components pursuant to art. 109, paragraph 4, first sentence. ", S. Fiorentino, IAS e neutralità fiscale nell'esercizio d'impresa, Rivista di diritto tributario,2009, 10, pag. 833.

[24] Sales of securities representing equity.

[25] See also art. 15 of DL n. 185/2008: in particular paragraphs 2 to 9 relate to the enfranchisement for differences in value for subjects IAS adopters, the paragraphs 10 to 12, the redemption value for differences arising from extraordinary transactions, but also relevant for non-IAS adopters.

Act. On this point it should be noted however, as there has been a significant change to Article 23, par. 9, of D.L. July 6, 2011 n. 98 which provides for significant differences from the previous regime. In fact it is now the option of offsetting tax losses not (as in the past) in full, but only up to 80% of taxable income for subsequent tax periods (not, mind you, on loss carried forward) in which the compensation is the same and for the full amount that is the same capacity in the amount of taxable income[26].With reference to the ratio underlying the above mentioned news, the government report to the DL No. 98/2011 stated that: «These estimates are measures to support enterprises which, coming from one crisis to the economic/financial unprecedented, are found to have large volumes of loss carryforwards that may not be used over five years' : "and, moreover, that" the norm ... wants to respond to the need for simplification: 1) by not requiring companies to engage in extraordinary times to get a refresh of the losses that expire, operations which effectively nullify the time limit for carry, 2) limiting complex exercises of the recoverability for same for the purposes of registration and /or maintenance of the related deferred during the formation process of the financial statements». Basically, as already previous mentioned, through the changes discussed above, the legislator wanted to allow companies that have achieved losses in recent years of economic crisis to avoid that the same can not be used due to the excess of the limit to its five-year carry-forward that was provided under the former Article 84 of Income Tax Code. Moreover, notwithstanding the use of new quantitative limit losses in an amount equal to 80% of the amount, even after the changes introduced were confirmed principles

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[26] *In practice, "this means that:" if the reported loss from previous years is over 80% of income for the year: the compensation must be limited to this last amount (considering the hypothesis of a loss reported of 200 and an income of 180. in this case, the compensation will be limited to 180 * 80% = 144 and, therefore, taxable income will be equal to 36); "if the reported loss from previous years is less than 80 % of income for the year: it will be fully used (consider the possibility of a loss of 100 and reported an income of 180. in this case the loss can be fully used to offset, such that taxable income will be equal to 80), was eliminated using a limit of five years for losses, by contrast, characterized the previous system such that, similarly to what was expected in the past limited only to realized losses in the first three fiscal years is now expected to possibility of use of the same even beyond the fifth period subsequent to that of the relative formation of the same. For subjects undergoing IRES IRES with the ordinary rate (27.50%), the introduction of above quantitative limit for carry-forward of losses that will result in subsequent tax periods, despite an income of less than past losses, you will still have a tax in an amount equal to 5.50% of income realized (ie 27.50% of 20% which, in any case remain taxable) " .*

(already provided previously in force under Article 84, paragraph 1, of the Income) under which: "1) assuming exercise of activities which benefit from tax relief schemes for partial or total income (ie income components of income statement taxed): its tax loss is relevant to the same extent in which these revenue is, in practice, excluded from taxation, "2) assuming use of exemption schemes in profits: the loss can not be used to offset the income of subsequent years up to for benefits already enjoyed the profits of previous years , "3) the tax loss is still reportable as a deduction from total income to the extent that the tax corresponding to taxable income result offset by any tax credits, corporate income tax withholding or surpluses of previous years".

In this last regard, it must be concluded that this forecasting application retains the same mechanism as ever, with the difference from the past in the fact that the amount taken as a deduction from income is set at a level equal to 80% of this 'last. Consequently, even after the new things that have been introduced by the legislature, must be considered, however, can waive a portion of the losses to be compensated, so that they can clear the tax debt, thus leaving those losses to offset of income in subsequent periods. For accounting purposes, the modification of the rules on tax losses generated within the IRES is able to produce effects on the findings of the balance sheet of those involved and this is because, as is easily understood, the latter will be required to enter higher current (coinciding IRES calculated on 20% of taxable income) with a smaller reduction in deferred tax assets related to the loss corresponding to the IRES is not used in the exercise[27].

In addition to this you must observe for the first three tax years worth differing rules, as though carried forward without time limit, does not undergo the new rules about the maximum limit of 80%.

Coming now analyze the other fiscal peculiarities, which then change the rules for determining the tax base compared to those who prepare balance sheet in accordance with the statutory criteria, provided for subjects who prepare financial statements according to IAS / IFRS as we can now analyze these under Article 85

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[27] See also: R. Lugano, M. Nessi, I nuovi criteri di utilizzo delle perdite fiscali per i soggetti IRES, Rivista dottori commercialisti, 2011, 04, 853

para 3 a Income Tax Consolidated Act constitute financial assets to financial instruments other than those held for trading. Therefore they do not constitute income/loss but (gain) losses. These, in the event that invoked the criterion in to art. 87 par 1, a) Income Tax Consolidated Act[28], will constitute capital gains exempt to the extent of 95% from the calculation of the tax base[29].

Difference greater undoubtedly both quantitatively and qualitatively regards profits earned in accordance with Article 89 Income Tax Consolidated Act. The rule provides that the profits earned on financial assets (stocks, shares and financial instruments like shares) held for trading fully contribute to the formation of business income in the period in which they are received. For these subjects so the general rule is not valid for other commercial companies that provides for the exclusion from taxation for 95% (as a rule that we have seen however remains for investment securities). This difference is still justified into substantial differences the balance sheet prepared in accordance with international accounting standards with respect to the financial statements. It is useful at this point, to clarify the above, consider the criteria for the classification of financial instruments as well as IAS 39[30]. 1) Financial assets at fair value and loss account, which are financial assets held for trading[31], derivatives, except for the purpose of financial security or for hedging purposes, 2) Financial assets held to expires[32], 3) loans and credits[33], 4) financial assets available for sale[34]. Regarding the

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[28] Twelve months uninterrupted possession.

[29] Participation exemption regime. This discipline is recognized in the presence of certain conditions: the uninterrupted possession for more than a year and enrollment among financial assets (according to specific rules), rather than speculative investment basically stable, the tax residence of the subsidiary in a country white list . In the case where the subsidiary is in a country blacklist the regime does not apply. See infra.

[30] Especially after the revision undertaken by the Regulation. 2008/1004/EC which amended the classification criteria.

[31] Are those that are held for a limited period of time because by their nature intended for sale within the short term in order to obtain an immediate profit.

[32] They are financial assets characterized by fixed or determinable payments that the company periodically fixed plan on keeping it until its expiry. This is not equity instruments that the company does not intend to divest before the deadline.

[33] Are financial assets with fixed or determinable payments, characterized by the absence of a listing on a market, not held for trading, not classified as available for sale.

[34] Are the residual category of financial assets other than expressly intended by the company for sale.

assessment of the value of these assets must have regard to the initial recognition in balance sheet[35] and future evaluation[36].

Upon initial recognition it is stated the obligation of fair value, regardless of the valuation criteria adopted later. The fair value still depends on whether the financial asset is held for trading (at fair value is the corresponding contract value, because the ancillary charges[37] are charged to the income statement),or is falling in other categories (in which the price contract will have to add up all the charges which are not directly included therein)

For subsequent measurement of the financial instruments held for trading will always be careful on the criterion of fair value (so the value will be constantly updated with each new budget) with the consequence that the capital gains / losses must be made in the income statement.

Financial assets held to maturity are valued at amortized cost using the effective interest[38].

Financial assets available for sale are measured at fair value, but unlike those held for trading possible breaches of the gains / losses are to be allocated to a reserve in equity until the disposal activity will not occur from the budget. However, they must be attributed to income from interest income, impairment losses for the test and any exchange differences[39].

What has been said has particular relevance because the criterion for recognizing provided for financial assets held for trading is the basis of related principle of total taxable profits from capital gain / loss arising from this category. So considering the provisions of art. 94 par 4 Income Tax Consolidated Act we take as the valuation of these securities at fair value is also relevant for tax purposes. Corollary to that is no reason to order the exclusion from the formation

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[35] IAS 39-43

[36] IAS 39-45-46

[37] Transaction costs.

[38] Which involves the periodic deduction of the cost initially enrolled because of depreciation that stems from the evaluation of the estimated useful lives and of effective interest rate adopted. For such activities is provided for the impairment test (ie assessing the possible loss of value).

[39] This category may also be included equity instruments of unlisted companies. If you can not do for these evaluation value budgeting should be done with historical cost basis.

of taxable dividends, finding this item appropriate positive counterpart in variations of equivalent value annually recognized[40].

Still on the provisions of art. 89 Finally, we must consider how the above rules apply, not unlike the IAS companies, including earnings from non-residents for assets held for trading (so they can have no competition for these gains to 95%) . For other categories of financial assets to the exclusion of 95% will still be given to the use for same conditions as all other persons resident for tax purposes in Italy.

Article 89 also provides additional rule of great importance for the banking world[41], that is the discipline to repos transactions in securities and banking current account. For the first "interest yield on securities purchased under repurchase agreements containing obligations of resale the securities concur to form taxable income of the transferee for the amount accrued during the term of the contract. The positive or negative difference between the estimated spot and forward, net of interest earned on the activities involved in the transaction during the term of the contract, goes to make up for the income amount accruing during the year."[42].

For the second instead the rule is that is considered accrued, and a portion of the taxable income, the interests legally compensated (so you do not look to any surplus). The same rule should apply also to the interests of steps, whose relevance is independent of the current account balance.

Another relevant article to the determination of the tax base is Article 91 for banks Income Tax Consolidated Act "Do not contribute to the formation of income: a) the proceeds the assets qualifying for exemption; b) income subject to withholding tax at way of tax or substitute tax, c) in case of capital reduction by cancellation of treasury shares purchased pursuant to such resolution or above, the positive or negative difference between the cost of the shares canceled and the

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[40] Falsitta, op. cit. pag 454.
[41] Regulating traditional banking assets such as the repo transaction.
[42] Art. 89 par 6 Tuir.

corresponding share of net assets d) the above issue prices for shares and interests of balance paid by the subscribers of new shares”.

This article takes on significance because, as previously mentioned, for subjects who prepare financial statements according to international principles buying back own shares implies that the shares are not to be included as assets, while the price will be paid as a deduction to be subscribe to net assets. In summary, the shares are canceled, and in light of the rule provided by this article may not generate income components active or passive.

At about of this, the italian Revenue Agency expressed the opinion that the use the balances of revaluation on the cancellation of own shares determines the taxation on the findings that the difference of cancellation is not a loss. According to The italian Revenue Agency then the transaction would be neutral, but only if is would proceed to cover the difference by cancellation of treasury shares, after resetting its reserve balance (through the use of reservesfiscally available[43]).

It seems clear then the critical points: IAS provide the irrelevance of the operation of “cancellation of equity” since the purchase for own shares (therefore being insensitive reduction of share capital), while this operation is of value to the fiscal agency revenue. In this respect, here we tend to share than projected by ABI[44] ,in Circular 3/2006, whereby the purchase of own shares should always achieve more than the cancellation of their value “from the balance sheet liabilities”, even “the recognition in of income statement differential between the purchase price and the book value, while the subsequent resale implies the application of the provisions relating to detection and evaluation requirements for the portfolio of destination”, which as it is believed that the treatment of these transactions directly descends from recognizing the same since “principle of derivation from balance sheet[45] taxable income means that the representation given in the balance sheet for these operations, in the absence of rules impediments, has relevance for tax purposes.”.

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[43] But in this last category would not be attributable to the revaluation reserve because unavailable. Revenue Agency res. 32/E/2005.

[44] Italian Banks Association

[45] Most true after the reform of Law 244/2007

Another article of Income Tax Consolidated Act be assessed in relation to the banking world is certainly the 94, which for subjects IAS "Notwithstanding paragraph 4, for entities that prepare financial statements according to international accounting standards referred to in Regulation EC n. 1606/2002 of European Parliament and the Council of 19 July 2002, the valuation of the assets listed in Article 85, paragraph 1, letter c), d) and e), made for the correct application of these principles is also important for tax purposes. "therefore remains the relevance the IAS accounting standards, as already stated several times, even in this case. So the assessments the stocks must always follow the above criteria based on the nature of the financial asset.

Article particularly relevant to the tax regulation of banking is definitely on the 96 Income Tax Consolidated Act deduction of passive interests[46] (of which we discussed previously in relation to the general subject the IAS). This article provides, as renewed from January 1, 2008 (reform driven by revenue needs rather than reasons of system or redistributive[47] purposes), that the general provisions on interest income "does not apply to banks and other financial entities mentioned in Article 1 of Legislative Decree 27 January 1992, n. 87, with the exception of the companies 'carrying on an exclusive or predominant activity' equity participation in companies 'activities merchants' other than the bank or financial, insurance undertakings as well as 'the company' parent banking groups and insurance. "and then (a par 5)" interest expenses incurred by persons specified in the first sentence of paragraph 5 shall be deductible from the taxable amount of that tax to the extent of 96 percent of their amount."[48].

The field of application of this standard should be drawn clearly delimited by passive interest and similar charges and negative from the exclusions provided by par. 1,3,6 of same article of the law. Reading the paragraph 3 of the same article we can see how are significant passive interests and financial charges

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[46] Standard that assumes considerable importance given the extent of financing activities liabilities held by banks. Lastly, we see only the large Italian banks underwriting loans ECB.

[47] C.d. Robin Tax created by Ministry of economy and finance Giulio Tremonti. See also Falsitta op. cit. pag 504

[48] Excluded from this provision at the time the loans secured by mortgages on property to be leased ex Art 1, par 36 L. 244/2007.

assimilated descendants of certain types of contract (loan, lease, bond issues), legal connotations in that it provides for the granting of loans, supplemented by a prediction of a general nature which refers to any successor financial relationship (contractual reason, not economic reason[49]).

With specific regard to the fact that subjects are banking we have to to see how the IAS-compliant accounting policies IAS have immediate relevance for tax purposes in terms of qualification, time charging, quantification[50]. Because of overcoming of the principle of neutrality, of the legislative decree 38/2005, we may assume that the interest charged to the income statement only "figuratively", as it does not express a genuine payment obligation to the creditor and are limited to expressed in economic terms, the discounting of assets placed in pursuance of the amortized cost method, must be considerer all interests to the effect of art. 96 Income Tax Consolidated Act[51].

It is useful at this point to clarify what is meant by "similar charges". According to the Italian tax law these are "a) the reductions and cost increases arising from the assumption of debt, respectively, above or below par (falling between the cost increases, for example, quotas for the year of the discount issuing of bonds and certificates of deposit); b) the fees and commissions payable calculated on the amount or duration of the debt which they relate, c) the negative balance of income and charges relating to "hedging "of activity 'and liabilities' interest-d) charges relating to carry-overs and repurchase agreements providing for an obligation on the transferee to resell the activities' (eg, securities) subject to such transactions, the fees are calculated taking into account the difference

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[49] It should refer, in the opinion of the writer, to relationships that involve the use of funds with repayment obligation. The point is still debated in academic. See also Rossi-Ampolla, Bollettino tributario, 08, pag. 467 ss.

[50] See for example, IAS 39, which provides for the valuation of financial instruments according to the amortized cost, as a result of which the income may be charged interest steps (ie active), not provided by the legal relationships that are a prerequisite, but which are required for expression of the corresponding current value.

[51] Falsitta. op. cit. pag 505. Otherwise if you look also to the actualization of high capital items such as trade credits and provisions for risks. These derive from even recent reports claiming financial See. Lipardi-Stancati, Bollettino tributario, 08, pag. 1653.

between the spot price and forward price of the benefits (eg, interest) generated by activities' in the same period of operation."[52].

Systematically related to the above arrangement (always being planned under the so-called "Robin Hood Tax" [53]) appears to be the prediction of the limitation of bad debt now limited to 0.30% per year[54]. This limitation particularly in times of crisis has strongly affected the Italian banks, leading to strong differences between the civilistic balance sheet write-downs and tax relevant write-downs[55], also with the provisions for loan losses that are deductible up to a maximum of 5% of the value of claims resulting from balance sheet.

Going at this point to look at the losses in equity and contingent liabilities and loss, we have to take care in conjunction with Art. 101 Section 2a Income Tax Consolidated Act with Art 110 par 1bis, according to which "1-a. Notwithstanding the provisions of subparagraphs c), d) and e) of paragraph 1, for entities that prepare financial statements according to international accounting standards referred to in Regulation (EC) n. 1606/2002 of European Parliament and the Council of 19 July 2002: a) higher or lower values the assets specified in Article 85, paragraph 1, letter e), which are considered financial assets under paragraph 3-bis of the same article, income statement for the correct application of these principles, are relevant also for tax purposes; b) letter d) of paragraph 1 shall apply only to shares, capital and financial instruments similar to actions that considered financial assets under Article 85, paragraph 3-bis c) for stocks, shares and financial instruments like shares, held for a period less than that indicated in Article 87, paragraph 1, letter a) , with the other requirements laid down in paragraph 1 of that Article 87, the cost 'the reduced gains earned during the

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[52] Revenue Agency, circular 141/E/1998. In academic it is doubtful that these could also traced the charges arising from the closure of hedging derivatives, however, giving themselves to the exclusion of certain expenses from the closure of speculative derivatives contracts. See on this point Falsitta, op. cit., pag. 507.

[53] See Art 106 par 3 Tuir

[54] This represent a major source of the tax system of deferred tax assets. The italian law provides for bad debts a limit on tax credits to depreciation at 0.30% of claims resulting on the balance sheet, the value of depreciation exceeding that plafond is deductible on a straight line in eighteen years and is the basis for the calculation of future tax savings (on balanche sheet activities for deferred tax assets).

[55] La tassazione delle Banche Italiane, pressione fiscale, determinanti e principali peculiarità, Bancaria, 11/2010, pag. 58. See pictures 9 on changes in time of the rate for bad debts.

holding period for the amount excluded from the income. 1-ter. For those who prepare financial statements according to international accounting standards referred to in Regulation (EC) n. 1606/2002, positive and negative components arising from the assessment made for the correct application of these principles, for liabilities' are relevant also for tax purposes". Therefore it is clear relevance for tax purposes of such a provision, with regard to measurement is stressed that these should follow the criteria for determining data from IAS and see the point in what has already been said.

Important considerations must be undertaken with regard to art 112 Tuir (off-budget), because of the prominence that they have taken in the banks' profitability in recent years. Under the objective point of view in this category "a) contracts that have not yet settled, spot or forward, securities and currency, b) derivatives with an underlying security; c) the currency derivatives, d) without underlying derivative contracts linked to interest rates, indices or other activities"[56]. For banks subject these components will contribute to the formation of income according to the application of the rules dictated by the IAS/IFRS standards[57].

Further specification deserves par 4 of that article that the hedge "of assets or liabilities, which are covered by assets or liabilities, the related positive and negative components arising from valuation or realizable in its taxable income under the same provisions governing the positive and negative components, arising from valuation or from sale of assets or liabilities, respectively, covered or hedging" united in par 6, which refers to the hedging definition, found into the IAS 39[58].

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[56] For the definition of a derivative contract see in Article 1 paragraph 2.3, the Consolidated Law on Finance (Legislative Decree n. 58/1998). It should also assess how the Bank of Italy (Order dated December 22, 2005, defines derivatives richiamadosi the definition of IAS 39. Therefore, the definition of the aforementioned article shall be considered as merely illustrative of the broader category.

[57] Therefore we will follow the general rule of evaluation planned for the financial assets (recalling also the value for the purposes of determining the tax base). For example, for assets held for trading IAS 39 (fair value).

[58] See circular ABI, tax series, 21 february 2006, n. 3.

Lastly we must point out specific rules for banks, the conversion of receivables due from companies in trouble in equity capital thereof (Article 113 Tuir).

With this rule, the legislature intends to meet the business risk of the banks regarding the insolvency of counterparties, giving the possibility[59] to banks to frame aforementioned shares the same way as the charges credits from which these are derived, so as to ensure an absolute continuity in the tax treatment of these items, in particular as regards the regulation of the evaluations[60].

This standard also found ratio civilistic / insolvency in the purpose of avoiding the failure of firms in difficulty (perhaps only illiquid but not insolvent), and for banks to avoid the devaluation of their claims in a possible bankruptcy.

1.3 The discipline of intragroup dividend and the treatement of branches

The discipline of intragroup dividend does not vary between the banking groups are groups of trading companies. Will be briefly given the situation of inbound and outbound dividends under current legislation.

The profits that are distributed by residents to non-residents have to look in case of persons within the EU and related subjects in the so-called whitelist, art. 27 of Presidential Decree 600/1973, which as a result of changes introduced by Law 244/2007[61], are subject to a treatment similar to those distributed to residents. Therefore, because of the so called "Participation exempition" contribute to the formation of taxable only in the extent of 5%[62]. Also in case of subjects will also look at EU directive "mother daughter" no. 436/1990 according to which if all

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[59] Be exercised through the procedure of article 11 L 212/2002.

[60] Dolce-Parisotto, Le operazioni in valuta e derivati finanziaria, 2005, pag. 67 ss.

[61] See the contrast detected by the European Commission on the regulation previously in force in the opinion C (2006) 2544 of 28 June 2006.

[62] Therefore, the actual tax will be 1, 375%. Application of a IRES equal to 5%.

parties are resident in EU member states, the exemption applies to dividends[63]. But in the case of countries outside the EU white list will be due a refund, provided they demonstrate that they have paid tax abroad definitively to the same profits, through certification of the office concerned foreign tax, up to a maximum of 4/9 of the withholding tax paid in Italy.

If the recipient entity resides outside the EU (or even EU) in a non-white list should be applied outbound dividend tax of 27%.

In the case of inbound dividends must have regard to the foregoing in connection with art. 89 Tuir (competition total dividends on securities held for trading the income formation[64]).

Branches for the treatment of non-residents subjects must be considered for the tax legislation in Italy the concept of permanent establishment. This is required by Italian law in Article 162 Tuir[65] (definition of permanent

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[63] Article 4 of the Directive. Exemption concerning 95%. then only 5% of the income will go to the tax base, taxation 1, 375%. Furthermore, if the foreign corporation owns at least 12 months for a stake of 20% of the company making the distribution, it will be entitled to a refund of tax thus made, resulting in certification by the competent foreign tax authorities, with which it proves the possession of such requirements. Note that the rule also applies in the case of having an intermediary fiduciary (resolution 109E/2005 Revenue Agency). Also according to par 3, Art. 27 bis, always have elapsed 12 months of ownership of the instruments, the withholding may be avoided by contacting the Financial Regulator.

[64] While the financial instruments categorized as financial assets must be remembered that these are counted as minus / plus values.

[65] Without prejudice to Article 169, for the purposes of income tax and regional tax on the activities' potential referred to the Legislative Decree 15 December 1997, n. 446, the term "permanent establishment" means a fixed place of business through which the non-resident enterprise is wholly or in part its activities' in the State. 2. The term "permanent establishment" includes especially: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop; f) a mine, an oil or gas well, a quarry or other place of extraction of natural resources, even in areas located outside the territorial waters in which, in accordance 'with customary international law and national legislation relating to exploration and exploitation of natural resources, the State can 'exercise rights with respect to the seabed, subsoil and natural resources. 3. A building site or construction or assembly or installation, or the exercise of activities' related to that supervision, and 'considered "permanent establishment" only if such site, project or activity' has a period exceeding three months. 4. A fixed place of business is not ', however, considered a permanent establishment if: a) uses facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to b) the goods or merchandise belonging enterprise are stored solely for the purpose of storage, display or delivery; c) the goods or merchandise belonging to the enterprise are stored solely for the purpose of processing by another enterprise; d) a fixed place of business and 'solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise, e) is used solely for the purpose of carrying on, for the enterprise, any other activities' which have a preparatory or auxiliary character; f) is used solely for any combination of activities' mentioned in subparagraphs a) to e), provided that 'activity' of the fixed place as a whole, resulting from this combination is of a preparatory or auxiliary. 5. In addition to

establishment) which reproduces almost entirely Article 5[66] dell'OECD model[67] and the determination of income you will have to look to the Articles. 151[68]-152[69] Tuir for the case of income generated in Italy by foreign companies.

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the provisions of paragraph 4 shall not of itself constitute 'permanent establishment the availability' of any kind of computers and related auxiliary equipment which allow for the collection and transmission of data and information aimed at the sale of goods and services. 6. Notwithstanding the preceding paragraphs, and except as provided in subsection 7, constitutes a permanent establishment of the company referred to in paragraph 1 a person, resident or not resident in the State that habitually concludes contracts on behalf of the enterprise other than and purchase of goods. 7. It does not constitute a permanent establishment of the non-resident merely because it carries on business in the State its activities' through a broker, general commission agent or any other agent of independent status, provided that such persons acting in the ordinary activity '. 8. Notwithstanding the preceding paragraph, does not constitute the establishment of the mere fact that the same armies in the territory of its activities' through a shipping agent of the Law of 4 April 1977, n. 135 or a broker of Law March 12, 1968, n. 478 which has the powers to manage business or enterprise operating the ships, even on a continuous basis. 9. The fact that a non-resident with or without a permanent establishment in the State controls a company resident, it is controlled, or that both companies are controlled by a third party operating activities or not 'business is not in if 'sufficient reason to consider any of a permanent establishment of such enterprises.

[66] For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on. 2. The term “permanent establishment” includes especially: *a)* a place of management; *b)* a branch; *c)* an office; *d)* a factory; *e)* a workshop, and *f)* a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. 3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. 4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include: *a)* the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; *b)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery; *c)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; *d)* the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise; *e)* the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; *f)* the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs *a)* to *e)*, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. 5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph. 6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. 7.The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

According to the provisions of Italian law the banking entities operating in the permanent establishment[70], will receive the same tax treatment given to other actors in the same scheme, but with the specification that the taxable amount will be determined solely on the income produced by the permanent establishment in the state, according to the principle of territoriality. In the determination of income in the state you should exclude income exempt from tax, and those for which replacement tax is expected (in line with expectations for residents).

Note that be considered as products in the State "income listed in Article 23 Income Tax Consolidation Act, taking into account for business income, including gains and losses of goods for or otherwise relating to business activities for or otherwise relating to the commercial activities in State, even if not gained through permanent estabilishment[71], and the profits distributed by companies and entities referred to in subparagraphs a) and b) of paragraph 1 of Article 73[72] and the gains indicated in article 23, paragraph 1) letter f).". In the event that the company operate with a permanent establishment on total income is determined according to art. 152 that "1. For companies and commercial entities with permanent establishments in the State, excluding partnerships, the total income

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[67] It seems useful to also compare the EU Regulation n. 282 of 15 March 2011, that defined PE as any organization other than the head of economic activity, characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources.

[68] Total income of non-resident companies

[69] Determination of total income of non-resident companies with permanent estabilishment.

[70] Even as the financial administration is applying in the tax assessment contained in the OECD document "Report on the attribuition of profits to permanent estabilishment" to all the PE of foreign banks in Italy. In particular, it requires that they have a minimum capital equal to the regulatory capital required to be independent according to the bank when provided by the Bank of Italy, thus challenging the ability of the same organization to provide stable funding so that should be imputed to the parent. Where, however, was followed the approach of case-law on royalties (Court of Cass. 83/7184, 88/5996, 88/4667), you would have trouble exercising very limited and therefore the attraction of PE SINCE impute economic operations in the income statement of this.

[71] The permanent establishment would attract upon himself the revenues generated by the parent company even if these have been produced directly from the latter. If anything, it is difficult to understand what attracted these incomes. The theory here is that you share that incomes are attracted to those resulting from activities normally carried out by the permanent establishment in the State. See also Nanetti, diritto e pratica tributaria internazionale, 09, 664-665; Falsitta, op. cit. pag 151.

[72] Limited companies and limited partnerships with shares, private limited company, cooperative companies and mutual insurance companies, European companies, European cooperative societies, public and private entities other than companies, and Trust (the object of which the sole or main 'operation of businesses) resident in the State.

and 'determined under the provisions of Section I of Chapter II of Title II, based on a special income statement[73] on the management of permanent estabilishment and on other activities that made taxable income in Italy.”.[74]

In Italy, following a lecture in conjunction with the principles laid down in Article 23 Tuir and 152 par 2 Tuir, there is a cd principle of “isolated treatment of income generated in Italy by non-resident entrepreneurs”.

The Italian case law has also repeatedly described the concept of permanent establishment. In judgment no. 16106 of July 22, the Supreme Court, which upheld the appeal of the Tax Administration, accepting with the referral decision under appeal: the notion of “permanent establishment”, elaborated on VAT, also work for direct taxation “the permanent establishment is an autonomous center of attribution of reports related to tax non-resident, enabled the implementation of legal requirements. This orientation, expressed on repayment of Value Added Tax deductible (judgments nos. 6799/2004 and 3889/2008), recognizes the permanent establishment of law subject to tax in relation to reports relating to the non resident.”. The term "permanent establishment" is not incompatible with the legal personality. The independent full legal subjectivity does not interfere with the allocation, to the permanent establishment, referring to reports of non-resident, the two remain separate profiles even in the hands of the same entities (see judgments nos. 17206/2006, 3889/2008 and 9265/2011). If the person is also the national legal permanent establishment of a non-resident, "nothing that addresses the financial administration and its claim and its tax declaratory action against him, as to the income produced by it with their own activities, and against the “permanent establishment” for income constituted separate ground attributable to non-resident person, with the peculiarity that, for these past, the tax will be applied according to the rules for non-residents and the

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[73] Does not seem possible to doubt that these subjects must prepare the income statement according to IAS, so will be worth all the above-mentioned rules regarding the determination of taxable income.

[74] Also according to the provisions of par 3 "there shall be deducted from gross, up to the amount, an amount equal to 19 percent of the charges referred to in subparagraphs a), g), h), h-bis), i) , i-bis) and i-c) of paragraph 1 of Article 15. In case of reimbursement of expenses for which we have 'benefited from the deduction of tax due for the period in which the company' or the entity has obtained a refund and 'increased by an amount equal to 19 percent of the burden repaid .

assessment will only result in the correction of the declaration of the permanent establishment".

With regard to the permanent establishment must be added as this has a principle of attraction on the income produced in Italy. In this perspective we can say as the permanent establishment would attract upon himself the revenues generated by the parent company even if these have been produced directly from the latter. If anything, it is difficult to understand what attracted these incomes. The theory here is that you share that incomes are attracted to those resulting from activities normally carried out by the permanent establishment in the State and not for those activities not covered by the typical activities of an establishment, which should therefore be attributed to the distinctly non-resident[75].

It should be added something to the treatment of income from dividends, interest and royalties, as according to the OECD Model, Article 7 par 7 OECD model, you should ask in relation to Article 7 (business profits) with Articles. 10 (dividends), 11 (Interest), 12 (royalties)[76].

The general rule established in the OECD model is that the items of income covered by specific Article which are attributable to a foreign firm, will be processed in the source state according to these articles, that is not as income from business profits. Only when that income is linked to a permanent establishment of a foreign company in the country of source taxation rights that have, will apply Article 7, paragraph 7 OECD model. If there is no connection between dividends, interest and royalties and the permanent establishment, such income can not be regarded as income of the permanent establishment and therefore will be taxed as business income only in the state of residence of the subject[77]. But as we said, if a

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[75] Nanetti, diritto e pratica tributaria internazionale, 09, 664-665; Falsitta, op. cit. pag 761

[76] Art 23 par. 1, e) Tuir. In this respect the case law, though limited to royalties made it clear that they do not qualify as an income paid by the Italian subject to foreign enterprise without permanent establishment in Italy. These payments are components of business income, but will not give rise to taxation. Court of Cassation 83/7184, 86/6804).

[77] See also: Carbonetti-Piacentini-Sfondrini, Manuale di fiscalità internazionale, Vicenza, 2008, Pag. 88.
See Also Court of Cassation Judgment about 9197/2011, which provides the point, although in reference to a previous legislation: the characterization of income as business income depends on the subjective requirement of a business trading by the perceiver, regardless of any other different requirement (being the recurrence of the permanent establishment simple condition of localization

permanent estabilishemt exist, we have to look to principle of attraction just mentioned.

Therefore it seems useful to conclude on this point by stating how the Italian standardization complies with the provisions of the OECD Model Art. 24 par 3 that "The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents."

1.4 The IRAP for banks and other financial institutions.

The appearance of application of the regional tax on productive activities (IRAP) is a critical issue in the panorama of Italian taxation.

In the international sphere plays an important role as not all countries provide the same tax treaties and in many there is a tax credit for the avoidance of taxation not discriminate and make the market distorting.

This tax qualifies as a tax indirect tax that is premised on the organized activity of the subject (Art. 2). Subject means any person habitually engaged in commercial activity organized by the characteristic element (Art. 3).

The Legislative Decree n. 446/1997 has, therefore, described the objective and subjective elements in the first 3 articles. In the following, however, is dedicated to calculating the tax base. In fact, the organized activity, such as tax base, according to the legislature, corresponds to net output.

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of the same income and its taxability in Italy) and, furthermore, that, in order to separate (and diversify in the fiscal treatment) income components d 'company of a foreign entity and no autonomous organization within the state, you need a specific statutory provision. Therefore, lacking permanent establishment the income will be taxed only in the state of residence of the subject.

In particular, reference is made to different calculations of net production for some taxable IRES.

Among these, the legislature will allocate a separate discipline to net product of banks and financial intermediation.

Article. 6 of Legislative Decree provides that:

"1. For banks and other financial organizations or companies mentioned in Article 1 of Legislative Decree 27 January 1992, n. 87, as amended by Legislative Decree 157 of September 1, 1993, n. 385, except as provided in paragraphs 2, 3, 4 and 5 of this Article, the tax base is determined by the difference between the sum of: a) interest income and similar income, b) the proceeds of shares in mutual funds investment, c) of commission income, d) of profits from financial transactions, e) of recoveries of loans to customers, f) other operating income, excluding the recovery of costs of staff seconded to third parties, and the sum , g) of interest expense and similar charges, h) of commission expense, i) loss on financial operations, l) administrative expenses other than those relating to employees, m) the amortization of tangible and intangible, n) of Value adjustments on loans to customers, including those related to credit implicit finance leases, or) other operating expenses.

For securities firms are excluded from taxable components of the shooting and value adjustments on loans to customers, profits and losses from financial transactions and profits referred to in e) and n), d) and) b) paragraph 1, interest income and interest expense and income and similar charges referred to in subparagraph a) and g) of that subsection detect limited to those relating to carry-over operations and repurchase agreements. The arrangement of the previous period does not apply to companies engaged in proprietary trading and placement of securities with a guarantee for which not only detect the shooting and value adjustments on loans to customers.

3 For companies managing investment funds are included among the components of the tax base only commission income and expense, other income and expenses, administrative expenses and depreciation in letters c) and h), f) o) l) m) of paragraph 1.

4 For investment companies with variable capital, the taxable amount is determined by the difference between the sum of underwriting fees and the amount of commissions payable to the distributors, the costs for consulting and advertising, real estate rents, costs for services data processing, administrative costs other than those relating to employees and the amortization of tangible and intangible.

5. For the Bank of Italy and the Italian Exchange Office, the taxable amount is determined using the criteria described in paragraph 1."

The quoted text identifies in the first part the elements that contribute to the formation of the taxable amount as interest income and other specific budget items that characterize banking financial activity.

In the second part, however, the legislature has provided the voices that do not contribute to the generation of income. In this category, however, also includes the Bank of Italy for the purposes of calculating the tax base must comply with the provisions of art. 6, paragraph 1.

For the specific activities carried out by the subjects mentioned Legislative Decree 446/1997 provided for a particular discipline.

It can certainly pick up in that forum the unreasonable exemption in terms of value added instead of the ordinary and subject to taxation on the net value of banks. It could certainly be glimpsed both in the field of international tax law than on constitutional optical, a substantial discrimination between an exemption and an ordinary system of taxation.

1.5 The VAT Regime.

Most banking business are subject to an exemption from VAT. Exemption that was in his day motivated by pragmatic assertion of inability to identify a clear consideration on which apply the tax[78].. Financial assets that are not included in this exemption are (among the most important for the financial sector)

78 Chiri-Borselli-Basotti, Il regime IVA dei servizi finanziari, Bancaria, n.7-8/2009, pag 90.

safekeeping and administration of securities, debt recovery, lease, general advice, rental of safe deposit boxes, the transactions relating to title to goods, some fees paid to financial promoter[79]. About the territoriality of the DPR 633/1972 provides, in line with the European Directive on VAT, that the financial transactions between taxable persons resident in different Member States is relevant for VAT in the country of residence of the customer, instead of the provider (Art. 7). The operations carried out against non-EU are not taxable and therefore eligible for a deduction.

The exemption from VAT regime of the core businesses results for subjects Italian bank in an strong penalization compared to foreign competitors, rather than at first glance it might seem at an advantage. This is because the exemption results in a greater cost to the banking business, given the constraints imposed by the legislature on the deductibility of input VAT when the same is not related to goods or services used for taxable transactions. This implies a loss of coherence of the whole VAT system, is less because the assumption of neutrality, which is one of the components of the tax in the relationships between companies.

Seems appropriate to note that this phenomenon is that possible, in the preparation of the VAT regime the Italian legislature has used, as was done by European counterparts to the preparation of its VAT system, the wide discretion granted by the European directive on this point[80].

Therefore it would be desirable to harmonize the various national rules, including through regulatory intervention implemented through a European Regulation, in order to make it neutral for business relations tribute "harmonized only in existence.".

To complete our discussion about VAT we have to discuss the three different rules applicable by the banks to manage VAT, without forget how just said about the VAT exemption rules.

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[79] Chiri-Borselli-Basotti, Il regime IVA dei servizi finanziari, Bancaria, n.6/2009, pag 83.
We have to note that this components represent a little part of bank income and of bank business activities.

[80] See Dir. 2006/112/CE

The first (pro rata regime) is provided by artt 19 to 19bis2. IVA paid for goods and services purchased, instrumentals to the business activities, can be deducted from the corresponding VAT collected for the operations in which the same bank is subject to VAT.

separate management of VAT (art 36): If a bank carries on both different categories of activities, the rules permit the adoption of separate management regimes in VAT. In this case, the pro rata tax deductibility applies with respect to the turnover of each activity, according to their national.

Finally it should be remembered with art. 36bis of the VAT Decree which allows only banks to opt for a special tax regime (lasting at least three years) that nell'esonerarle obligations billing and registration of exempt transactions required to exclude any deduction of VAT on purchases. The scheme under. 36bis, besides increasing the cost of inputs for the subject bank, also has the demerit of foreclosing any adjustments that might favorably determined upon sale of depreciable property subject to tax and does not entitle for the special exemption that is generally provided for the supply of goods on which the taxes are not deducted[81].

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[81] Chiri-Borselli-Basotti, Bancaria, op. cit.

Chapter Second

The Taxation On Financial Instruments

2.1 General definitions

The Italian tax legislator does not have a clear definition of what are the financial instruments. This can still be obtained from the prediction that the returns of the same form for the beneficiary income from capital (Article 44 Tuir), or income of a different nature (Article 67 Tuir). But even the definition of what are income from capital or income of a different nature does not appear unique, having been chosen a casuistic approach to character rather than gender[82]. This gap has resulted in a deep layering standards requiring the legislature to constantly chase the market in order to avoid that certain remuneration, linked to new forms of employment of the capital escape to taxation.

Fundamental distinction to be made is that on capital income (the expression of use of capital) from the income of a financial nature, in which they are subject to tax differentials in value arising from speculative activities objectively (and therefore the class in question will be to derivatives, such as swap[83].

The first will cause both the income is in the form of dividends, whether in the form of capital gain[84], only the latter will generate income from capital gains, not guaranteeing any dividend or interest[85].

Continuing in the definitions must have regard to the categories that make up a part of the capital gains and other income of a financial nature.

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[82] See also Gallo, I redditi da capitale, Reddito Imponibile Uckmar, pag 315; Falsitta, op. cit. pag 221.
[83] Gallo, Diritto e pratica tributaria, 1998, I, pag 1219.
[84] The capital gain appears, however, to be different income or expense.
[85] Are taxable according to the principle of cash, unless they are generated in the context of business income. Should follow specific rules of this.

They are capital gains and interest, profits and income arising from the use of capital (this category includes for example: bank interest, bond, dividends[86]). The framework is set out in Art Tuir 44-48.

are income of a different financial nature capital gains arising from acts of dealing in securities (capital gains[87]) or refund the same and the proceeds of random points about c-quinques art. 67 Tuir.

The two categories are distinguished by the fact that in the first find sources of income that (as defined in Article 44 par 1, h, Tuir) arise from the mere enjoyment of the capital. In syntheses are that income earned by capital as a result of a legal agreement concerning the use of capital itself, except those which can be achieved through differential positive or negative depending on an uncertain event (derivatives).

Note well that there are capital gains interest, profits and other income earned by commercial companies. These, according to the rule of attraction will help to form business income.

Incomes constitute of a different financial nature the income arising from the on speculative market use of the capital which can be achieved by differential positive and negative. The use in this case it is configured as a dynamic, risky, not of mere enjoyment of the capital. Do not fall into this category, as in the previous plus/minus differential, and other values obtained from commercial companies. Such income to the principle of attraction will help to form the basis of business income tax.

In the first category, which is included in the art. 44 Tuir, we find shares and similar securities, bonds and similar securities, and securities other than shares or certificates of mass, while in the second category, that is discipline in

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[86] Dividends are ex Article 44 par 1, e) Tuir "gains from the equity or assets of companies and entities subject to income tax." For financial instruments treated as we see how the art. 44 par 2, a) provides for the extension of this definition, even in the profits arising from that investment (and therefore are subject to the same taxation). According to the definition of the OECD model income dividends are expressing the profitability of capital investment made by the shareholder.

[87] Note the extent that capital gains are related to investments in companies resident: Those not qualified and not traded on regulated markets wherever held, non-qualified, and not traded in regulated markets, wherever held, where the holding is of a subject.

Article 67 Tuir (other income), we find the provisions on capital gains and derivative financial instruments[88].

Bonds under the law are those debt instruments autonomousissued en masse, which summarize a number of loan agreements entered into by the issuer with the subscribers, subject to independent events, but they are united as to the applicable laws and regulations applicable thereto. The bond's credit incorporates a right of subscriber to the issuer the payment of a specified sum to an expiration date and to pay interest periodically on the amount invested[89].

The definition of bond is then inferred from Article 44 para 2, c, which identifies the characteristic features in the return of invested capital, the absence of direct or indirect participation in company management, lack of rights of participation in society.

Are financial instruments similar to bonds for the purposes of tax law those titles characterized by the absence of participatory rights, the absence of risk of loss, having to in any case provide for the repayment of capital, supervisory powers other than those attributable to bondholders aimed only to protect the category of lenders.

Are defined shares in the proper sense those titles that are part of equity capital (parsquota) and attributed social rights in proportion (parsquanta). Therefore are those titles that represent the contribution to companies equity and whose performance is due to the economic performance of the company (profit distribution).
Are titles similar to shares those titles set out in Article 44 par 2 Tuir in which the remuneration is made entirely from participation in the economic performance of

[88] Although with the specification referred to below.

[89] This is true in general, given the consideration that there are categories of Bonds, zerocoupon, where interest is the difference between nominal and will be refunded the purchase price of the security.

the issuing company or of other companies within the same group or of the deal in relation to which such titles were issued[90].

They are atypical securities, but also subjected to the discipline of income from capital, those titles that mix characteristics of the previous categories. The legislature in reforming the 2003[91] wanted to give the market a total freedom of form in modeling tools, to make them more attractive to investors and more in line with the interests of the issuer.

Are derivatives for tax purposes these financial contracts type translational from which the right or obligation to sell or buy forward financial instruments, currencies, precious metals or commodities (futures typical example) and those financial contracts of differential type hence the obligation or the right to receive or make payments at the end connected to one or more rates of interest (eg interest rate swap) prices or the value of the securities of foreign currencies, precious metals or goods (eg: index swaps)[92].

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[90] Note how the assimilation is closely linked to remuneration due to the economic performance to companies. So what matters is fiscally for actions for similar securities is the correlation between income (taxable) and the profit of the company that distributes the profit.

[91] See D.lgs 344/2003.

[92] For the purposes of the italian legislation are financial derivative contracts (Article 1 paragraph 2 Tuf): d) option contracts, financial futures standardized ("future"), "swap" agreements for future exchanges of interest rate derivative contracts and other related to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or financial measures which may be settled physically or through payment in cash; e) option contracts, financial futures standardized ("future"), "swap" agreements to exchange interest rate futures and other derivative contracts relating to commodities on which settlement takes place through payment in cash or may occur so at the discretion of either party, except in cases where this option follows a default or other event triggering the termination of the contract; f) option contracts, financial futures standardized ("future"), "swaps" and other derivative contracts relating to commodities whose regulation may be through the delivery of the underlying and which are traded on a regulated market and / or in a MTF; g) option contracts, financial futures standardized ("future"), "swap" contracts ("forward") and other derivative contracts relating to commodities whose regulation may be through physical delivery of the underlying asset, other than those in point f), which have no commercial purposes, and having the characteristics of other derivative financial instruments, considering, inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls; h) derivatives to transfer credit risk; i) contracts for difference; j) option contracts, financial futures standardized ("future"), "swap" contracts on interest rates' s interest and other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics, which settlement takes place through payment in cash or may occur in this way at the discretion of either party, except in cases where this may result in default or other event triggering the termination of the contract and other derivative contracts relating to assets, rights, obligations, indices and measures other than those indicated in the preceding paragraphs, with the characteristics of other derivative financial instruments, considering, among the 'other, they are

As regards the generation of income must look to the subject percipient.

If this is such individual or entity subject to corporate income tax or tax resident or non-resident (and combinations of various categories).

2.2.Taxation of financial instruments for individuals resident [93] or non-residents[94] without permanent establishment.

For interest and other income derived from bonds, from bonds similar securities and other titles similar to shares other than shares and certificates of mass (atypical securities) receive a final withholding tax[95] at a rate of 20%[96]. This tax applies in the case of residents is that the income from both domestic source, whether the income is foreign source.

The withholding tax is made directly by the institutions and companies referred to in Article 73 par 1 Tuir. It must be specified as in the second case (foreign source) the replacement tax applies to subject c.d. "nettisti"[97] and the collection is performed by intermediaries authorized under Article 2 par 2 of

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traded on a regulated market or an MTF, if they are cleared and settled through recognized clearing houses or are subject to regular margin calls.

[93] Note well that the imposition of which you will see replacement is also applicable for income from foreign sources, that is paid by non-residents, received by residents individuals. In this case it should be noted that individuals, non-commercial entities and partnerships and treated residents must declare (by compiling module called RW) transfer to or from foreign countries or the detention of foreign capital if the value is greater than € 10,000.

[94] "Some commentators have suggested a possible discrimination to the detriment of non-resident shareholders, who are seen to apply a withholding tax (or tax replacement) (...) with respect to outstanding teaching, however, noted that the imposition of the subject is not made on the part of resident of the State of source, even on a conventional, is a reasonable compromise, since the State of residence should in turn recognize the applicability of the methods due to elimination of international double taxation. ": Dragonetti, Piacentini, Sfondrini, *Manuale di fiscalità internazionale*, 2008, pag. 416.

[95] Applied by intermediaries or by substitute tax if the taxpayer has opted for the assets under administration. Next to the withholding scheme is expected to substitute tax, established by virtue of Legislative Decree 239/1996. The substitute tax is applied by banks or by other authorized intermediaries that still involved in collecting these revenues.

[96] The same charge applies to the case of capital gains. There is no distinction between large issuers and other issuers. Notice how all the rates of which will be discussed below have been amended by DL 138/2011, converted into Law 148/2011, as part of cd operation in August.

[97] Individuals, companies simply, a company that although still in a commercial and those entities not subject to the discipline of corporate income.

Legislative Decree 239/96[98]. For other subjects so called “lordisti”[99] income and capital gains will contribute to the formation of business income, provided the securities are deposited with brokers authorized under art 2 par 2 of Legislative Decree 239/96.

It should be noted about how the Italian legislation has standardized the tax, in fact, previously generally were two different rates (one 12.5%, the other 27%), according to the applicable retention period and the rate of interest made So today, after the of the standardization rate to 20% is unique[100].

In case of non-residents is also provided for taxation generally at 20%[101], as a substitute tax. On this point we must make distinctions concerning the case where the beneficiary's income is in fact a non-resident. In this case we must first look at the nature of the issuer the title.

If big issuer[102] the percipient, if resident in state white list, can enjoy an exemption, provided that, in accordance with Article. 7 of Legislative Decree 239/1996, have deposited titles similar to shares directly or indirectly from a bank or a Sim-resident, or a PE of a bank or brokerage companies not resident in Italy who maintains direct telematic relations with the Ministry of Economy and Finance. This subject "broker" must acquire self certification[103]. by the actual beneficiary, by which is declared to possess the requirements necessary to receive the exemption.

For capital gains on these securities the general rule, the rate of 20%, again unless otherwise agreed. The returns generated from the imposition, however, will

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[98] If this withdrawal is not carried out the "subject c.d. "nettisti" must declare the amount received in the tax return and subject them to the same rate as the substitute tax. Remember to save these people the chance to not take advantage of tax substitution and opt for taxation ordinary in accordance with Article 18 Tuir. In this case, they have right to tax credit for foreign income.

[99] Mainly commercial companies.

[100] Provided by: DL 138 del 13 ago 2011, conv. with mod. L. 148 del 14-9-2011

[101] Unless an international agreement does not comply.

[102] Like bank and listed companies.

[103] That can be released in free form provided in accordance with the requirements of the Ministerial Decree of 12 December 2001. In the case of foreign institutional investors not subject to tax these are obliged to submit the application form, being considered by the agency of revenue such beneficial owners (see Internal Revenue Service Circular 23 / E, 1 March 2002). In the absence of self certfication will apply a substitute tax to the extent of 20%.

be exempt if the recipient of the income is resident in a country white list or the title is traded on a regulated market or is not located in Italy.

In the event that the financial instrument is issued by an issuer that are not contained into the first category will be the substitute tax rate of 20% in the case of both income and in the case of capital gains. The above unless agreed otherwise with the state of the recipient[104].

Proceeds from securities class shares or similar to shares (both in the case of dividends[105] of financial gains) must first be divided between those perceived for qualified or unqualified investments in equity.

For residents non-IRES that hold a stake not qualified[106] for the taxation is provided under one tax (withholding tax or substitute tax) with a rate 20%[107].

For non-resident individuals is expected to substitute taxation as a tax of 20%[108]. For non-residents other than individuals is expected to apply a reduced

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[104] Dragonetti, Piacentini, Sfondrini, op. cit., pag 624.

[105] Even in the case in which the resident receives them from foreign sources. If so that is defined by dividing the payment must be made solely by profits, or to be representative of a participation in the economic performance of the issuer, the compensation must to be fully deductible from the income of the issuer in accordance with law applicable in the State of residence of the company issuer.

[106] Participation is defined qualifiedvoting rights at shareholders' meetings proportional) if more than 2% for shares traded on regulated markets, more than 20% for shares not traded on regulated markets., or for an equity participation in or the assets over 5% for shares traded on regulated markets, more than 25% for shares not traded on regulated markets. The one of participation not qualified. is residual category.

[107] In the case where the profits are generated foreign, in accordance with Article 27 par 4 DPR 600/73 the net amount actually paid to the beneficiary is named "Net border". The tax will then amount to the net and gross of taxes paid abroad. In the event that the State of residence of the issuer applies a withholding of an amount greater than that required conventionally the Italian taxpayer is entitled to claim reimbursement of the amount paid greater. Note on the point as in the case of non-qualified excess amount refunded will be subject to tax in Italy according to general rules of taxation on dividends (withholding or substitute tax at 20%): Revenue Agency Circular 26/E/2004 par 4.3

[108] In many cases of international agreements such rates are not applicable, since the conventional system is more favorable. As an example we can see that in most cases the tax rate is 15% for non-qualified. In some cases, the negotiated rate was 10% (treated with Albania, Bulgaria, China, Croatia, Georgia, Hungary, Kuwait, Malaysia, Oman, Poland, Romania, Russia, Singapore, Slovenia, Tanzania, Venezuela). In cases other than (India, Pakistan, Thailand, Trinidad and Tobago). These rates are applicable regardless of the legal nature of the subject percipient. Please remember that non-residents, regardless of their legal nature, may request reimbursement of up to 4/9 of the withholding suffered if they demonstrate that such profits were ultimately subject to tax in his State of residence certificate issued by the competent tax authorities. The tax mentioned applies pursuant to and in the manner prescribed by Article 5 Paragraph 2 of Article 6 of Decree Law 239.

rate[109] of 1, 375% as a Tax on 5% with corporate income tax rate of 27.5% as long these persons reside in a State UE or in a See[110] white list State, or otherwise they will apply the rate to 20%[111]. It must specify that in case of capital gain[112] the rate is only and 20%[113].

Further specification is worth the possible application of the directive mother's daughter. In case there will be no tax, but only if there is a distribution of dividends, but will still apply withholding tax of 20% for capital gains.

For those individuals residing entrepreneurs, who have a qualified partecipation in Italian resident company will apply, equally to the case of dividend or capital gains, ordinary taxation but with the specification that will be taxable only 49.72% of the income received[114]. In the case of those individuals who are not entrepreneurs will apply a withholding of payment (20%) income for the taxable portion (40%), determined net of required paid abroad for a maximum of how much provided by the international conventions[115].

For non-residents instead we have to distinguish according to country of residence of the recipient of the dividend, subject to the general rule of taxation in respect of withholding tax at 20%. The general rule does not apply to the case where the subject is corporate. In this case, if resident in EU country or white list will apply the taxation of 1, 375% (ie by 27.5% to 5% of income, being free,

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[109] According to Art 27 par 3 ter (introduced by the Finance Act 2007).

For other non-resident must be noted that Italy has complied with the rate recommended by the OECD model (5%) only with business partners called strong (France, Russia, USA, Great Britain).

[110] European economic area.

[111] Unless more favorable international agreement.

[112] The capital gains in the case is formed through the transfer for consideration, compensation for loss and damage of property and allocation of participatory tools for purposes not connected with the company. See Article 86 Tuir.

[113] Unless more favorable international agreement.

[114] Under the provisions of Ministerial Decree (Ministry of Economy and Finance) of 2 April 2008. This prediction means that the overall taxation on shareholder is equal to 43% on the gross profit.

[115] Any refund may be requested by the taxpayer for withholding taxes applied by the State in excess of the source with respect to the agreed convention. See Revenue Agency Circular 26 / E 16 June 2004, par 4.3.

95%). Deserves further specification applies when the mother-daughter directive. In case there will be no tax.

In the case of capital gains that we have as a general rule for these individuals will ordinarily taxed to the extent of 49.72% of income for individuals. While in the case of EU corporate entity or white list will apply the taxation of 1, 375% (ie 27.5% on 5% of income, being free, 95%), again unless the scope of the directive mother-daughter.

With regard to derivatives[116] these, by their nature give rise to income but only to the case of capital gains. The taxation in the case follow the general rule of withholding tax of 20%. The rule was affected except for the case where the recipient is resident white list or the security is traded on a regulated market or is not located in Italy. In this case the capital gain is exempt or not subject to taxation.

As previously mentioned, in the case of non-residents, the limit in the agreement is more favorable than Italy could have signed with the State of residence of the recipient's of income.

Capital gains are taxable as described above following the principles of cash[117] and gross[118], that means without any possibility of deducting any costs incurred in their production.

It should be noted that the income from capital earned by resident individuals are taxable regardless of where their perception. Therefore, although foreign sources. On this point we must clarify, however, as according to the provisions of Article 27 par 4-bis of Presidential Decree 600/73 the withholding tax applicable on profits from foreign sources is computed from the amount

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[116] For financial institutions and credit institutions, and also to commercial companies, see what has been said about the first chapter of off balance sheet.

[117] The dividends received even if in the exercise of business will be taxed according to this rule.

[118] Except as stated above for those called subject c.d. “nettisti”.

received by a resident taxpayer, net of any withholding taxes applied foreign (called “net frontier”)[119].

In the case of profits from foreign sources moreover the resident, if an individual not an entrepreneur, in the tax return must declare the income and levy substitutive tax at the rate of 20%. This scheme is now mandatory and has completely eliminated the previous voluntary system where the taxpayer could choose to apply to such income taxation and ordinary use of the credit for taxes paid abroad.

Deserves further specification in the case where the profits come from non-white list. In this situation applies a principle of full 100% tax on income. This rule also applies when earnings are distributed by companies resident in countries with intermediate white list but are coming from the country in tax-subsidized system[120].

2.3 Taxation of financial instrument over resident Ires subject and non resident whit a permanent estabilishment.

Reviewing briefly the situation for residents with non-resident company or permanent establishment[121] in Italy we can say that the income generated will be counted in the total income and corporate tax will follow rules laid down for this as seen in the first part of this work[122].

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[119] “Deductions referred to in par 4 shall be made net of withholding taxes levied by the foreign state”

[120] Tripartite scheme. Note that the rule of total taxation applies to both individuals and for corporate entities. On this matter see Circular No 4 August 2006. 28 Revenue Agency.

[121] For which, however, as mentioned above also applies the principle of attraction. Italy has expressed its reservations about the commentary on Article 10 par 82 of the OECD, according to which Italy has the right to enforce taxation of dividends in accordance with its internal non-resident if the recipient has a permanent establishment in Italy, regardless of whether participation is effectively connected with such permanent establishment. On this regard see Dragonetti, Piacentini, Sfondrini, op. cit., pag 446.

[122] Is enough to recall such as the participation exemption regime, whereby if the financial instrument is held participatory least 12 months, budgeted as immobilization, and the subsidiary is a business and resides in a state to tax exemption will be the ordinary 95% of of income. Here it should be added as the exemption is closely linked with the principle of Article. 109 par 5 Tuir the

So for those who must prepare financial statements according to IAS / IFRS (which are all under the Italian financial institutions), you must first look to the accounting in the balance sheet in accordance with the proper exercise of international accounting standards, and according to proper exercise of the criteria for charging time, qualification and quantification, in order to see what components constitute taxable income and what is simply a positive asset.

But we must add that for those residents subject to corporate income tax, the regime now applies without distinction of participation exemption for dividends and profits from foreign sources (provided they are data from financial instruments that are as mentioned Shares or similar to shares). These will be excluded from the formation of the tax base to 95% (with the exception of income distributed by its blacklist, which will be taxed on 100%, if there wasn't a positive questioning from the Revenue Agency, or charged to the member for transparency according with the legislation about controlled foreign Company[123]).

Under the provision Article 165 Tuir for the portion of taxable profits will receive a credit for taxes paid abroad.

Regard to capital gains[124] on financial instruments provided by the subject to non-residents to residents subject IRES we have to see how it operates equally the principle of participation exemption. Thus the conditions of Article. 87 par 1[125] Tuir, the gain will be exempt from income to the extent of 95%. In the case in

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non-deductibility of expenses related to exempt capital gains. Then see how the interest and other income paid to ie: bonds, forming the tax base. The withholding mentioned above are then made on account title.

[123] Artt 167-168 Tuir

[124] Assumption by the Italian legislature did just that dividends and capital gains' represent the same kind of income to be taxed in the party who actually produced them (ie the subsidiary) making fiscally neutral, with the exemption, the tuttel subsequent events related income "

[125] Not contribute to the taxable income as exempt to the extent of 95 percent and capital gains determined in accordance with Article 86, paragraphs 1, 2 and 3 with respect to shares or interests in companies and other entities listed in Article 5 excluding partnerships and entities to be treated themselves, and article 73, including those not represented by securities, with the following requirements: a) continuous possession from the first day of the twelfth month before the assignment transferred to the first recital the shares acquired on the most 'recent b) classification in the category of financial assets in the first financial statements during the holding period; c) tax residence of the subsidiary in a state or territory in which the decree of the Minister for the Economy and Finance issued pursuant to Article 168-bis, or, alternatively, the demonstration took place, following the exercise dell'interpello in the manner referred to in paragraph 5, letter b), Article 167, which by equity has been achieved since the beginning of the holding period, the

which these requirements are not met, the taxable will be constituted by 100% of this[126].

income effect of locating in states or territories other than those identified in the same order under section 168-a, d) exercise by the investee company business enterprise as defined in Article 55. Without proof to the contrary can be assumed that this condition is lacking with regard to investments in companies whose value the heritage and 'mainly consists of property other than land to which or to whose production and trade' actually direct the activities of the company, from facilities and buildings used directly in the performance business. Is deemed to be directly used in the conduct of business buildings leased and owned land on which the company operates in the agricultural.

[126] In this case, the payment of tax can also be done in installments over 5 years.

Chapter Third

Special Tax For The Banks And The Purpose For A Taxation On Financial Transaction (FTT)

3.1 Introduction

In the last period from many voices in society we heard the purpose of fix new special tax on bank, to the scope of equity, or (it seems most true) to the scope of

get more tax revenue.

At the day the European tax on financial instrument (recalling the c.d. "Tobin Tax") is only a purpose, and for the author a bad purpose, because if this new tax is only an EU tax the european banks lose competitiveness against international counterparts.

We have seen in Chapter one how, in 2008, the italian lawmaker introduced the c.d. Robin Hood Tax which provides for an heaver taxation on banks. We remind on this point to the how said before[127].

3.2 Historical review.

The first purpose of a tax over financial transaction came by Professor James Tobin (nobel laureate) which suggested his currency transaction tax in 1972 in his Janeway Lectures at Princeton, shortly after the Bretton Woods system of monetary management ended in 1971. The tax on foreign exchange transactions was devised to cushion exchange rate fluctuations. The idea is very simple: at each exchange of a currency into another a small tax would be levied -

[127] In this historical moment from italian parliament we have purpose to introduct for bank activities great reform, for example the purpose of introduce differentiated taxation of banking aimed to encourage the financing activities for families and businesses instead of speculative activity OdG 9/3075/2 presented by Roberto Calderoli, 31 January 2012, session n. 666.

let's say, 0.5% of the volume of the transaction. This dissuades speculators as many investors invest their money in foreign exchange on a very short-term basis. If this money is suddenly withdrawn, countries have to drastically increase interest rates for their currency to still be attractive. But high interest is often disastrous for a national economy, as the nineties' crises in Mexico, Southeast Asia and Russia have proven. My tax would return some margin of manoeuvre to issuing banks in small countries and would be a measure of opposition to the dictate of the financial markets[128]. So we see how the original idea was only a taxation on currency transaction, but with passing of time the project will become greater than the original one. So we have in in the middle '80 the attempt by the Swedish lawmaker of setting a tax on financial transaction. In January 1984, Sweden introduced a 0.5% tax on the purchase or sale of an equity security. Thus a round trip (purchase and sale) transaction resulted in a 1% tax. In July 1986 the rate was doubled. In January 1989, a considerably lower tax of 0.002% on fixed-income securities was introduced for a security with a maturity of 90 days or less. On a bond with a maturity of five years or more, the tax was 0.003%.

The revenues from taxes were disappointing; for example, revenues from the tax on fixed-income securities were initially expected to amount to 1,500 million Swedish kronor per year. They did not amount to more than 80 million Swedish kronor in any year and the average was closer to 50 million. In addition, as taxable trading volumes fell, so did revenues from capital gains taxes, entirely offsetting revenues from the equity transactions tax that had grown to 4,000 million Swedish kronor by 1988. On the day that the tax was announced, share prices fell by 2.2%. But there was leakage of information prior to the announcement, which might explain the 5.35% price decline in the 30 days prior to the announcement. When the tax was doubled, prices again fell by another 1%. These declines were in line with the capitalized value of future tax payments resulting from expected trades. It was further felt that the taxes on fixed-income securities only served to increase the cost of government borrowing, providing

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[128] James Tobin: "The antiglobalisation movement has highjacked my name"". Jubilee Research, a successor to Jubilee 2000 UK. September 3, 2001. Archived from the original on 6 March 2005. Retrieved 11 February 2010.

another argument against the tax. Even though the tax on fixed-income securities was much lower than that on equities, the impact on market trading was much more dramatic. During the first week of the tax, the volume of bond trading fell by 85%, even though the tax rate on five-year bonds was only 0.003%. The volume of futures trading fell by 98% and the options trading market disappeared. On 15 April 1990, the tax on fixed-income securities was abolished. In January 1991 the rates on the remaining taxes were cut in half and by the end of the year they were abolished completely. Once the taxes were eliminated, trading volumes returned and grew substantially in the 1990s.[129]

An existing example of a Financial Transaction Tax (FTT) is Stamp Duty Reserve Tax (SDRT) and stamp duty. Stamp duty was introduced as an ad valorem tax on share purchases in 1808[130], preceding by over 150 years the Tobin tax on currency transactions. Changes were made in 1963. In 1963 the rate of the UK Stamp Duty was 2%, subsequently fluctuating between 1% and 2%, until a process of its gradual reduction started in 1984, when the rate was halved, first from 2% to 1%, and then once again in 1986 from 1% to the current level of 0.5%[131].

The changes in Stamp Duty rates in 1974, 1984, and 1986 provided researchers with "natural experiments", allowing them to measure the impact of transaction taxes on market volume, volatility, returns, and valuations of UK companies listed on the London Stock Exchange. Jackson and O'Donnel (1985), using UK quarterly data, found that the 1% cut in the Stamp Duty in April 1984 from 2% to 1% lead to a "dramatic 70% increase in equity turnover"[132]. Analyzing all three

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[129] See about Campbell, John Y. and Froot, Kenneth A. “International Experiences with Securities Transaction Taxes (December 1993),” NBER Working Paper No. W4587. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=338864; Marion G. Wrobel, Senior AnalystFinancial Transaction Taxes: The International Experience and the Lessons for Canada. http://dsp-psd.tpsgc.gc.ca/Collection-R/LoPBdP/BP/bp419-e.htm, June 1996: which said also “The City of London has had great success in attracting financial services activity from other countries as a result of regulation and taxation. Thus it is no wonder that one of the most ardent supporters of an American FTT is the London financial community” reproposing the idea explained by J.A. Grundfest, "The Damning Facts of a New Stocks Tax," *The Wall Street Journal*, 23July 1990.

[130] See http://www.hmrc.gov.uk/so/manual.pdf

[131] Source OXERA (May, 2007). "The effectiveness of Keynes-Tobin transaction taxes when heterogeneous agents can trade in different markets: A behavioral finance approach". Oxera Consulting Ltd. Retrieved 2010-03-04

[132] Jackson, P. and A. O’Donnell, 1985. The effects of stamp duty on equity transactions and prices in the UK Stock Exchange. Bank of England Discussion Paper No. 25.

Stamp Duty rate changes, the academics found that the announcements of tax rate increases (decreases) were followed by negative (positive) returns, but even though these results were statistically significant, they were likely to be influenced by other factors, because the announcements were made on Budget Days. Bond et al. (2005) confirmed the findings of previous studies, noting also that the impact of the announced tax rate cuts was more beneficial (increasing market value more significantly) in case of larger firms, which had higher turnover, and were therefore more affected by the transaction tax than stocks of smaller companies, less frequently traded.[133]

Because the UK tax code provides exemptions from the Stamp Duty Reserve Tax for all financial intermediaries, including market makers, investment banks and other members of the LSE, and due to the strong growth of the contracts for difference (CFD) industry, which provides UK investors with untaxed substitutes for LSE stocks, according to the Oxera (2007) report, more than 70% percent of the total UK stock market volume, including the entire institutional volume remained (in 2005) exempt from the Stamp Duty, in contrast to the common perception of this tax as a "tax on bank transactions" or a "tax on speculation". On the other hand, as much as 40% of the Stamp Duty revenues come from taxing foreign residents, because the tax is "chargeable whether the transaction takes place in the UK or overseas, and whether either party is resident in the UK or not."[134]

3.3 The european project for a financial transactions tax.

In late 2001, a Tobin tax amendment was adopted by the French National Assembly. However, it was overturned by March 2002 by the French Senate.

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[133] Saporta Victoria, Kan Kamhon. "The Effects of Stamp Duty on the Level and Volatility of Equity Prices", *SSRN Electronic Journal,* 1998, doi:10.2139/ssrn.93656.

[134] Steve Bond, Mike Hawkins, Alexander Klemm, "Stamp Duty on Shares and Its Effect on Share Prices", *Public Finance Analysis* 61, 2005, pagg 275–298

On June 15, 2004, the Commission of Finance and Budget in the Belgian Federal Parliament approved a bill implementing a Spahn tax[135]. According to the legislation, Belgium will introduce the Tobin tax once all countries of the eurozone introduce a similar law[136]. In July 2005 former Austrian chancellor Wolfgang Schüssel called for a European Union Tobin tax to base the communities' financial structure on more stable and independent grounds. However, the proposal was rejected by the European Commission.
On November 23, 2009, the "President of the European Council, Herman Van Rompuy, after attending a meeting of the Bilderberg Group argued for a European version of the Tobin tax[137]". This tax would go beyond just financial transactions: "all shopping and petrol would be taxed.". Countering him was his sister, Christine Van Rompuy, who said, "any new taxes would directly affect the poor"[138].
On June 29, 2011, the European Commission called for Tobin-style taxes on the EU's financial sector to generate direct revenue starting from 2014. At the same time it suggested to reduce existing levies coming from the 27 member states.
So we have to analyze the directive proposal on the matter[139].

This is a tax (proposed) that follows this criteria: "The territorial application of the proposed FTT and the Member States' taxing rights are defined on the basis of the residence principle. In order for a financial transaction to be taxable in the EU, one of the parties to the transaction needs to be established in the territory of a Member State. Taxation will take place in the Member State in the territory of which the establishment of a financial institution is located, on condition that this institution is party to the transaction, acting either for its own

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135 Paul Bernd Spahn . "International Financial Flows and Transactions Taxes: Survey and Options", (June 16, 1995), University of Frankfurt/Main, Paper originally published with the IMF as Working Paper WP/95/60
136 On regard see: European Central Bank (2004). Opinion of the European Central Bank (CON/2004/34)
137 http://www.independent.ie/national-news/eu-president-wants-to-see-a-new-euro-tax-1950730.html
138 Macer Hall and Alison Little (November 19, 2009). "Belgian PM Herman Van Rompuy called clown by sister Christine". Daily Express. Retrieved 2010-01-29.
139 Brussels, 28.9.2011 ,COM(2011) 594 final, 2011/0261 (CNS): Proposal for a COUNCIL DIRECTIVE on a common system of financial transaction tax and amending Directive 2008/7/EC, {SEC(2011) 1102}, {SEC(2011) 1103},
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0594:FIN:EN:PDF

account or for the account of another person, or is acting in the name of party to the transaction.". So the tax is applicable to every financial transaction in which an EU financial institution is part of contract[140].

How said from proponent "The scope of the tax is wide, because it aims at covering transactions relating to all types of financial instruments as they are often close substitutes for each other. Thus, the scope covers instruments which are negotiable on the capital market, money-market instruments (with the exception of instruments of payment), units or shares in collective investment undertakings (which include UCITS and alternative investment funds) and derivatives agreements.".[141] Excluded from the application of new taxation on financial transaction are the transactions with the European Central Bank and national central banks are however excluded from the scope so as to avoid any negative impact on the refinancing possibilities of financial institutions or on monetary policies in general.

To the scope of this purpose of law definition of financial institutions is broad and essentially includes "investment firms, organised markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and their managers, pension funds and their managers, holding companies, financial leasing companies, special purpose entities, and where possible refers to the definitions provided by the relevant EU legislation adopted for regulatory purposes. Additionally other persons carrying out certain financial activities on a significant basis should be considered as financial institutions."[142].

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[140] To not be considere estabilished in a EU member state the parties have to that demonostrate there isn't economic link between the transaction and the Union: "However, in case the person liable to pay the tax was able to prove that there is no link between the economic substance of the transaction and the territory of any Member State, the financial institution may not be considered established within a Member State.".

[141] Are included in the application the operation OTC (over the counter), structured financial instrument, instrument offered by the way of a securization. We have to note that for the scope of the law the derivative contract have some distinction in their inclusion under the new tax "derivative agreements thus referred to, these concern derivatives for investment purposes. It emerges from the definitions used that spot currency transactions are not taxable financial transactions, while currency derivative agreements are. Derivative contracts relating to commodities are also covered, while physical commodity transactions are not."

[142] Central Counterparties (CCPs), Central Securities Depositories (CSDs) and International Central Securities Depositories (ICSDs) are not considered financial institutions in as much as these are exercising functions which are not considered to be trading activity in itself. They are

The moment of chargeability[143] is defined as the moment when the financial transaction occurs. Subsequent cancellation cannot be considered as a reason to exclude chargeability of the tax, except in cases of errors.

The taxable amount depends on the nature of financial instrument. So for instrument with a market price there isn't any problem, because the taxable amount is equal to this. For derivative contract the taxable amount shall be the notional amount at the time the derivative agreement is purchased/sold, transferred, concluded or modified (on line with the nature of derivative).

To avoid the risk of delocalization of financial transaction and financial institution "The rates should also take into account differences in the applicable methods for the determination of the taxable amounts. Generally speaking, the minimum tax rates (above which there is room of manoeuvre for national policies) are proposed to be set at a level sufficiently high for the harmonisation objective of this Directive to be achieved. At the same time, the proposed rates are situated low enough so that delocalisation risks are minimised."

To avoid the risk of more taxation by the single State, the same proposal provides that " Member States should not be allowed to maintain or introduce taxes on financial transactions other than the FTT object of the proposed Directive or VAT".

For the proposer the application of the tax provided by the proposed directive will have, depending on market reactions, a revenues that could be 57 EUR billion on a yearly basis in the whole EU.

This brief summary of the new purpose of law is necessary to discuss how provided. Surely the provision of a tax on financial transaction is on a time of

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also key for a more efficient and more transparent functioning of financial markets. So we can see that for the purpose of law are excluded the primary market.

[143] Connected to this moment is the moment when the tax is due. So we can observe that for financial transactions that are carried out by electronic means. In these cases, FTT should be due immediately at the moment of chargeability. In other cases, FTT should be due within period which, while being sufficiently long so as to allow for the manual processing of the payment, avoids that unjustifiable cash-flow advantages accrue to the financial institution concerned. A period of three working days can be considered appropriate in this sense.

great sacrifice very popular. But we have to discuss the real impact of this on the financial market and on competivity of european financial inistitution.

We have to note that the proposed directive doesn't provide any sure rate for the taxation, we think that, having seen the prospected revenue, the rates for this tax will be between 0,01% e lo 0,1%[144] (how prospected for a just rate for the international financial transactions tax[145]) .

3.4 Conclusions about the purpose of an european FTT.

Now, saw some experience from the past and briefly analyzed the european proposal, we think it's fair to say that the problem with this kind of tax isn't that the rates is low or high, but is the existence of the rates. We can imagine that nothing happens, so the financial institution and the financial market continue to work as ever, but on contrary we could imagine that the financial transactions from Europe will go on market without any tax on it (as we saw with the swedish example and on contrary with the UK example with it's large exemption).

If the capital are free to move above the world nothing can ensure from this risk. Moreover, even in the first prospected situation, we have to look to the damages done on competitivity of european bank in front of their international partners. Europe can assume the risk of making weaker it's financial (and expecially bank) system? I believe not.

The solution about the FTT problem, for the writer, will be found on the point of G20 and consequently globally. Only in this case, whit the major country of the world on the same side, we may imagine an FTT tax applicable and without the risk prospect for competitiveness of European financial markets. So i've to conclude affirming that the EU area is to small for the application of this kind of

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[144] How prospected to IMF. See about: http://www.imf.org/external/np/exr/consult/2009/pdf/Comment37.pdf

[145] “The rate would have to be set so low that "a tax on futures markets will not achieve any important social objective and will not generate much revenue.": Edwards, Franklin R, "Taxing transactions in futures markets: Objectives and effects", *Journal of Financial Services Research,* 1993, pag 75–91. doi:10.1007/BF01048341

tax in the era of globalization, but from the Eu can came the pressure on internation community to adopt the Financial transactions tax.

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GLOBAL INTERNATIONAL TAXATION

"From national tax systems towards global tax system"

Calculation of the tax base

(national tax accounting systems, relationship to IAS/IFRS,US GAAP, CCCTB)

Sarah Supino

Matr. 091773

SUB THEME VI - CALCULATION OF THE TAX BASE

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CHAPTER 1 - COMMERCIAL ACCOUNTING: NATIONAL FRAMEWORK

1.1. LAWS AND INTERPRETATIONS

Italian legislation has always given attention to accounting rules. It wants to offer a uniform scheme to operators, so that all differences can only depend on economic results of the business activity, and not on choosing freely the way of accounting operations. This is why most of rules are mandatory.

In 1865, Commercial Code already contained a few provisions which regulated accountancy. In time, law intervention has deepened and now accounting is fully regulated by the civil code, in force. In fact, articles from 2423 to 2435-*bis* of the Italian civil code substantially and formally describe accounting principles and criteria in details.

Anyway, accounting is a specific and technical matter, so that law provisions cannot be complete enough to regulate it. Therefore, the contribution of the OIC is essential. The OIC (Organismo Italiano di Contabilità) was formed in 2001 as a registered Foundation, "in response to the need perceived by the main public-sector and private-sector parties to establish a National Standard Setter that would be appropriately representative and would voice national opinions on accounting matters"[1]. The OIC Founders include various organizations largely representing the parties interested in the accounting matters.

The importance of OIC in issuing the Italian accounting standards is relevant, because of the large number of entrepreneurs that are not required to comply with IAS/IFRS in drawing up their financial statement. However, the activity of the OIC is not strictly limited to national matters. The Foundation also participates in the activities about international accounting standards development, providing technical support to relevant international bodies and coordinating its work with the activities of other European accounting standard setters. Finally, the OIC also supports the legislator in issuing regulations on accounting and related matters, since the subject has technical profiles, that law makers could ignore or neglect.

[1] See www.fondazioneoic.eu.

1.2. GENERAL REPORTING DUTIES: BOOKKEEPING RULES

Individual business men and companies are obliged to draw up their individual accounts. Anyway, accounting duties cannot be deeply understood without taking into consideration preliminary reporting duties.

According to Italian law, commercial enterprises, either individuals or companies, are obliged to respect some mandatory provisions on accounting and reporting. Italian civil code contains a few rules which define these duties, from both a subjective and objective point of view.

Subjectively, art. 2214, par. 1 establishes some of the reporting and accounting duties that businessmen running a commercial business[2] must respect. This article concerns, in particular, individual businessmen. Anyway, provisions in matter of companies expressively refer to it, so extending this duty to collective entrepreneurs, too[3]. To summarize, we can individuate subjects whom 2214 is directly or indirectly referred to. They are:

a) businessmen, who make a commercial business and do not exercise it with and for their family only;

b) companies which are allowed by law to exercise a commercial business, regardless of the business actually exercised;[4]

c) public entities and unrecognized associations and foundations exercising a business activity[5].

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[2]Actually, commercial business is positively described by art. 2195 of Civil Code, and agricultural one, either, is defined in art. 2135 of the same Code. Anyway, according to majority of Italian doctrine, a business can be defined as *commercial business* when it cannot be defined as an *agricultural* one. They consider the art. 2195 of the Civil Code as defining a residual category, in order to avoid to build up a third category of enterprise (that the minority of doctrine calls *civil enterprise*), which would lack in regulation, if were existent (F. GALGANO, *Diritto commerciale*, Bologna, 1982, p. 36; G.F. CAMPOBASSO, *Diritto commerciale,* I, Milano, 2008, p. 58; G. VISENTINI, *Principi di diritto commerciale*, Verona, 2008, p. 106). A minority part of doctrine does not agree with them, thinking that the civil enterprise is a third category of enterprises which in regulated neither by art. 2135, nor by art 2195 of Civil Code (G. OPPO, *Note preliminary sulla commercialità dell'impresa*, in *Riv. Dir. Civ.,* 1967, p. 561; M. CASANOVA, *Impresa e azienda,* in *Trattato di diritto civile*, Torino, 1974, p. 170), but it is a restricted minority.

To summarize, according to majority of doctrine, *commercial business is every kind of business that does not have the characteristics required for being considered an agricultural one*, according to art 2135 of the civil code.

[3]In particular, art. 2302 (general partnership), 2315 (limited partnership), 2421 (public company), 2478 (limited liability company), 2454 (partnership limited by shares).

[4]According to Italian commercial law, all companies and partnerships, excluding the simple partnerships, are allowed to make a commercial business.

[5] Even the European Economic Interests Groups are obliged to respect all reporting duties provided for by art. 2214 and following of the Civil Code, regardless of the business actually

The objective content of the provision is the following.

First of all, Italian law obliges these subjects to record all operation in a daily journal. This way, every business day has an analytical-chronological description in this progressively ordered book. In the second place, they must save files of correspondence (such as business letters) and provide for all reporting duties requested by the enterprise's type and size. Moreover, they must draw up an yearly inventory, in which they must record all realized assets and occurred liabilities, with respective evaluations. Inventory is drawn up at the beginning of the activity and then every year. It ends up with the financial standard[6].

Once we have concluded this necessary introduction, we can delve into accounting principles and rules, from a company perspective.

1.3. ACCOUNTING: GENERAL AND SPECIFIC PURPOSES

In order to examine and interpret Italian accounting rules, it is important to take into consideration its aims. In fact, accounting laws and principles are both oriented to the realization of purposes which financial reporting activity is referred to.

Some reporting duties are directly adapted to the specific aim which they are directed to. In Italy, we can individuate different kinds of accounts, related to particular needs or situations. Among them, the most important ones are[7]:

- consolidated accounts, aimed to point out the group revenue;
- accounts drawn before the legal end of the accounting period[8], in occasion of exceptional events requiring a complete and actual trend analysis;
- accounts in occasion of extraordinary operations, such as mergers, acquisitions , conversions, spin-offs, etc.;
- winding-up accounts, when the business ends and its results must be liquidated;

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exercised. This is established by art. 7 of decree 240/1991, which implements in details the reg. n. 85/2137/EEC, on EEIG, indeed.

[6] Art. 2217 of the Civil Code.

[7] L. DE ANGELIS, *Elementi di diritto contabile*, Milano, 2011, p. 10.

[8] The duration of the period is determined by the articles of incorporation, in lack it lasts one year and coincides with the calendar year.

- accounts in occasion of shareholder recess, in order to calculate the share value that must be paid back to the holder;
- annual accounts, which are the most important ones, and which will be made reference to, in our analysis.

A fundamental role is played by the annual financial accounts, which are the documents closing the yearly inventory. In fact, they represent the ordinary annual business reports and show a final balance for each business period. Anyway, such as in case of specific accounts which are listed above, all provisions regulating financial statements cannot be deeply comprehended without taking into consideration accounting aims[9], either generic or specific ones.

First of all, we can individuate several main-purposes of financial statements[10].

Formerly, accounting system is "internally oriented": statement is useful in order to check the *self-assessment* of the enterprises. In financial statements, in fact, either business man or directors of companies can find a trend analysis, and it can be useful to know how the business is going on.

Latterly, accounting system is "externally oriented". It is a source of *information* for shareholders and creditors, to let them control that business is going on without prejudice to their interests[11]. It is important to remember that shareholders and creditors are both considered third parties, relating to company and its own legal relationships. The company a perfect legal entity is on its own, separately from each natural person which operates in its organization (shareholders and directors) or who has relations with it (creditors and stakeholders in general). Therefore, these individuals need to control if the company is optimizing or wasting their external contributions, respectively as investments, for shareholders (risk-exposed) or loans, for creditors (no risk-exposed)[12], and this happens just

[9] Accounting aims are described in the national accounting standard n. 11.

[10] A. QUAGLI, *Bilancio d'esercizio e principi contabili*, Torino, 2006, p. 5.

[11] At this aim, accounting must be deposited and published in the registrar of companies where the certificate of incorporation of the company has been deposited, too. This way, all interested subjects can consult it (art. 2435 of the Civil Code).

[12] The risk upon shareholders and creditors is not the same. Shareholders run the juridical risk of losing the invested capital if the business wealth decreases, since in case of equity investments the company is not bound by a juridical duty of restitution of invested capital (rather there is the shareholder's right of receiving dividends if the business produces wealth). Creditors, on the contrary, save their right to restitution of loan and interests: they do not run a juridical risk of not having back their money. They only run the economical risk (which is the intrinsic risk of every

because there is not a legal coincidence between the company/legal person and each individual/natural person (if there had been legal coincidence between company and stakeholders/shareholders, any reference to an "external control of business" by these last would have been senseless).

Accounting system in Italy plays also another specific, fundamental role: it has an *organizational aim*[13]. In fact, the difference between revenues and costs, as resulting from the income statement, shows if the company has produced further revenues or losses.

From this point of view, the outcome is remarkable from an *economic perspective*: it helps the directors to understand if the direction of the company has been productive. Anyway, the positive or negative difference between revenues and costs has also *juridical consequences*, for companies in particular. When the difference is positive, law imposes some limits[14] to the possibility of sharing net profit among shareholders, after a dividends distribution has been formally deliberated in an ordinary shareholders' meeting[15]. On the other hand, if the difference is negative, other commercial provisions establish mandatory behavior for directors. In particular, if losses erode more than one third of the share capital amount, or even if this reduces under the legal minimum[16], directors are obliged to convene the shareholders' meeting in order to determine what measures are to be taken[17].

This means that accounting rules have relevant implication on the internal organization of the company: in other words, profits and losses are not only useful to know economic issues of management, but they also constitute the base for applying legal provisions and requesting mandatory behaviors upon managers and directors.

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business activity) that the company cannot pay back the loan because it has not any resources (i.e., it is in bankruptcy).

[13] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 9.

[14] Even if there is a positive result, commercial law imposes alternative destination of earnings, before they are distributed to shareholders. I.e., 5% of profits must be imperatively destined to the legal reserve (until it reaches the amount of 20% of share capital) and to any other reserve eventually constituted by the articles of incorporation (art. 2430 cc).

[15] As requested by art. 2433 cc.

[16] 120.000 € for public companies (art. 2327) and 10.000 € for limited liability companies (art. 2463).

[17] P. SPADA, *Appunto in tema di capitale nominale e di conferimenti*, Studio n. 127-2006, in *Rete unitaria del Notariato in C.N.N. Notizie – Studi,* 2006.

1.4. RULES AND PRINCIPLES: A "THREE LEVELS" SYSTEM

Italian civil code is the principal source of rules about accounting principles and criteria, all aimed to realize the basic purposes described above. These rules are even the result of EU Directives implementation, in most cases. The most important Directives are the fourth[18] and the seventh[19] ones, respectively setting out annual and consolidated accounting rules[20]. Another important reform has come in 2003[21]: it changed some provisions of the civil code and even solved some accounting problems[22].

Principles and criteria can be divided in three macro-categories. They are distributed on a hierarchical order, so that lower criteria cannot violate upper ones, except for explicitly stated cases. The categories can be so summed[23]:

a) general clause: accounts must reflect business results by clearness, truth and fairness[24];
b) general principles: prudence, going concern, continuity of forms, substance over form, accrual[25];
c) evaluation criteria: they are all different, depending on the specific assets they are referred to; however, they are all inspired to general principles[26].

General clause, general principles and evaluation criteria will be better explained in the following three sub-paragraphs.

a) The general clause

The general clause expresses the three main principles in drawing up accounting sheets. These must always lead accounting drawing. The systematic interpretation of this clause reveals its hierarchical supremacy, upon specific principles and criteria of redaction. We can deduct it by three provisions, at least.

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[18] Dir. 78/660/EEC.
[19] Dir. 83/349/EEC.
[20] M. CASSOTTANA, A. NUZZO, *Lezioni di diritto commerciale comunitario*, Torino, 2006, p. 105.
[21] Decree 6/2003.
[22] G.F. CAMPOBASSO, *Diritto commerciale,* II, Milano, 2008, p. 448.
[23] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 13.
[24] Art. 2423, par. 2, cc.
[25] Art. 2423-bis cc.
[26] Art. 2426 cc.

Art. 2423, par. 2, establishes that accounting drawers must give supplementary information if mandatory ones are not enough to assure a clear, true and fair view. Moreover, art. 2423, par. 4, requests not to apply specific criteria of evaluation, whether it could compromise a clear, true and fair view. Finally, art 2423-bis, n. 6, gives the possibility to change formal criteria which have been applied in the previous annual statement, as an exception to the ordinary prohibition, but only when the respect of the ban can compromise the good application of general clause. Summarizing, not requested information must be compulsorily given, and, on the opposite, mandatory criteria must compulsorily be set aside, in order to guarantee the predomination of general clause. This way, its hierarchical supremacy is always respected, even in spite of sub ordered principles and criteria application.

But, what does *clear, true and fair view* mean? Each one of these three concepts has a specific meaning, gathered by law provisions and literature interpretation.

Clearness concerns formal schemes. Balance sheet is *clear* if it is drawn up in respect of formal rules. In fact, law describes in details accounting structure, in particular in art. 2423-ter and following. Notes on the accounts play a fundamental role in order to draw up a clear balance sheet. The width of the *clearness* meaning has been discussed for a long time and variously interpreted by Italian doctrine and jurisprudence[27]. Italian courts, in particular, have closer examined this notion. They have specified that directors can give further information about balance sheet to shareholders, in occasion of their meeting to endorse accounting, with the purpose of making balance sheet as much *clear* as possible.

Truth concept is more complex and controversial than the other two ones. It is not so simple to define when and whether accounts are true and when they are not so.

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[27] P. BUTTARINI, *Autonoma rilevanza del principio di chiarezza del bilancio: le sezioni unite accolgono l'orientamento della dottrina prevalente (Nota a Cass. sez. un. civ. 21 febbraio 2000, n. 27)*, in *La Nuova Giur. Civ. Comm.*, 2001, p. 336; G. VIDIRI, *I principi di "chiarezza" e di "verità" nel bilancio d'esercizio delle società per azioni (Commento a Cass. sez. un. civ. 21 febbraio 2000, n. 27)*, in *Corr. Giur.*, 2000, p. 1212; P. BALZARINI, *Chiarezza del bilancio, effetti dei chiarimenti forniti in assemblea e cause di decadenza dei sindaci (Nota a Cass. Sez. I civ. 9 maggio 2008, n. 11554)*, in *Le Soc.*, 2009, p. 1110.

Truth has two different profiles[28]. From an objective point of view, accounting is true when it reflects the reality of facts: what happens during the enterprise's economic life must be truly described and analyzed in balance sheet. From a subjective perspective, instead, accounting operations can never be objectively true, overall. They could rather be truthful[29]. In fact, all accounting items are evaluated on the basis of assessment criteria, which intrinsically give margins of uncertainty. In other words, an *objectively true evaluation* cannot be realized, just because evaluations cannot be objective by nature. This is why an accounting sheet can be defined truthful, and not true, if its drawers have respected all evaluation criteria, so that the assessment can be at least *verified*, according to evaluation parameters, which are positively objective only because they are positively imposed by law and even mandatory for everyone[30].

Fairness deals with respect of law provisions, in general. In particular, it refers to respect of general principles as established in art. 2423-bis[31]. Respect of rules, anyway, does not refers to correct technical application of them, only. It also deals with a correct interpretation of law, taking into consideration its aims. A fair redaction must be inspired by professional ethics, in order to avoid that drawers could exploit rules for personal interests, neglecting law purposes.

Clearness, truth and fairness are surely linked each other, and give all together the whole picture of formal and substantial principles that must be followed by accounts drawers in interpretation of other sub ordered rules. One of the most relevant indicator of its primacy is the *dispensation at art. 2423, par. 4*. This provision establishes that, in exceptional cases, mandatory norms which regulate accounting matter must not be applied if this application results in contrast with the general clause. It is important to underline the fundamental elements of the provision. First of all, the provision establishes a duty, without giving any possibilites of choice: if account drawers run into an exceptional situation and notice that the formal application of a provision could contrast with the general

[28] F. GIUNTA, M. PISANI, *Il bilancio*, Milano, 2008, p. 36; . VISENTINI, *Principi di diritto commerciale*, cit., p. 483.

[29] In Italian code, the word defining this concept is "truthful", and not "true".

[30] In practice, the most evident violation of truth in accounting is the fraudulent accounting, which is punished with criminal sanction by art. 2621 of the civil code.

[31] They will be analyzed in the following paragraph.

clause, they must not (it is mandatory, there is no chance to decide otherwise) apply that rule. Secondly, the exceptionality of the case must be demonstrated[32], in order to avoid that directors could apply the dispensation at the only purpose of accounting more revenues or less costs than those which have been actually produced. Finally, if, as a result of the dispensation appliance, more revenues come out than those which would have been accounted just applying the non-applied provision, this difference must be neutralized by allocating in the statement a reserve corresponding to this further amount: this income will not be able to be distributed to shareholders as dividends. The rule aims to avoid the distribution of non occurred revenues, whose amount is only the result of accounting norms' appliance.

b) General principles

Art. 2423-bis of Italian Civil Code lists and describes general accounting principles[33]. They must lead the accounts drawers in applying all specific evaluation criteria[34], which are hierarchically sub ordered to them. Analyzing these principles, we can individuate differences between IAS/IFRS system and Italian system, more than by examining any other rules[35].

Prudence[36] is the first main-principle that comes into consideration. This principle assures that assets and income are not overvalued and liabilities and expenses are not undervalued. It means that prudence imposes an asymmetric approach, depending on whether it refers to balance sheet assets or liabilities. It reveals the basic difference between Italian system and IAS/IFRS system: in fact, Italian accounts aim to protect third parties from the possibility of stating, in accounts, any income that is not realized, and no profits are recognized until a sale has been completed. The most evident application of prudence, in this sense, is the *historical cost*[37] criterion. It imposes to value assets at their original cost of sale or production, without taking into consideration any evaluations which would be

[32] The exceptional case must be described and justified in notes on the accounts, too.
[33] G.F. CAMPOBASSO, *Diritto commerciale,* II, cit., p. 450.
[34] G. VISENTINI, *Principi di diritto commerciale*, cit., p. 514.
[35] The matter will be deepened at the following paragraph.
[36] Art. 2423-bis, par. 1, n. 1).
[37] The historical cost is opposed to the "fair value" criterion, as expression of two different aims: it is better analyzed in chap. 2.

relevant, if we considered IAS/IFRS "fair value" criterion**.** Another appliance of prudence in balance sheet assets is credits evaluation criterion: credits must be recorded on the base of presumed realizable value[38]. In addition, a cautious view is taken for future problems and costs of the business if there is a reasonable chance that such costs will be incurred in the future. They must be recorded in risks and charges funds, expressly provided for, even to stop net income from being overstated. Summarizing, this means that Italian accounts oblige to have a prudential approach, by excluding non realized assets and including non realized (but supposed to be realized in future) liabilities.

Another key accounting principle is *accrual*[39]. According to this principle, business transactions must be recorded when they occur and not when the related payments are made or received[40] (if it were the opposite, accounting would be inspired to cash-basis principle). In respect of this principle, only revenues occurred within the end of the accounting year can be recorded in the statement. Future income recording must be postponed to the following years accounts[41]. Moreover, balance sheet assets and liabilities must be included in the statement even if directors gain knowledge of them once the accounting period has already ended, but the statement has not been shown to shareholders for being approved, jet[42].

Other two leading-principles are *continuity of forms* and *going concern.* The first one obliges not to modify evaluation criteria from an accounting period to another, unless this continuity contrasts with the general clause. The second one specifies that financial statements are prepared assuming that the company is a "going concern". It means that the company intends to continue its business and is normally able to do so, unless there is evidence to the contrary, that is that a company is going broke. The most important appliance of this principle is *depreciation* criterion: it refers to spreading over multiple periods the acquisition cost of fixed assets in a systematic manner, over their estimated useful economic

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[38] See the following paragraph.
[39] Art. 2423-bis, par. 1, n. 3) cc.
[40] A. QUAGLI, B*ilancio d'esercizio e principi contabili*, cit., p. 40.
[41] Art. 2323-bis, par. 1, n. 2) cc.
[42] Art. 2423-bis, par. 1, n. 4) cc.

lives. There could not be any depreciation over future periods, if there was not a going concern[43].

The last, but not least, principle is the *substance over form* one. It has been introduced in Italy in 2003[44], in occasion of a radical reform of Italian Commercial law which has modified art 2423-bis, par. 1, n. 1. In this article a new sentence has been added: evaluation of accounting must be done "*taking into consideration economic function of items*". In matter of substance over form, Italian civil code contains any specific provisions which seem to be positive applications of this principle: i.e., art.2424-bis, par. 5 establishes that, if an item is sold under a buy-back clause, it must remain recorded in the seller accounting, even if the buyer is the legal owner until the clause comes into force. Anyway, the provision which imposes to take into consideration economic function of items seems to introduce the general substance over form principle (as in case of IAS/IFRS principles), as a general principle that should lead in drawing all accounts and in interpreting all criteria. Anyway, this change, which is considered as an attempt to introduce the IAS/IFRS principle of substance over form in Italy, has been retained a failure by most of doctrine[45].

Even considering that this provision is not so clear[46] and that it seems a ideological statement, lacking in concreteness, the reason of this failure is upstream.

Any attempt to change a national accounting system has to be set against the background context in which it unfolds, because an accounting tradition is deeply linked to the given environment, which is Italian country, in this case. The elements characterizing the accounting practice of a Italy are the civil and commercial regulation, the professional accounting standards, but most profoundly characterizing elements of accounting practice in Italy and in any

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[43] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 17.

[44] The reformation decree is the n. 6/2003.

[45] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 62.

[46] The "leasing" case is an example. Internal law does not distinguish between financial and operating leasing, since they are both accounted with the patrimonial method. In particular, in all cases the lessor (owner) records the asset it its balance sheet, by deducting depreciation rates. The lessee (user) only records the payments sustained against the right to use, by deducting it if they are inherent to the company's activity, even if he suffers all risks and benefits coming from its use. It is evident that the juridical form prevails on the economic substance. In the following chapter, IAS/IFRS treatment of leasing will be analyzed. Chapters 3 and 4 will show its tax implications.

other countries are the average size of the enterprises, their major finance providers and the socio-economic role and perception of the accounting craft[47]. If we assume this, then we can understand the reason of the lack of any significant modifications in matter of substance over form, in Italy. A true change could occur only if the social and economic environment, and its implication on accounting, changes, in the meantime. In Italy form prevails over substance, and that depends on the history of the nation, on its accounting tradition and on its socio-economic context. The main example of this conclusion is the strict use of historical cost, the importance of asymmetric prudence, the will of protecting third parties from the possibility of overvaluing the enterprise. These principles have had much time to come embedded, and a formal modification of a provision is not enough to overturn them. Moreover, all Italian accounting system is still too anchored to a formal approach, because of the worry of giving misunderstanding information to third parties and of distributing non realized revenues, so violating one of the principal accounting scopes. Italian accounting practice needs more time to actually let the substance prevail over the form, since this last principle overthrows a deep tradition. We can conclude that, nowadays, Italian accounts are ruled by the principle of form over substance: changing a law provision is not enough to change the system[48].

In the future, maybe that the continuous comparison to other national system (which the opening to European and worldwide market requires) and even the higher and higher harmonization between European States' accounting systems (as demonstrated by the perspectives of IAS/IFRS) would help the change in future.

c) Evaluation criteria

Evaluation criteria are all established by art. 2426 cc. They are all inspired to accounting aims and superior principles. They are referred to items which could be divided in the two macro-categories of balance sheet assets an balance sheet liabilities.

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[47] S. ZAMBON, C. SACCON, *Accounting change in Italy. Fresh start or Gattopardo's revolution?*, in *Eur. Acc. Rew*, 1993, p. 245.

[48] B. JOHN, *Aspetti tributari del processo di adeguamento ai principi IAS,* in *Corr. Trib*, 2002, p. 4353.

With regards to *balance sheet assets*, the category can be even more divided in two groups of items: fixed assets and current assets. The former are items which are owned and used in the production of income for a long time and are not expected to be consumed or converted into cash in the short term. The long-term possession in justified by the item nature or even by its use, as decided by directors. Current assets are items which are expected to be soon converted into cash in the normal course of business.

Fixed assets are recorded on the base of the cost of acquisition or production[49]. This is a specific application of *historical cost rule*. It is important to underline what happens if this value increases or decreases, in time: in fact, this rule is one of the most evident applications of *asymmetric prudence* principle. In particular, if it increases, the upper value cannot be recorded in accounts, until the item is sold and its value is realized[50]. Nevertheless, if the value decreases, the loss must be recorded[51] in that accounting period and cleared in the following periods statements if the value increases again. Anyway, even further to revaluation and devaluation, the recorded value must never be higher than the historical cost, unless it is established by an express exception.

The cost of fixed items which have a limited "useful economic life" must be depreciated. Depreciation is the process of expensing out fixed assets over their limited useful life. Assets having indefinite or unlimited useful life, such as lands or brands, are not depreciated. Moreover, if the enterprise holds at least 1/5[52] of another company equity, this block of shares is recorded in statement as a particular category of fixed items. In fact, it must be recorded in respect of the fixed items rule (recording the cost of sale or production) or even by recording in statement the amount of the subsidiary equity which corresponds to the held shares[53].

Current assets are assets on the balance sheet which can either be converted to cash or used to pay current liabilities in the short-medium term. They are

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[49] Art. 2426, par.1, n.1, cc.
[50] Commercial law establishes some exceptions to this rule. I.e., the dispensation to general clause (art. 2423, par.4) allows this revaluation, by observing all law limits and duties.
[51] Art. 2426, par.1, n.3, cc.
[52] 1/10 if the subsidiary is listed in the Stock Exchange.
[53] Art. 2426, par. 1, n. 4, cc.

constituted by raw materials, components, finished products ready to sell, credits and short-term investments[54]. They are recorded at the less value between historical cost and fair value. Even evaluation of credits must be inspired to prudence principle. In fact, drawers must value the credit according to the amount that they suppose will be paid by the debtor.

Balance sheet liabilities are mainly composed by debts and risk and charge funds. The main difference between these two categories is the certainty of payment: in fact, provisions for risks and charges are set aside to cover losses or liabilities that are certain or probable, but for which the amount or time of payment cannot be defined yet. Accounting drawers must estimate the risk as precisely as possible, basing on the facts which are available at that time. Risks for which a liability is only possible are mentioned in the notes at the accounts, without any specific provision in balance sheet or income statement[55]. The aim of the regulation is clear: it wants to avoid the distribution of the corresponding income, in order to earmark it for covering future charges.

1.5. SHEET STRUCTURE

Italian financial statement is composed of three documents:

1) The balance sheet
2) The income statement
3) The notes on the accounts

The *balance sheet* summarizes the company's assets, liabilities and shareholders' equity. These three balance sheet segments give investors an idea to what the company owns and owes, as well as the amount invested by the shareholders. It is called a balance sheet because the two sides balance out, as a result of the *double-entry bookkeeping system*[56]. The sense is the following: a company has to pay for all its assets, which are included in the balance sheet assets' column, by either borrowing money (liabilities) or getting it from shareholders (shareholders'

[54] It is a residual category: it includes all investments that do not satisfy the requirements to be considered fixed assets, according to 2424-bis, par.2.
[55] I.e., an uncertain business transaction which could generate e future loss. F. GIUNTA, M. PISANI, *Il bilancio*, cit., p. 445.
[56] G. VISENTINI, *Principi di diritto commerciale*, cit., p. 483.

equity), both included in balance sheet liabilities mirror column. In fact, the amount of assets is always equal to the sum of liabilities and equity.

The *income statement* indicates the revenues recognized for a specific period and the cost and expenses charged against these revenues, including write-offs (e.g., depreciation and depreciation of assets). It shows to managers and investors whether the company has earned or lost money during the period being reported. At the end of the accounting period, the resulting net income (revenues minus costs) is recorded on the equity line of balance sheet.

Notes on the accounts contain information about business which are not relevant in the previous documents, even if they offer a plainer picture of economic situation. Their minimum content is established by civil code, in particular by art. 2427.

The financial statement must be supplied with reports by the directors[57], the controlling body[58] and the accounting auditor[59].

The financial statement plan is drawn up by director and must be approved by shareholders, in the only compulsory annual meeting.

1.6. DIFFERENT RULES FOR DIFFERENT FORMS OF ENTERPRISES: SMALL COMPANIES AND GROUPS

Since accounting rules are very complex, law allows *small companies* to draw up a less elaborate statement, that is the financial statement in a short form[60]. Companies which respect some requirements[61] can draw up shorter accounts, skipping some items and rules which are compulsory for other companies. They

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[57] It is different from notes, since it gives management information and describes future perspective of business, too.

[58] In Italy, it is the board of auditors, composed by three people at least (the possibility on certain conditions, for small companies, to have only one auditor has been introduced in 2011).

[59] Art. 2409-bis and following establish that listed companies must compulsorily entrust the accounting auditing to an auditing company. Other companies can also entrust it to individual auditors, if the non-listed company makes financial transaction, or, in other cases, to auditing body, if all its members are auditors.

[60] Art. 2435-bis.

[61] Art. 2435-bis, par. 1: "The companies, which have not traded securities on regulated markets, may draw up financial statements in a short form when, in the first year and thereafter for two years running, they have not exceeded two of the following limits:

1) Total assets of the balance sheet: 4,400,000 EUR;
2) Revenues from sales and services: 8,800,000 EUR;
3) Employed on average during the year: 50;"

can also miss out the director reports, if all information that this document contains are included in notes on the accounts.

Moreover, law provides for a specific regulation of *groups*. In fact, the decree n. 127/1991 has receipt the IV and VII EU directives, respectively about annual and consolidated accounts. In particular, art. 27 and following provide for *consolidated accounts*.

According to the decree, companies who hold enterprises, and economic public bodies controlling companies are required to draw up consolidated accounts[62], as parents undertaking. This is compulsory if they have a majority of the shareholders' voting rights in the subsidiary undertaking or even the right to exercise a dominant influence over it[63]. It is important to underline that, in Italy, the dominant influence in undertaking consolidated must be exercised only by votes, and not by contracts[64]. Anyway, art. 26, par. 2 a) adds that subsidiaries undertaking are even "companies in which another is entitled, by a contract or a statute, to exercise dominant influence, when the state law permits such contracts or clauses". However, in Italy, this kind of contract, called domination agreement, is forbidden, according to majority of literature[65]. If it is so, how must this provision be interpreted? We could conclude that it can be applied only to foreign subsidiaries, whose States of residence allow such contracts.

In consolidated accounts, the general clause and general principles are the same as in annual accounts. Anyway, there are specific rules that must be considered, because of the confluence, in the same statement, of income coming by different companies which are all linked each other.

First of all, the assets and liabilities of undertakings included in a consolidation shall be incorporated *in full* in the consolidated balance sheet, regardless of the amount of held shares; even income and expenditure shall be incorporated in full

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[62] Art. 27 of the decree 127/1991 establishes some cases of exemption from this duty.

[63] Art. 28 of the decree 127/1991 establishes some cases of subsidiaries' exclusion.

[64] In fact, it is incorrect to consider the *group* as synonymous of *undertaking consolidated.* According to Italian law (art. 2359 cc), a dominant influence in groups can be achieved by contracts, too, under art. 2359, par.1, n. 3. On the contrary, in undertaking consolidated regulation, there is no refer to art. 2359, par 1, n.3, so that this way of exercising influence will be relevant only for provisions regarding *groups* (2497 and following), and not for those regarding *undertaking consolidated.* L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 163.

[65] F. GALGANO, *Direzione e coordinamento*, Bologna, 2005, p. 180; G.F. CAMPOBASSO, *Diritto commerciale,* II, cit., p. 290.

in the consolidated income statement. All resulting from transactions among the undertakings must be cleared[66]. As obvious consequence of the full incorporation of assets, all shares held in consolidated companies and any corresponding portion of their equity must be cleared. If subsidiaries hold parent's shares, these must be recorded as treasury stock, in consolidated accounts.

Consolidated accounts are primarily aimed to *inform* investors and creditors about *economic situation of the group as a whole*, since the belonging to a collectivity of enterprises surely influences individual companies' business. Anyway, they have not any organizational scope, as calculating income to be distributed to shareholders.

[66] In particular, credits, debts, profits and losses resulting from transactions between them (art. 31, par.2, decree 127/1991).

CHAPTER 2 - COMMERCIAL ACCOUNTING: THE IMPACT OF IAS/IFRS

2.1. HOW ITALY RECEIPTED IAS/IFRS

Regulation 1606/2002 introduced the use of international accounting standards in the European Union with a view to "harmonizing the financial information presented by the companies referred to in Article 4, in order to ensure a high degree of transparency and comparability of financial statements"[67]. As established by art. 4 of the regulation, "companies governed by the law of a Member State shall prepare their *consolidated accounts* in conformity with the international accounting standards […] *if*, at their balance sheet date, their securities are *admitted to trading on a regulated market*". This norm, as we know, does not necessitate a reception by Member States, since its source is a regulation[68]. Anyway, the reg. 1606/2002 gives the States the possibility of subjective and objective extensions of the provision, in form of compulsory duty or elective choice by enterprises. In particular, according to art. 5, "Member States may permit or require the companies referred to in Article 4 to prepare their annual accounts and/or the companies other than those referred to in Article 4 to prepare their consolidated accounts and/or their annual accounts in conformity with the international accounting standards".

Italy had already taken a step forward by partially receipting the directive 65/2001, introducing information duties upon directors, regarding to fair value of items[69]. Anyway, what happened with regulation 1606/2002 is something more: it is nearly a revolution[70]. In fact, in Italy, we can find two different regulations, as a result of the allowed extension.

In some cases, the use of IAS/IFRS is mandatory. In particular:

[67] Art.1, reg. 1606/2002.

[68] EC regulations are directly applicable and mandatory inside States' law systems, unlike directives, which need to be receipted.

[69] For example, further to the implementation, art. 2427-bis cc establishes that notes on the accounts must explain information about financial instruments fair value. Anyway, it is an information duty and does not bear on evaluation.

[70] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 121; VISENTINI, *Principi di diritto commerciale*, cit., p. 525.

a) Listed companies, companies issuing financial instruments widely distributed to the public, banks, other regulated financial bodies and insurance companies are obliged to apply the IAS/IFRS in their *consolidated accounts*;
b) Listed companies, companies issuing financial instruments widely distributed to the public, banks, other regulated financial bodies and insurance companies[71] are obliged to apply the IAS/IFRS in their *annual accounts*.

In other cases[72], the use of IAS/IFRS is elective. In particular:

a) No listed and no insurance companies which are included in undertaking consolidated as subsidiaries of listed or insurance companies and all companies who make consolidated undertaking as parents without being obliged to IAS/IFRS can apply IAS/IFRS for their *consolidated accounts;*
b) Companies who make consolidated undertaking as parents using IAS/IFRS without being obliged can apply IAS/IFRS for their *annual accounts,* too*;*
c) All other companies can use IAS/IFRS for their *annual accounts*, starting from a date that will be decided by a finance ministry decree, which has not been issued yet[73].

What's the matter with this so wide extension of the option provided for by the regulation? The problem is all linked to the different scope of consolidated accounts and of IAS/IFRS accounts compared with the national annual accounts aim: this latter has an organizational scope which the previous ore lack in. So said, it is important to focalize the attention on the nature of IAS/IFRS and on their principles and scopes, paying attention on the differences between this system and the Italian one, and finally on remedies provided for by Italian law, in matter.

2.2. IAS/IFRS AIMS: DIFFERENCES WITH ITALIAN SYSTEM

Aims of IAS/IFRS accounts are deeply different from local accounting aims[74].

[71] These last are obliged only if they issue financial instruments widely distributed to the public and do not draw up consolidated accounts.
[72] Companies which are allowed to draw up their accounts in a short, apart from their concrete choice of adopting this form or not, can never opt for IAS/IFRS.
[73] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 88.

In fact, as the Framework[75] and the IAS 1[76] explain, IAS/IFRS accounts must give information about the company's global fair value, so that external and internal investors or even creditors can make aware decisions about providing resources to the enterprise. The main scope is the *informational* scope. In a world of global enterprises and global capital markets, the biggest problem is a lack of transparency and comparability of information. The main objective of International Accounting Standards is to provide a global standard for drawing up annual financial statements, to ensure that investors can compare data extensively by each reporting period and company and thus obtain a basis on which taking their decisions. This is why the basic principle behind the IAS is that of providing a true and fair view of the business activity. The following potential and current investors and creditors are among the most important groups requiring information. They need a clearly defined basis to decide their investment strategy. To do this, they need companies to provide them with forecasts of future payouts as well as information on the risks involved[77]: in other words, they need to know a company's economic substance, regardless of the juridical form of its transactions.

IAS accounts do not take in consideration the *organizational* scope, which is preliminary in Italian system. In fact, according to this last, financial statement aims to "prove, by evidence and truth, occurred profits and losses", as established by art. 2217 of the civil code. In addition, art. 2433 forbids the distribution of non occurred revenues. This scope is totally absent in IAS accounts. In fact, the risk that they show even not-yet-occurred revenues is very high, if we think that the main criterion is the fair value one. It means that Italian accounting in not *directed to creditors*, in order to let them know if it is worth to give credit to the company

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[74] P. MORETTI, *Finalità e destinatari di un bilancio IAS,* in *Corr. Trib.,* 2004, p. 2593.

[75] Conceptual Framework, issued by the IASB in September 2010: "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit."

[76] IAS 1: "Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions".

[77] N. SEEGER, *International Accounting Standards (IAS) implications on financial institutions*, in www.hfb.de/forschung/veroeffen.html., 2001.

(as IAS accounts): it is rather *set for creditors*, in order to avoid that their interests could be prejudiced by a distribution, to shareholders, of non-occurred revenues[78]. All differences between the two systems depend on the different scopes that they aim to satisfy.

2.3. MAIN PRINCIPLES: RELATION BETWEEN IAS/IFRS AND NATIONAL SYSTEM

All main principles ad formally the same in both IAS/IFRS system and national one. Anyway, in most cases, their meaning is different[79].

About the general clause, the *framework* explains that, even without dealing directly with such concepts, "the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial reports that convey what is generally understood as a true and fair view of, or as presenting fairly such information[80]".

General principles' meaning, instead, can be deducted by specific adopted criteria of evaluation.

The main different principle is surely *substance over form* one. As underlined in chapter 1**,** in Italy this principle is not actually applied, since it is sub ordered to other principles, such as prudence. Italian system is still inspired to form over substance principle. On the contrary, in the IAS/IFRS system this principle is the leading one, transversally applied, representing the base of all principles and criteria that IAS/IFRS provide for. According to it, financial statements must show the financial reality of the transaction, rather than its legal form. As a consequence, if the wholly considered transaction economically represents two or more different transactions, the whole must be disaggregated in more single operations, that will be accounted individually, and vice-versa. This could never happen, according to Italian accounting principles.

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[78] RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, in *Rass. Trib*., 2008, p. 1624.

[79] It also depends on the fact that IAS/IFRS are provided for by private bodies (as IASB) which acknowledge all the best accounting practices. It is a natural way of making rules for common law States. Italy, on the contrary, is a civil law State. For this reason, many differences between IAS system and internal one can be revealed, since this last is much more legal-based and less flexible, too. L. POTITO, P. TARTAGLIA POLCINI, *I principi contabili internazionali: riflessioni critiche*, in *Riv. Dott. Comm,* 2010, p. 10.

[80] IAS *Framework,* par. 46.

The leasing accountancy is the main example, in matter. Leasing is a contractual arrangement calling for the lessee (user) to pay the lessor (owner) for the use of an asset (a vehicle, i.e.). According to IAS 17, a distinction is required. If the lease transfers substantially all the risks and rewards incidental to ownership, it is a *financial lease*. The transfer of risk to the lessee may be shown by lease terms such as an option for the lessee to buy the asset at a low price (typically the residual value) at the end of the lease. The nature of the asset (whether it is likely to be used by no one other than the lessee), the length of the lease term (whether it covers most of the useful life of the asset), and the present value of lease payments (whether they cover the cost of the asset) may also be factors. In all other cases, in which the lessor simply conveys to the lessee the right to use an asset for an agreed period of time, in return for a payment or series of payments and without indexes of transferred risks and benefits, it is defined as *operating lease*.

According to principle of substance over form, the financial lease is qualified as the sum of a sale and a loan, as if the item had been immediately sold and paid in time through the corresponding which are, formally ad juridically, defined as payments against the use. The lessee (user), and not the lessor, records the asset in its balance sheet and depreciates it, by recording the interests paid to the lessor, too. This last records the value of the item plus the receipt interest, just as the item had been sold and the loan paid. The substance over form principle appliance is evident: the item is depreciated by the operator to whom significant risks and rewards of ownership of the goods have been transferred, nevertheless he is not the juridical owner. In the Italian system, on the contrary, this could not happen, since only the juridical owner is entitled to depreciate the asset. The juridical owner is the lessor, until the option clause to buy the good comes into force (and it happens, in general, at the end of the agreement duration, if the lessor wants to exercise this right). It means that the lessor (owner), and not the lessee, depreciates the item, according to Italian accounting principles[81].

The substance over form principle has its implication on other principles, too. An example can be the meaning and operating of *accrual* principle. In matter of

[81] A. QUAGLI, B*ilancio d'esercizio e principi contabili*, cit., p. 121.

timing, accrual principle leads IAS/IFRS application, as in Italian system. Anyway, the meaning of the term is different. In Italy, in fact, law specifies when rights and duties are legally acquired. Property right is acquired "by giving consent in forms provided for by law"[82]: real estate, in particular, is acquired by stipulating the contract in writing (this is the legally required form). It means that, in case of building sale, only after this stipulation the asset will be recorded in the buyer's financial statement. Accrual principle, in IAS/IFRS system, is different. As established by IAS 18, par. 14., the buyer's right of accounting the items is acquired after having "transferred to the buyer the significant risks and rewards of ownership of the goods", aside from the legal transfer of right of property. It means that the accrual strictly depends on the application of substance over form principle or even on the opposite form over substance principle, since it defines the moment at which the right of recording the asset arises.

This difference of accrual meaning could even provoke a particular consequence in case of relations between IAS-adopters and no IAS-adopters. Let's think to leasing case as described above: if the lessee adopt IAS accounts and the lessor adopts national principles, the leased asset would be recorded and depreciated in both the accounts. This is one of the malfunctions depending on the appliance of IAS/IFRS to annual accounts, indeed[83].

Even *prudence* has a different meaning. In fact, IAS/IFRS statements are equally prudential, but in order to satisfy their own scopes. In some cases, they seem even more prudential than Italian ones: i.e., they impose a periodical impairment test[84] of some assets, which Italian system does not know at all.[85]

2.4. THE MAIN IAS/IFRS CRITERION: THE FAIR VALUE

Regarding to evaluation criteria, the *fair value* criterion in the one which most expressively demonstrates the aims of IAS/IFRS system. It is the criterion that better expresses the substance over form principle sense, too. For this reason, the fair value criterion represents a relevant difference between national and international system in the evaluation of assets, even because the former is

[82] Art 1376 cc.
[83] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 134.
[84] IAS 36.
[85] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 138.

inspired to a form over substance principle, whose related criterion is the historical cost one.

According to IAS 18, "revenue[86] shall be measured at the *fair value*"[87], which is defined as "*the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.*"[88]

The fair value calculation has an high element of evaluation, since its represents the amount for which an asset *could be exchanged*, and not the amount for which an asset *has been exchanged*, as historical cost. This evaluation has several consequences.

Firstly, it can ever express the actual, "substantial" value of an asset, by guaranteeing a correct information to investors. From this point of view, it contributes to realize the most important scope of IAS/IFRS accounting, which is the informative scope.

Secondly, if it is higher than the historical cost, it shows in accounts a value which has not been realized, yet, so that the accounts could bring out not-yet-occurred profits. Moreover, it is changeable, year by year, and it means that value of assets as recorded in accounts changes with it[89]. Moreover, its calculation gives high margins of discretion to directors.

The historical cost criterion, on the contrary, has the exactly opposite effects. It is inspired to the form over substance and prudence principles, so it does not show the substantial value of the asset. It shows a realized value, without the danger of recording not-yet-occurred profits[90]. This way, it contributes to the organizational aims of the accounts (in fact, IAS/IFRS accounts do not have any organizational aims). It does not leave any margins of discretion to accounting drawers, since they must just record the cost incurred against the bought of that asset.

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[86] The fair value is even the criterion to calculate the value of property, plant and equipment (IAS 16), intangible assets (IAS 18), financial instruments (IAS 32 and 39), investment property (IAS 40).

[87] IAS 18, par. 9.

[88] IAS 18, par. 7.

[89] It happens, in particular, in the case of those enterprises which have many fair value recorded assets, such as banks and financial enterprises. L. POTITO, P. TARTAGLIA POLCINI, *I principi contabili internazionali: riflessioni critiche*, cit., 2010, p. 10.

[90] The provision at art. 2433 of the civil code, which forbids the distribution of non occurred revenues, is considered a pillar of accounting system and it would be infringed, if the increase of value as a result of fair value criteria was shared as dividends.

Obviously, the initial fair value (at the first recording period) coincides with the historical cost[91]. Anyway, if that assets increases in value in time, the initial recorded cost increases in proportion. For this reason, the fair value always expresses the current value of assets, that would be reasonably recoverable by using or selling that item running the business. In the following periods, the fair value can be lower or higher than the historical cost. In both cases, the difference must be recorded at that moment. On the contrary, national accounts allow the decrease of cost by depreciation (depreciation is planned at the moment of acquisition, it is not immediate) and do not allow the recording of value which are higher than cost, as a rule[92].

For all these reasons, the introduction of the fair value in Italian accounts entails the same difficulties that have been noticed with substance over form principles (this is a consequence of the fact that fair value applies this principle, indeed). Its introduction in Italy is particularly complex. Through a partial implementation of EU Directive 65/2001[93], the fair value has already been introduced in Italian annual accounts, through art. 2427-bis of Civil Code. This article obliges to provide for further information about the financial instruments fair value, in the notes on the accounts. It also defines the meaning of fair value and the way of calculating it[94]. Anyway, these information in the notes have only an informative scope. In fact, the provision does not entails any evaluative consequences[95] and the evaluation criterion remains the historical cost, anyway, for all assets (but credits)[96].

With IAS/IFRS, the fair value criteria has been fully introduced in Italy by the EU regulation which is directly applied in Italy and prevails on national provisions (since it is imposed by a European source). The evaluating impact of

[91] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 126

[92] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 128.

[93] It was done by the decree 394/2003.

[94] Art. 2427-bis, par. 3 of the Civil Code: "The fair value is: a) the market value for financial instruments for which you can easily locate an active market; if the market value is not identifiable for an instrument but it can be identified for a similar instrument, this last value shall be adopted;
b) a value resulting from evaluation models and techniques generally accepted, for those instruments which cannot be located in an active market; the value calculated in this way shall be a reasonable approximation of market value."

[95] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 65.

[96] In case of stocks and financial instruments, the market value is recorded if it is lower than cost (in application of prudence principle).

fair value has determined any problems. The solution has been introduced by art. 6 of decree 38/2005, that conciliates the rule established by art. 2433 of civil code and the fair value accounting criterion, in order to avoid the distribution of revenues which have not occurred yet. It will be explained in the following paragraph.

2.5. ADJUSTMENTS PROVIDED FOR BY ITALIAN LAW

If the IAS/IFRS had been introduced without any adjusts, it would have totally upset the Italian system, because of their deep difference, as described above. Moreover, traditional accounting rules are deeply rooted in Italian world of economics, even more than in law.

Therefore, the decree 38/2005 cares about avoiding that the main principle established in art. 2433, which forbids the distribution of non occurred revenues, comes violated.

In particular, art. 6 of the decree establishes that companies that draw up their financial statements according to IAS/IFRS cannot distribute:

a) profits arising from the application of fair value criterion;
b) equity reserves allocated in correspondence with fair value evaluations.

All profits indicated by letter *a)* are allocated in a non-distributable reserve, in turn. If profits of that period are not enough to “full” all fair value reserves, these must be “filled” with other distributable profits, even coming from other distributable reserves. In absence, no profits can be shared. Obviously, if evaluated profits are realized, i.e. by sailing the corresponding asset, the reserve can be proportionally reduced. The fair value reserve cannot be used for other scopes described in par. 4 and 5, such as capital increase.[97]

[97] According to par. 4 and 5 of art. 6, these reserves are also unavailable for: distributing dividends by related shares; being computed in the legal amount of shares indicative to buy treasury shares, subsidiary shares, or even to distribute shares to employees or founders and promoters. They can be used to cover losses only if all other reserves, including legal reserve, are not enough at this aim.

2.6. UNSOLVED PROBLEMS: THE (IN)COMPARABILITY

The decision of having extended the IAS/IFRS to annual accounts, either compulsorily or electively, has been criticized by Italian literature[98]. This choice, in fact, has been partially counterproductive, non only because of accountable costs increase upon operators, but also because it has negatively weighed on comparability, which is one of the most important aims of IAS/IFRS introduction, as underlined by the *Framework*[99], too. The difficult to compare statements is noticed on two levels: the internal one and the external one.

By the internal side, it can happen that different companies operating on the same market have chosen two different ways of accounting[100]. It means that the first one records its assets on the base of historical cost and the second one records the same items by fair value. Two equal economic situation will result different, only as a consequence of two different adopted accounting methods, without caring about comparability.

The same can happen by the external side. The real aim of IAS/IFRS is to let enterprises compare their statements with other EU State enterprises' ones, if they operate on the same market: what if an Italian enterprise has adopted IAS/IFRS for its annual account, but foreign enterprise has adopted its local accounting rules, because its State does not allow the use of IAS for annual accounts? There is no comparability, in this case, either.

In conclusion, the Italian choice has surely been brave, but the whole comparability requires a deeper nationwide harmonization of accounting rules, which now is still far from being realized.

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[98] L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 79.

[99] IAS Framework, par. 24: "The four principal qualitative characteristics are understandability, relevance, reliability and comparability." Par. 39: "Users must be able to compare the financial reports of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial reports of different entities in order to evaluate their relative financial position, financial performance and cash flows. "

[100] It happens with two big Italian enterprises operating on the oil market: Eni (which is IAS adopter) and Esso Italiana (which is not IAS adopter). L. DE ANGELIS, *Elementi di diritto contabile*, cit., p. 79.

CHAPTER 3 - TAX ACCOUNTING: THE RELATIONSHIP BETWEEN TAX AND COMMERCIAL ACCOUNTING

3.1. FROM COMMERCIAL LAW TO TAX LAW: THE PRINCIPLE OF DEPENDENCY

Italian accounting rules have a direct tax relevance. In fact, Italian law[101] establishes a strong link between financial reporting duties and companies' taxation.

Italian most important law concerning taxes is the decree 917, enacted in 1986, here and after Income Tax Act. In Italy only law can provide for tax provisions, according to art. 23 of Italian Constitution, which establishes that "personal and monetary obligations can be imposed only by law". This provision requires that the law provides for fundamental elements of a tax[102], such as individuation of taxpayer, taxable base and tax rate. The detailed aspect of the tax can be even established by regulation or other acts which are hierarchically sub-ordered to law, such as many regulations of Ministry. Considering the strong link between tax and accounting rules, it is necessary to refer to accounting principles and criteria and to their OIC interpretation, either. They have indirect relevance herein.

As we know, according to the national principles, the accounts drafting is based on key criteria of prudence, represented by "Historical cost" as insurmountable barrier in evaluation of assets and operating asymmetrically by setting out only the occurred positive components and even potential negative components, on the contrary. Therefore, it is natural that the accounts have been used as the basis of taxable income in accordance with the principle of ability to pay, as the most objective description of the produced wealth[103]. Anyway, tax discipline requires any adjustments. It is not a contradiction, since all tax variations are aimed to expunging or limiting the relevance of tax components of evaluative nature, and this for obvious reasons of legal certainty in the tax ratio.

Starting from general tax principles, this link is in evidence, already.

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[101] For an historical picture, G. TINELLI, *Commentario al Testo Unico delle imposte sui redditi*, Padova, 2009, p. 661.

[102] In fact, it is a relative statutory reserve. I. MANZONI, G. VANZ, *Il diritto tributario,* Torino, 2008, p. 27.

[103] G. FALSITTA (and others), *Commentario breve alle leggi tributarie*, Padova, 2011, p. 408.

The main company income tax principle is established in art. 83 of the Income Tax Act. According to it, the taxable income is determined by increasing or decreasing the amount of the profit or loss, as resulting by the income statement, in appliance of tax criteria as defined by tax law provisions. This rule is known as *principle of dependency*[104]. In other words, the result of income statement does not fully constitute the companies' taxable base. It is necessary to make some adjustments to it, both temporary and permanent, resulting from different relevance of items[105] in tax law rather than in commercial law.

To summarize, the calculation of the taxable income can be divided in three steps[106]:

a) first of all, the profit or loss must be calculated by applying commercial accounting rules;
b) secondly, tax provisions which evaluate items differently than commercial criteria must be applied to all relative items and transactions occurred in the accounting period;
c) then, once a difference has come out, it is necessary to correct the statement result in the income tax return, by making as much increasing and decreasing adjustments as all noticed differences.

An increasing adjustment can occur if a deduction from income statement is not totally or partially allowed as deduction from taxable base, or even if a taxable item is not recorded as a positive income item in statement. The opposite happens with decreasing adjustments. The adjustments are so many that the statement result always comes fully adjusted in tax return. Therefore, this rule is better known as *partial-dependency principle*[107].

The mechanism of adjustments gives the possibility of respecting both tax and commercial law, even when the two systems provide for different way of

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[104] F. ROCCHI, *Accounting and taxation in Italy,* in *Eur. Acc. Rev,* 1996, p. 981.

[105] I. e., art 109, par. 2, establishes the accrual principle in tax income, which is different from accrual principle provided for by commercial law. For its description, see chap. 5.

[106] G. FALSITTA, *Manuale di diritto tributario*, Padova, 2010, p. 289.

[107] A part of Italian literature hopes that legislator will opt for the perfect congruence principle, repealing all differences between commercial and taxable income. Among others, M. DAMIANI, *La rilevanza fiscale delle scritture contabili e del bilancio,* in *Corr. Trib*., 2007, p. 3752. Anyway, a pure coincidence would ignore any other tax matters, such as double taxation. E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

evaluation or classification of items. In fact, tax law does not interfere with accounting reports, since the adjustments are made directly on the tax return, and the financial statement is (or better should be, as described in this chapter, at paragraph 3.1.3) autonomous from any tax influence[108].
To understand the aim of the principle of dependency, another provision must be taken into consideration. It is the art. 109, par. 4., of Income Tax Act. This provision establishes that no costs are deductible by tax basis if they are not recorded as costs in income statement. Differently from what is provided for in case of revenues (which are tax relevant even if they are not recorded in the income statement, by art. 109, par. 3), costs can concur to decrease the taxable base only if they have reduced the commercial income, yet.
Italian legislator has refused the one-track system, even if the taxable income is still linked to the commercial one. It has preferred to link tax return and income statement, without requesting their perfect congruency. In lack of congruency, adjustments to the income statement are required.
The reasons of this difference between tax and commercial income are several. In any cases, the need of certainty and precision in evaluating the tax components has induced tax law to establish specific rules which commercial law does not provide for. In other cases, tax law does not want to leave to operators any margins of discretion in evaluating tax components, since they could apply them at the only scope of paying less taxes, in the detriment of the true and fair commercial evaluation[109]. Anyway, one of the most important aims of tax law is avoiding that profits are distributed as dividends before having being taxed in the hands of the company. This would happen if the commercial income was higher than the taxable one and it would damage Treasury revenues, by cutting out a piece of taxable base. The provision at art. 109, par. 4, is aimed to prevent it, indeed. In fact, if no costs are deductible by tax basis if they are not recorded as costs in income statement, it means that no decrease on the taxable base are possible without a previous decrease of commercial (and then distributable) income[110].

[108] G. TABET, *Il reddito d'impresa*, Padova, 1997, p. 45.
[109] G. TINELLI, *Commentario al Testo Unico delle imposte sui redditi*, cit., p. 665.
[110] This is the traditional literature theory. G. TABET, *Il reddito d'impresa*, cit., p. 95.

3.1.1. ADJUSTMENTS TO THE RESULT OF THE INCOME STATEMENT

The principle of dependency is better defined as principle of partial-dependency because the bottom line of the income statement does not coincide with the taxable base. In fact, to calculate the taxable base it is necessary to make all adjustments to income statement which are provided for by tax law. If all tax and commercial criteria of evaluation and classification had bees exactly the same, no adjustments would have been necessary, in tax return. In this case, a full-dependency would have been applied, which is even called a one-track system[111]. Since tax and commercial rules are not exactly coincident, these adjustment correspond to those criteria of evaluation or classification which differ in the two systems.

Adjustment to income statement are not equal to each other: they have different characteristics and different effects[112].

Some adjustments are *permanent*, since they are expression of different evaluation of the same item by tax and commercial law. It means that, if such an item is recorded in accounts, a tax adjustment will be always requested. It is the case of items which are totally or partially not deductible from tax base, even if they have been recorded as costs in income statement.

One of the main examples is the provision of art. 109, par. 5, which forbids the tax deduction of costs which are related to activities which generate tax free profits. If these costs have been deducted in income statement, a proportional increasing adjustment is requested, upon taxable income.

Anyway, adjustments can even derive by taxable revenues which are not recorded in the income statement. It happens, i.e., with self-consumption of goods, which generate revenues or capital gains, depending on the tax classification of the good[113]: they request an increasing variation, since they are relevant only under tax law.

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[111] E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

[112] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 290.

[113] Articles 85 and 86 of Income Tax Act respectively provide for revenues and capital gains. The same economic operation can generate the ones or the others, depending on the good interested in. In fact, produced goods, semi-worked goods, goods which are bought to be immediately used or re-sold and non-fixed financial instruments generate revenues. All others generate capital gains.

Some other adjustments are *temporary*. They depend on the possibility for companies, expressively provided for by law, of choosing a way of tax deduction which is coincident with the one already applied in economic statement, or either a different one. Only in this second case, an adjustment will be necessary. It often happens with depreciating rules. For instance, the company can choose to depreciate advertizing costs over a period which cannot be longer than five years[114]. According to tax law[115], this cost must be all deducted in the first period, or, as only alternative, it can be deducted from tax basis in a systematic manner, over exactly five tax periods (neither more nor less than five years). It means that, i.e., if directors choose to depreciate advertizing costs in three years, tax deduction and economical deduction cannot coincide, at all. Supposing that on the income tax return the company opts for deducting them all in the first tax period, a decreasing adjustment in this first period economic statement result is requested, in proportion to cost rates which have been accounted in the following two periods; on the opposite, an increasing adjustment is necessary upon these other two periods' results, correspondently to the accounting rates which must not be considered as deductions on the tax base (since they have both been considered as tax negative components in the first period, already).

All these cases are example of the sense of tax adjustments to income statement results. In fact, in all these cases the taxpayer could choose to deduct costs in the tax period in which the deduction is more advantageous, and tax law wants to avoid it, indeed.

This aim is clear in matter of provisions, too. Law provides for the *principle of typicality*[116] of deductible provisions[117]: it means that only provisions which are expressively provided for by tax law can be deducted by taxable basis, independently on all provisions which have been recorded in the income

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The difference is relevant since art. 85 and 86 provide for rules which are different from each others.

[114] Art. 2426, par.1, n.5), cc.

[115] Art. 108, par.2, of Income Tax Act.

[116] E. DELLA VALLE, *Riflessioni in tema di accantonamenti per rischi e oneri fiscalmente riconosciuti*, in *Riv. Dir. Trib.*, 1994, p. 327.

[117] Art. 105, 106 and 107 of Income Tax Act,

statement[118]. This outline gives a restricted possibility of deducting provisions, in order to avoid that they are recorded in accounts only in order to reduce the company's taxable basis and to pay less taxes, since this behavior would damage Treasury revenues. It means that an increasing variation is required for those recorded provisions which are not tax deductible.

3.1.2. THE LINK BETWEEN RECORDED COSTS AND DEDUCTIBLE COSTS

As underlined in the first paragraph, tax law and commercial law are independent one each other. Anyway, the art. 109, par. 4, of the Income Tax Act provides for a direct connection between commercial and tax deduction of costs[119]. This provision establishes that no costs are deductible by tax basis if they are not recorded as costs in income statement. There are two exceptions to the rule: in fact costs can be deducted anyway if a specific provision provides for this (as in the case of art. 100 of Income Tax Act, about donations to institutions, associations, committees, foundations, etc.) and if the cost has already been recorded in previous income statements even if its tax deduction has been postponed (such as art. 108, about advertizing costs).

As underlined in par. 1, the link between accounting deduction and tax deduction has an important aim. It wants to avoid that non taxed profits are distributed. Anyway, interpreting this provision, we can even observe that legislator wants to be sure that the cost has been really sustained by the company before giving it the possibility of reducing the taxable basis by deducting it. For this reason, it requires the previous deduction in the income statement. In fact, the tax deduction is surely a tax advantage, since it reduces the taxable basis and, as a consequence, even the tax that must be paid. The recording of the cost in the income statement acts as an insurance that the cost has been really sustained[120].

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[118] The company can record provisions for all future risks and charges whose occurrence is certain or probable, but whose timing and/or amount are uncertain. Future liabilities which are only possible to occur must be just indicated in notes on the accounts.

[119] E. NUZZO, *Esegesi delle norme in tema di documentazione delle componenti negative del reddito di impresa*, in *Dir. Prat. Trib.,* 1987, p. 937; M. DAMIANI, C. RICCI, *Inquinamento fiscale del bilancio e potere di sindacato del fisco sulle valutazioni civilistiche,* in *Corr. Trib.* 2008, p. 857; G. TINELLI, *Commentario al Testo Unico delle imposte sui redditi*, cit., p. 663.

[120] G. TABET, *Il reddito d'impresa*, cit., p. 99.

This interpretation is confirmed by the same article at the letter b). This provision gives the possibilities of deducing even non recorded costs, if they are related to non reported revenues came out after a tax assessment. Anyway, it is requested a certain and precise proof to demonstrate that these costs have been really sustained, just because they are not recorded in income statement and their occurrence needs to be proved otherwise.

3.1.3. FROM TAX LAW TO COMMERCIAL LAW: CONVERSE DEPENDENCY AND FISCAL POLLUTION OF ACCOUNTING

The link between commercial and fiscal reporting duties can have consequences even in the opposite sense: the tax treatment can influence the drawing of accounts. In these cases, the dependency principle overrules, turning into "reverse dependency"[121] principle.

It happens when annual accounts bend to tax law and represents an overturning of the principle of dependency. In fact, it induces the operator to record an item in a way better than in another just because this accounting behaviour has a positive effect upon tax duties. This behaviour inverts the logic meaning on principle of dependency. The tax income depends on the commercial income, because this last is the most reliable representation of a company's wealth. If the reverse happens, tax evaluation could compromise own accounting rules and scopes, firstly its clearness, truth and fairness[122].

Even the provision at art. 109 par. 4, forbidding to deduce a cost which is not recorded in the economic statement, could influence the way of recording costs, so that directors will consider fiscal implication of costs recording, even forgetting accounting typical scopes and specific rules. This phenomenon is known as "fiscal pollution of accounting"[123] and expresses the risk to violate or elude commercial accounting principles and criteria, the general clause in particular, only to obtain fiscal reduction or to spread the tax burden on the base of the company convenience.

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[121] G. FALSITTA (and others), *Commentario breve alle leggi tributarie*, cit., p. 410.
[122] G. FALSITTA (and others), *Commentario breve alle leggi tributarie*, cit., p. 410.
[123] M. DAMIANI, C. RICCI, *Inquinamento fiscale del bilancio e potere di sindacato del fisco sulle valutazioni civilistiche,* cit., p. 857.

This can happen, in particular, with evaluation and depreciation of assets, because these operations imply a certain degree of discretion. In order to avoid this, Italian law had introduced the possibility of deducting by tax non accounted costs, in particular depreciation rates, on condition that they were indicated in a specific document. This provision has been repealed[124] in 2008[125]. The law change has surely simplified the calculation of the tax base and reduced the taxpayers' compliance costs. Anyway, it poses again a lot of problems in matter of fiscal pollution of accountings and, consequently, of power of tax inspectors in controlling the application of accounting rules[126]. In fact, in its substitution, tax inspectors have now the power of denying some costs' deduction if it does not have a proved economical reason. Maybe this power will be strictly used[127]: it brings with itself another important matter, that is the possibility, for tax inspectors, of inspecting accounting rules application[128] in their commercial sense. In particular, tax inspectors can refuse deduction of depreciation rates, provisions and other evaluation costs if they are not justified by the economic substance of business operations in previous accounting periods[129], unless a contrary evidence provided for by the taxpayer. In most cases tax inspector does not need to fall back upon the accounting rules, because most of items find an alternative regulation in tax law, which inspectors can refer to, in assessment. If it is not possible, the only way of denying tax payer's behavior is objecting to commercial law appliance. This problem is even worse in case of flexibility of commercial norms, since tax inspector have high margins of discretion, and it could entail higher conflicts. Italian literature[130] objects this praxis, but Italian legislator in any cases (as shown in the example among) consents it.

[124]It has been repealed in return for a tax cut, as if it was a tax relief. Literature underlined that the provision was not a relief but a systematic rule introduced with the intent that it could avoid fiscal pollution of accounting. . FALSITTA, *Manuale di diritto tributario*, cit., p. 404.
[125] Law 244/2007 has provided for it.
[126] M. DAMIANI, C. RICCI, *Inquinamento fiscale del bilancio e potere di sindacato del fisco sulle valutazioni civilistiche,* cit., p. 857.
[127] M. PROCOPIO, *Il reddito d'impresa e la sua progressiva armonizzazione con il principio di dipendenza*, in *Dir. Prat. Trib,* 2007, p. 1129.
[128] M. DAMIANI, C. RICCI, *Inquinamento fiscale del bilancio e potere di sindacato del fisco sulle valutazioni civilistiche,* cit., p. 857.
[129] L. 244/2007, art. 3, par. 2.
[130] M. DAMIANI, C. RICCI, *Inquinamento fiscale del bilancio e potere di sindacato del fisco sulle valutazioni civilistiche,* cit., p. 857., . FALSITTA, *Manuale di diritto tributario*, cit., p. 405.

3.2. TAX AND COMMERCIAL LAW: DIFFERENT SCOPES FOR DIFFERENT SYSTEMS, REJOINED UNDER THE *ABILITY-TO-PAY* PRINCIPLE

The link between income statement results and taxable income depends on the fact that accounting is the most detailed and precise instrument in order to calculate a company's wealth, since its drawing up is fully regulated, in principles and criteria, by commercial law. It means that income statement is not only *a proof* of economic results, which taxable income calculation must be referred to. It c*onstitutes, on its own, the instrument to calculate taxable base,* so that it must be adjusted only if this is expressively established by tax law. This way, Italian legislator attributes to financial statement a public function, too, to be added to all other private functions that reporting duties already have for a company. Anyway, we need to analyze, again, aims of commercial and tax system, in order to better understand the role of financial instruments in calculating companies' tax basis.

Differences between economic and taxable income depend on various causes. First of all, we must consider that commercial and tax sets of rules have different scopes. Commercial accounting primarily set self-assessment, information and organization goals[131]. Tax provisions are established to secure equitable and even sufficient contributions from taxpayers, instead, and their leading principle is *certainty*[132] of relations between taxpayers and tax administration, even to reduce the opportunities of contention or litigation. With regards to this, we must consider that, in any cases, accounting evaluation involves a certain degree of discretion. Depreciation is an example, since directors choose how to spread the cost of depreciated assets over more periods, depending on the evaluation of the good's economic life. This flexibility in economic choices cannot reflect on tax returns, because the certainty principle forbids it. For this reason tax rules define the relevant amount of these costs in details. Depreciation rates of fixed assets[133], i.e., are deductible in respect of rates which are defined by a Treasury Minister decree[134]. Or even, representation costs[135] are deductible in proportion to

[131] See chap. 1.
[132] Even art. 109, at par 1, establishes, as general principle, that revenues and costs are tax relevant only if they result from certain and precise elements.
[133] Art. 102, par. 1, Income Tax Act.
[134] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 276.
[135] Art. 108, par.2, Income Tax Act.

revenues, if they fulfill the requirements of inherence and adequacy established by a Treasury Minister decree, in order to avoid that any costs occurred for self-interests reduce the taxable basis.

Moreover, tax law, unlike commercial one, is deeply connected to national interests, such as political matters. Tax relevance of profits and losses can encourage or discourage certain types of investments and transaction, by allowing a tax relief on income items resulting from activities that law wants to incentivize.

Nevertheless all these differences between the two systems, tax legislator considers that accounting rules are the most precise method, in order to calculate companies wealth. This is why it establishes a link between tax and commercial system in order to apply, in case of companies, the *principle of ability to pay.* The principle at issue, provided for by art. 53 of Italian Constitution, establishes that taxes should vary according to an individual's level of wealth or income. It attempts to reduce the tax burden of people with a lower ability-to-pay, too. The company is a perfect legal entity, on its own, since it can be in legal relationships with other entities, either collective or individual. It has rights and duties upon itself, since it can be defined as the legal owner of wealth that it produces[136]. This is why a company has its own ability to pay, regardless of its shareholders, which are different legal subjects with different respective abilities to pay, too. Accounting rules, as inspired to principles such as truth, fairness, clearness and others, seem to be the most precise and trustworthy ones to refer to in order to calculate a company's increase or decrease of wealth, that must be calculated as much exactly as possible to avoid that the constitutional principle at issue comes violated. Moreover, accounting in Italy is based on historical cost principle, which excludes flexibility and non occurred revenues to concur to taxable base[137].

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[136] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 241.

[137] The individual ability to pay upon companies can also create the problem of economic double taxation on dividends, since the same flow of income is taxed twice, in the hands of the company, before, and of the shareholder, after. Italy has adopted, as all European Union States, the exemption method (it has been introduced in 2004 in substitution to the credit method) in order to relieve it. According to this method, the dividend upon the shareholder is partially excluded by taxation (the exclusion amount is 95% of dividend if the shareholder is a company in turn. If the shareholder is a physical person, the exclusion regards the 50,28 % of dividend) . This rule is also extended to dividends which have their source abroad, with the only exception of companies residing in tax shelters (according to art. 167, par. 5 b) of the income tax act, in this case the shareholder can ask to tax administrators to apply the 95% exclusion anyway, by giving proof that there are no tax avoidance effects), in which case no exclusion is allowed since law considers no

3.3. GROUP CONSOLIDATED ACCOUNTING AND ITS IRRELEVANCE FOR TAX PURPOSES

Italian law does not consider groups as perfect legal entities. Anyway, it considers that companies' business is influenced by their inclusion in a group. In fact, relations between parents and subsidiaries are specifically ruled in Italian civil code[138].

Tax law does not ignore this phenomenon and provides for a specific regulation, too, providing for consolidated tax return. Three precisions need to be underlined in matter.

First of all, there is no coincidence between group and tax consolidated undertaking. In fact, the area of groups is wider than the consolidating area, since this last requests an high control by parent upon its subsidiaries to be applied (at least 50% of equity shares and 50% of profit shares). Moreover, commercial accounting rules are considered to be too complex to reveal even for tax matters[139].

Secondly, there is no coincidence between commercial consolidated undertaking and tax one. The two different instruments have different aims, conditions and rules and they are linked to each other in no way. Consolidating accounts have commercial aims, in particular it aims to give information about the economic wealth of the group, as a whole. Consolidated tax returns have tax scopes, in particular they are aimed to make advantageous (and disadvantageous) tax positions of individual companies reveal in the whole consolidated income for their compensation.

Finally, it is important to underline that the group is not a taxable legal entity[140], on its own. Tax law provides for specific rules that can be applied to groups, in order to give relevance to this particular link between companies. Anyway, it is

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double taxation existing, because, in tax shelters, tax burden is very low, so dividend is taxed, in practice, only in the shareholder's hands. The same happens with capital gains, even if, in this case, other requirements are needed to apply the tax exemption (see chap. 4).

[138] Art. 2497 and following of civil code.

[139] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 525.

[140] This consideration can be valid for both commercial and tax consolidated undertakings.

still far from accepting the conduit theory: the parent and its subsidiaries are separate entities, with individual tax duties and rights[141].

That being stated, in Italy a parent undertaking, having some conditions, can draw up a comprehensive tax return that encompasses other entities' returns. It is filed both for simplicity and to allow the parent organization to receive tax benefits that may otherwise be forfeited. However, this instrument is elective. We can find two different kinds of consolidated tax returns. The *domestic consolidated tax regime*[142], ruled under Articles 117 to 129 of the Income Tax Act, can involve only controlled companies which are resident in Italy. Non-resident controlled companies cannot be included in the domestic consolidated tax regime, but may only opt for the *worldwide consolidated tax regime*[143] set out in Articles from 130 to 142 of the Income Tax Act.

In both domestic and worldwide regimes, the parent have return, settlement and payment duties on global income tax[144]. As specified above, this does not mean that the group, on itself, is a legal tax entity. Anyway, consolidated return has its

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[141] M. VERSIGLIONI, *Indeterminazione e determinabilità della soggettività passiva del "consolidato nazionale*", in *Riv. Dir. Trib,* 2005, p. 389.

[142] The parent can opt for it with each one of its subsidiaries if it holds over 50% of its subsidiary's equity interest and a profit share of over 50%. Not resident parent companies can opt for consolidated taxation in Italy, too: in such cases, however, the parent must be resident in a country which has stipulated a tax treaty with Italy and must also carry on business activities in Italy through a permanent establishment, to which the participation in the tax-consolidated subsidiaries is effectively connected. Controlled companies must all be resident, instead. The overall consolidated taxable income is the amount of all companies' income, which is totally considered *independently on the amount of the profit share percentage*. The same happens with tax losses, with a specification: tax losses arising prior to the election of consolidating taxation may only be offset against the taxable income of the individual company which generated them. Tax losses incurred after the election may be offset against the consolidated taxable income.

[143] In this case, the parent company must be a listed on as an alternative controlled by the State, by a public entity or even by a physical person who does not control another resident or no resident company and commercial entity residing in Italy. The percentages of holding are the same than the domestic consolidated regime, but any other rules are different. In fact, the subsidiaries' income is included into the consolidated taxable income *in proportion to the amount of the profit share percentage.* This regime is based on the *'all-in all-out'* approach. Companies of the group that fulfill the requirements have to be consolidate, so that the parent cannot chose to consolidate only some subsidiaries among all. This provision aims to safeguard tax coherence and Treasury's reasons. In fact, if this limitation was not disposed, every parent would consolidate only losing subsidiaries, in order to reduce global income. This way, Italian Treasury would suffer non-resident losses (since these reduce the taxable base end even the amount of tax to pay) without benefits coming from non-resident revenues. Even in this case, only tax losses incurred after the election may be offset against the consolidated taxable income. Tax losses arising prior to the election are relevant only upon individual companies.

[144] In the domestic regime, all companies draw up their own returns and send them to the parent, which works on global income return. In the worldwide regime, instead, only parent draws up the return, since all subsidiaries are resident abroad and know and apply tax rules provided for by their respective States.

advantages[145]: mainly, it gives the opportunity to give tax effects to the losses of companies[146] in the group and to transfer benefits among companies, either.

[145] In 2008, other advantages provided for have been reaped (i.e., total dividends exclusion).

[146] A specific transitional rule has been introduced: if, in the 10 fiscal years preceding the option, a holding company recorded writedowns (which were deductible under the former rules) on shareholdings in group companies, a fiscal value adjustment is requested, in order to prevent a tax benefit from being granted twice: a first time with the deduction of the writedown in the hands of the parent company, and a second time when the cost becomes deductible, once that subsidiary's income and losses are included in the tax consolidated regime.

CHAPTER 4 - TAX ACCOUNTING: THE RELEVANCE OF IAS/IFRS

The impact of IAS/IFRS on tax matters has been very relevant, in Italy. This depends on two factors, at least.

First of all, Italy made a wide use of IAS/IFRS, not only by extending their appliance to a great number of enterprises, but most importantly by extending IAS accountancy to annual accounts, too. In fact, if IAS/IFRS had been applied to consolidated accounts only, they would not have had any tax relevance, since these accounts are linked to tax basis calculation in no way[147]. By the other hand, the choice of extending them to annual accounts directly involves tax matters.

Secondly and consequently, the more accounts are linked to tax base, the more applied standards are relevant in calculation of taxable income. In Italy, principle of dependency makes this link very strict: it implies that IAS/IFRS relevance is a direct tax matter, as well as a commercial one.

Moreover, we cannot forget that the importance of the matter also depends on the aims of IAS accounting, which are less compatible with fiscal aims than national accounting ones. In fact, IAS scope is not protecting the integrity of corporate assets, but guaranteeing the comparability of financial results, in order to give correct and objective information to investors. In this sense, they are not inspired to prudence, by giving also the possibility for discretional or arbitrary choices, on evaluating bases. Cornerstones of this new structure are the fair value criterion and the substance over form principle.

That being stated, it is possible to comprehend the attention of Italian tax legislation to IAS/IFRS.

4.1. THE IMPACT OF IAS/IFRS ON THE TAX BASE: PROGRESSIVE LAW CHANGES

Italian law approach about the impact of IAS/IFRS on the tax base has deeply changed, in time.

At the beginning, it tended to *neutrality* towards IAS/IFRS accounting. In 2005, the legislator cared for fiscal matters in the same decree[148] that regulated

[147] As shown above in chap. 2.
[148] The decree 38/2005.

IAS/IFRS commercial adoption. The decree, at art. 11, established any adjustments to the decree 917/1986 (Income Tax Act), that could be summarized in two rules.

First of all, art. 11, lett. a), of decree 38/2005, by modifying the art. 83 of the Income Tax Act, imposed increasing or decreasing variation of the bottom line of income statement, for items which were directly recorded in balance sheet (without influencing the economic statement) in appliance of IAS/IFRS rules, on companies adopting these standards.

Secondly, the same decree of 2005 imposed to IAS adopters all adjustments to income statement which were established for no-IAS enterprises. We could say, in brief, that IAS adoption was tax neutral[149]. In fact, the link between IAS financial accounting and taxation was so weakened that every reference to the principle of dependency was senseless[150], for IAS adopter enterprises: all these numerous and complex adjustments[151] caused the lack of congruence between accounts and tax reports. As a result, the IAS/IFRS adoption revealed a disadvantage, in terms of additional burdens and costs of accountancy, compared to the choice (if and when a choice was possible) of continuing to adopt national standards. The only positive consequence, that had fully inspired this legislative approach, was the removal of every difference in terms of ability to pay, between IAS and no-IAS enterprises: their taxable income was not influenced by the choice of the adopted accounting standards, since all differences, which came out above all by the appliance of historical costs criterion, in national standards, and fair value criterion, in international ones, became tax irrelevant further to fiscal adjustments which fully neutralized them, even remaining relevant for commercial aims[152].

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[149] G. ZIZZO, *L'IRES e i principi contabili internazionali: dalla neutralità sostanziale alla neutralità procedurale*, in *Rass. Trib.,* 2008, p. 316.

[150] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 28.

[151] These adjustments were so numerous and complex because of the deep difference between national and international standards, above all determined by the use of substance over form principle and fair value criterion, fundamental for the latter ones and nearly irrelevant for the latter ones.

[152] G. FALSITTA (and others), *Commentario breve alle leggi tributarie*, cit., p. 411.

Anyway, according to economic operators and doctrine[153], this last advantage was considered otherwise solvable and even too weak to offset the huge compliance costs upon IAS adopters. The system in force was deemed an unacceptable penalization for them. Italian government took into consideration this unease and, after having weighed up all proposals of solution[154], in late 2007 opted for the adoption of principle of dependency even for IAS/IFRS accounts, in a manner that will be described in the following paragraph.

4.2. THE CURRENT LEGISLATIVE APPROACH: THE GENERAL PRINCIPLE FOR IAS/IFRS ADOPTERS, AS A DISPENSATION TO THE SYSTEM PROVIDED FOR NO-IAS/IFRS ADOPTERS

The law 244/2007 adopted a new approach towards IAS/IFRS relevance in tax matters. As clearly exposed by art. 1, par. 58, this law agreed with the simplification of the compliance process and the reduction of its costs, by decreasing the great number of adjustments which were compulsory before, and by giving tax relevance to international standards principle of substance over form. Law provision have been specified by the decree 48/2009, which is more precise about the disposition field and its limits, and by various Revenue Agency circulars[155]. At the same aim, has been approved the recent decree 134/2011.

The law of 2007 modified the art. 83 of Income Tax Act, again. The paragraph which imposed all the off-set adjustment was abrogated and a new disposition was introduced, in place of it. This new rule establishes that, for those enterprises which prepare financial statements according to IAS/IFRS, the criteria for *qualification, classification and allocation in time* which those standards provide for are applied even for calculation of the tax base, *notwithstanding any contrary provisions established in the Income Tax Act*. In other words, all these IAS principles have become completely relevant for the calculation of IAS adopters tax basis since they are not more neutralized by all the off-set adjustments that

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[153] G. ZIZZO, *I principi contabili internazionali nei rapporti tra determinazione del risultato d'esercizioe determinazione del reddito imponibile*, in *Riv. Dir. Trib.,* 2005, p. 1178.; G. FALSITTA, *Manuale di diritto tributario*, cit., p. 28.

[154] For a wide description of the potential solutions, M. VENUTI, *Measuring company income tax on the basis of the international accounting standards/international financial reporting standards (IAS/IFRS): the Italian case*, *Riv. Dott. Comm.*, 2011, p. 161.

[155] The last one is the circular 7/E of 2011.

were in force before. Moreover, as we know, if some of tax dispositions establish criteria of qualification, classification and allocation in time which are different by the national criteria which regulate the same subject, tax law imposes adjustments to economic statement result. In IAS cases, instead, the IAS principles prevalence is specifically ruled out, by the provision at art. 83 of Income Tax Act, indeed. There is not automatic prevalence of tax criteria over IAS/IFRS, so that only a specific dispensation could ensure it. The main example is in matter of accrual. In fact, the criteria to individuate when an element concurs to taxable income prevail on national accounting diverging criteria, as established by art 109[156], par. 1 and 2, of the Income Tax Act. In case of IAS, on the contrary, this prevailing is excluded, just because IAS criteria are applied "notwithstanding any contrary provisions established in the Income Tax Act".

The upset is radical: in fact, before 2007 the link between IAS revenue and tax base was so weak that Italian doctrine excluded the application of principle of dependency in case of IAS/IFRS[157]. Nowadays, the tie between IAS accountancy and tax base calculation is so strict that we cannot simply talk about dependency, in general. In fact, Italian literature has emphasized this stronger link by relating it to the *principle of reinforced dependency*[158].

4.2.1. THE PARTIAL DISPENSATION: "QUALIFICATION, CLASSIFICATION AND ALLOCATION IN TIME"

The disposition about IAS accounts at art. 83 does not purely give relevance to IAS/IFRS principle and criteria. It clearly limits its effects to:

a) *qualification*
b) *classification*

[156] To summarize, the article specifies that, at fiscal aims, concur to taxable base only if they are certain in existence and reasonably determined in amount. Moreover, it specifically defines when sales of goods and services are considered as occurred, at tax aims.

[157] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 28.

[158] The reform of 2007 has abrogated the disposition that imposed increasing or decreasing variation of tax base for items which were directly recorded in balance sheet (without influencing the economic statement) in appliance of IAS/IFRS rules. Anyway, the decree specifies that this abrogation does not involves substantial variations. In fact, art. 2, par. 2, of the decree specifies that these elements still concur to compose the amount of the taxable income, if the component is tax relevant, according to Income Tax At. An adjustments to the bottom line of the income statement will be necessary, in these cases (E. ROSSI, *Soggetti IAS/IFRS. Qualificazione, imputazione temporale e classificazione in bilancio*, in *Sett. Fisc.*, 2009, p. 38).

c) allocation in time

which IAS/IFRS provide for. This is why the referring dependency is reinforced, but not total[159].

Anyway, a preliminary remark is necessary: *qualification, classification and allocation in time* which IAS/IFRS provide for are deeply different from the same criteria as meant by national standards, because they are all specific applications of the general *substance over form* principle. In fact, Italian literature has individuated mainly in this provision the legislative attempt to give tax relevance to this fundamental IAS principle, nevertheless it is not significant for national standards[160] and for tax law, either.

So being stated, a literal interpretation of the provision requires to full of meaning these three categories, in order to avoid a wider application of the dispensation, by ignoring legislative intents. The Revenue agency circular 7/E of 2011, at par 3.2 and following, specifies these concepts, each one in a very detailed way.

a) Qualification

The qualification of an economic operation consists in subsuming it under a juridical category. It is preliminary to the classification[161], which is the way of recording it in accounts and depends on how the operation has been qualified, indeed. They can be examined both together, since they can be considered two different aspects, the substantial one and the procedural other, of the same concept.

First of all, the IAS qualification and classification of an operation must show the financial reality of the transaction, rather than its legal form. All economical effects must be taken into consideration, without being bound by terms and content of the contract which formally qualifies and regulates them. It does not mean that the legal form must be totally ignored: it must simply be a reference,

[159] Revenue agency circular 7/E of 2011, par. 3.2.

[160] As underlined in the previous chapter, in case of national accounting standard the substance over form principle is provided for, but it is very restrictively interpreted. It is underlined even in E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

[161] Classification will be described in the following sub-paragraph.

useful to find out the economic substance of the transaction[162]. The main example[163] is the *leasing* case[164].

As even underlined in chapter 2, leasing is a contractual arrangement calling for the lessee (user) to pay the lessor (owner) for the use of an asset. According to IAS 17, a distinction is required. If the lease transfers substantially all the risks and rewards incidental to ownership, it is a *financial lease*. In all other cases, in which the lessor simply conveys to the lessee the right to use an asset for an agreed period of time, in return for a payment or series of payments and without indexes of transferred risks and benefits, it is defined as *operating lease*.

Internal law does not distinguish between financial and operating leasing, since they are both accounted with the patrimonial method. In particular, the lessor (owner) continues to record the asset it its balance sheet, by deducting depreciation rates. The lessee (user) only records the payments sustained against the right to use, by deducting it if they are inherent to the company's activity.

On the contrary, in IAS accounts[165] operating lease recording is identical to internal law method, but financial lease is recorded differently.[166] In fact, in this last case the leasing is qualified as the sum of a sale and a loan, as if the item had been immediately sold and paid in time, through the corresponding which are, formally ad juridically, defined as payments against the use. This means that the lessee (user), and not the lessor, records the asset in its balance sheet and depreciates it, by recording the interests paid to the lessor, too. This last records the value of the item plus the receipt interest, just as the item had been sold and the loan paid.

In tax return, the items, revenues and losses will concur to compose the taxable income exactly as they have been recorded in accounts. It means that, in no-IAS cases, the applied rule will be the art. 102, par. 7, of Income Tax Act, which imposes the tax depreciation of the asset to the lessor (owner) and the deduction

[162] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 284.

[163] For other examples, see Revenue agency circular 7/E of 2011, par. 3.2.1.

[164] E. ROSSI, *Soggetti IAS/IFRS. Qualificazione, imputazione temporale e classificazione in bilancio*, cit., p. 37.

[165] IAS 17 provides for leasing accounting.

[166] E. ROSSI, *Soggetti IAS/IFRS. Qualificazione, imputazione temporale e classificazione in bilancio*, cit., p. 37; P. MORETTI, *Finalità e destinatari di un bilancio IAS,* cit., p. 2593.

of paid rents[167] to the lessee (user). In IAS cases, this rule shall not be applied, since the IAS qualification of the operation prevails on it, in force of art. 83 of Income Tax Act. It means that the financial leasing shall better involve art. 102, par. 2, in matter of depreciation of fixed asset, since the asset is qualified by IAS as depreciable fixed asset upon the user, indeed. It also generates interests, which are totally absent in operating leasing, upon the lessor and the lessee, and they must be revealed in tax return by observing tax disposition which provide for interests[168].

The economical evaluation can occur even in reverse cases, that is when an operation - which could be considered tax realized because it has juridically happened - is not represented in the IAS-compliant financial statements (without producing, therefore, any tax or accounting effects): this is the case of the so-called "continuing involvement", when juridically transferred assets to third parties whose certain (and significant) risks and benefits are maintained continue to be recorded in the IAS account of the transferor. As the circular 7/E of 2011 specifies[169], it is also the case of financial instruments which are formally transferred to the purchase without the transfer of risks and economic benefits of the instrument, anyway (it happens, i.e., in case of equity swops).

The qualification of an operation or an item could also require the *combining* of more than one operations, or even the *segmenting* of sole operation which are, substantially, the sum of more ones. An example of combining is installment sale or sale against long lasting deferred payment. In this case, if the fair value of the good is lower than the nominal value of the receipt amount, it means that the difference between the two value represents the amount of interests which the deferment has generated. The whole operation, when qualified and classified, has to be divided in two different ones: a sale and a financial operation. From the tax law perspective, the amount referred to the good will be a revenue or a capital gain, depending on the nature of the good, and the plus-difference will represent

[167] For the lessee who records leasing rents in the income statement, the deduction is permitted provided that the duration of the contract is not less than 2/3 of the depreciation time; a specific rule is provided for in case of buildings.

[168] They are principally art 89, for receipt interests, and art 96, for paid interests, of decree 917/1986.

[169] At par. 3.2.2. of the circular.

the amount of occurred interests, subjected to the specific interests rules which tax law provides for.
The qualification, moreover, is relevant even in order to apply the IAS accrual principle[170], so this is the preliminary and most important element of the disposition. The example about sale of goods, at the following sub-paragraph, well explains the case.

b) Classification

As shown in the previous paragraph, the classification is the way of recording the assets in accounts. It depends on how the operation has been qualified, so it is strictly linked to the qualification. The IAS classification prevails on the Income Tax Act one, because it is expressively included in the reinforced dependency principle. Anyway, in any cases classification provided for by IAS/IFRS is not enough, because in certain cases tax rules are linked to the Italian tax law classification and they can be applied only with reference to this last.
In these cases, the legislator intervention is necessary, in order to reconcile the principle of reinforced dependency with the coherence of tax system, as a whole. It is what happened in matter of financial fixed assets, in case of participation exemption.
Participation exemption is a general term relating to an exemption from taxation for a shareholder on capital gains arising on the sale of shares. The justification for a participation exemption is to eliminate double taxation of shareholders. In fact, in any accounting period, the company pays the corporate income tax on its taxable income and the shareholder pays taxes on its own income. In absence of a participation exemption, shareholders pay taxes on the amount of capital gains arising on the sale of shares, and this results in double economic taxation, since the same wealth is double-taxed, in the hands of the company, before, and of the shareholder, than. A participation exemption avoids the taxation in the hands of shareholders, by exempting the capital gain, indeed.
Even Italy provides for participation exemption, at art. 87 of Income Tax Act. Anyway, some conditions are required. One of them is the classification of the

[170] L. MIELE, *Criterio della prevalenza della sostanza sulla forma e imponibile IRES per I soggetti IAS*, in *Corr. Trib.,* 2009, p. 346.

participation in financial fixed assets, in the first accounting period in which that participation is bought[171].

The problem is that IAS accounts do not provide for financial fixed assets. The IAS 39 classifies financial instruments into the following four categories:

- A financial asset or financial liability at fair value through profit or loss
- Held-to-maturity investments
- Loans and receivables
- Available-for-sale financial assets.

The IAS classification has caused any problems, in order to apply the participation exemption rule, because it was not clear which of these instrument had to be considered financial fixed asset. To solve the problem, the law 244/2007 has provided for a specific definition of financial fixed assets, without giving any margins of discretion: among the four categories of financial instruments provided for by IAS 39, only financial asset or financial liability at fair value through profit or loss shall not be considered as financial fixed assets. The other three categories are all considered financial fixed asset and permit the application of the participation exemption rule, if there are also all other required conditions provided for by art. 87 of Income Tax Act.

c) Allocation in time

The concept of *allocation in time* has given less problems of interpretation and application to Italian literature and economic operators. It is plainly referred to the choice of the moment in which an economic phenomenon gains accounting (and consequentially, IAS taxable) relevance. Formally, the dispensation could appear not much relevant, because national and international principles are both inspired to *accrual* principle. Anyway, as underlined in previous chapters[172], the meaning of this principle is very different, and this difference rebounds on taxable income[173]. Moreover, we must consider that accrual principle, as applied in tax

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[171] Other three conditions are required: a) the participation must have been owned without interruption since the first day of the twelfth month before the sale; b) the participated company must not reside in a tax shelter; c) the participated company must run a commercial activity.

[172] See chap.1 par 3 lett. b) and chap. 2 par. 3.

[173] E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

returns, is specified by art 109, par. 1 and 2[174]. So, in order to comprehend this difference, two steps are required.

First of all, we must consider that IAS criterion of *allocation in time* prevails on art 109, par. 1 and 2, because it must be applied *notwithstanding any contrary provisions established in the Income Tax Act*[175]. This predominance is also specified by decree 48/2009, whose art. 2 expressively says that "the provisions of Article 109, paragraphs 1 and 2, of the Income Tax Act, as well as any other provision about taxable income determination that is not in line with the substance over form IAS principle, shall be deemed as not applicable to IAS adopters".

Secondly, being stated that the accrual IAS principle is both economic and tax relevant, there is nothing more to do than applying it to accounting recording and then for tax income, too. It means that no adjustments on the bottom line of economic statement will be necessary, since the economic principle is identical to tax one.

An example can be represented by the sale of goods with buyback option at a price fixed in advance. If the property of good has been transferred and the good has been delivered, this sale is tax relevant according to the art. 109, par. 1 and 2, of Income Tax Act. This criterion is formal and juridical. On the contrary, if all the significant risks and rewards of ownership of the goods have not been transferred to the buyer, IAS 18 does not consider the property as been transferred. Therefore, the good will remain in the activities of the seller, who will record the price of buyback sale as an income, by considering the financial substance of the operation, and not its juridical form of sale. In this second case, the good will not stop concurring to the taxable base of the seller.

At this point, more precise information is needed. IAS criterion prevail on tax one only in case of "external accrual", or better when they are applicable to economic operation which are realized with third parties (i.e., sales of goods). They are not applicable in cases of "internal accrual"[176], or better when the choice of recording

[174] See chap. 5.
[175] Art. 83 of decree 917/86.
[176] G. FALSITTA (and others), *Commentario breve alle leggi tributarie*, cit., p. 412.

the item or the operation in one or more accounting period is offered to directors by tax disposition and depends only on internal discretion[177].

Moreover, IAS criterion is repealed by explicit dispensation on the basis on tax general interests or even coherence of tax system. This happens, in particular, with cash-basis provisions derogating the general accrual principle. I.e., compensations to directors, even in form of stocks, occur to decrease the company revenue according to cash-basis principle, since their taxation upon the director as personal income is cash-based, too. This way, at the same moment, it is negatively (upon the company) and positively (upon the director) tax relevant[178].

4.2.2. OUT OF THE DISPENSATION FIELD: EVALUATION, QUANTIFICATION AND EXPRESS EXCEPTIONS

The provision at art. 83 of the Income Tax Act only refers to *qualification, classification and allocation in time*. It does not expressively refer to evaluation, quantification or even spreading costs over periods, such in case of depreciation. By literally interpreting the disposition, it is possible to deduce that legislator denies the possibility of making reference to such IAS categories in order to calculate taxable income. This interpretation has been confirmed by decree 48/2009, whose art. 2, par. 2, establishes that " IAS adopters, anyway, are subjected to the provisions of the Income Tax Act about quantitative limits (or even prohibition in whole) to the deduction of negative components or even to provisions permitting the spread of the component over more accounting periods[179], as well as to those provisions which partially or totally exclude positive components from the taxable income and that establish cash-basis relevance of them[180]".

The reason of the norm is evident. This is a way of safeguarding the national tax yield[181] and the legal certainty, which inspires tax system. They are basic

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[177] These cases will be better analyzed in the following paragraph.

[178] E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

[179] I.e., depreciation is regulated in details by art. 102, 103, 104 and 108 of decree 917/86, which provide for limits to depreciation rates. These limits are compulsory for IAS adopters, too.

[180] I.e., interests on arrears, dividends, etc.

[181] In confirmation of this approach, art. 3, par. 1, of the decree 48/2009 establishes that also "the recognition for tax purposes of IAS qualification, classification and allocation in time criteria does

principles of tax legislation, which could be weakened if there was total discretion upon directors in choosing tax evaluation amounts. If so, i.e., a company could define depreciation rates only for tax purposes, by increasing this rate in an accounting period just in order to deduct it by taxable income. In conclusion, according to the legislator perspective, the protection of these fundamental principles has seemed more important than the necessity of reducing IAS adopters compliance costs. This is why these cases slip out of the principle of reinforced dependency and are still inspired to neutrality.

The problem, anyway, arises when it is necessary to distinguish "evaluation" criteria from "qualification" ones. In most cases, the decrees specifically refer to provisions and dispositions about evaluative operation, so solving the problem at its base[182]. In other cases, no specifications are provided for, so the definition of concepts is essential, in order to subsume the operation under the category of "evaluation" or "qualification". An example[183] is represented by credits with a very low interest rate, lower than the market rate. In this case, IAS substance-oriented accountancy requires to relieve in accounts the difference between the arranged interests and the (potential) market interest as a loss, upon the creditor, and as a revenue, upon the debtor. Is this the result of an evaluation, or of a qualification? If the latter was the answer, virtual interests would be tax relevant, through the provision of art. 83. This way, a saving (which is not an occurred revenue) upon the debtor, who has paid a less interests than those required by the market, and a lack in profit (which is not an income loss) upon the creditor, who has received less interests than the market ones, would concur in increasing or decreasing the respective taxable basis. Is it acceptable in a tax system as the Italian one, which is fully oriented to the ability to pay principle, the concurrence to taxable basis of "virtual" amounts of interests? The answer is not so foregone.

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determine, in any case, neither double deduction or no deduction of negative components nor double taxation or no taxation of positive components".

[182] Before its approval, doctrine opinions were very contrasting. Any of them opted for the application of art. 83 in any doubtful cases which was not expressively excluded by principle of reinforced dependency through law provisions. In other words, in their opinion neutrality operated only in expressly established cases (D. STEVANATO, *Profili tributari delle classificazioni di bilancio*, in *Corr. Trib.*, 2008, p. 3159).

[183] For this and other examples, L. MIELE, *Criterio della prevalenza della sostanza sulla forma e imponibile IRES per I soggetti IAS*, cit., p. 346; D. STEVANATO, *Profili tributari delle classificazioni di bilancio*, cit., p. 3158.

Anyway, the point at issue is upstream, and not downstream. If we consider it as a qualification, the IAS logic is allowed to influence taxable income in a whole, by accepting all its evaluating effects, because the upstream legislative choice is clearly in this way: the fair value principle and all its consequences have direct access in tax system, through the new art. 83 of the Income Tax Act.

Thus, it is important to define what an evaluation is and to distinguish it from qualifications. In order to understand it, the Revenue Agency circular n. 7/E[184] of 2011 expresses an important clarification. It specifies that the explanatory memorandum to the decree 48/2009 refers to certain cases[185] that are "evaluations", and which are subtracted to reinforced dependency principle at art. 83 of the Income Tax Act, which does not provides for them. The same happens with all those evaluations which are totally independent from a previous qualification: i.e., the qualification of an asset as fixed asset (by IAS/IFRS) does not necessarily involves its evaluation by fair value; the asset will be a fixed asset (if IAS establish it) but will be tax evaluated by its cost. To summarize, all evaluations which are listed in the circular and all evaluation which are totally independent by qualification of the asset are not included in art. 83 and their IAS accounting value has not tax relevance. In these cases, Income Tax Act rules are valid.

Anyway, the circular has made the doctrine realize that there is a second category of evaluations which are linked to qualification, classification and allocation in time, so being linked to the principle of reinforced dependency, too. In example, it is the case of financial leasing, whose evaluation is strictly linked to its financial/operative qualification. It happens whenever the recording in IAS accounts is different by the same in no-IAS accounts. In this case, the evaluation is strictly linked to the qualification, classification and allocation in time, this is why the rule provided for at art. 83 of Income Tax Act is applied to these kinds of evaluations, too, even if they are not named in the provision. Anyway, the respect of limits provided for by art. 2, par. 2, of the decree 48/2009, described above is

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[184] Specifically, at par. 3.3.

[185] In particular: valuation of assets under "revaluation model", at IAS 16; evaluation with the fair value criterion of fixed assets, at IAS 40; application of the method of impairment test, at IAS 36. In these hypothesis, the higher or lower value does not assume any relief for tax purposes.

always mandatory, even in case of evaluations depending on qualifications, since these limits can never be violated by IAS principles[186].

In conclusion and to summarize, evaluation which are not linked to qualification, classification and allocation in time are tax neutral, rather evaluation which are linked to them have tax relevance, through the provision at art. 83.

This specification in matter of evaluations has been useful to dispel most of the doubts casted by doctrine, but has not solved all application problems, as a whole[187].

4.3. THE STATE OF ART: MOOT POINTS AND OPEN MATTERS

The Italian choice of giving relevance to IAS/IFRS represents a revolution in tax domain, as well in commercial one. Italian doctrine[188] has noticed that this is the only case in which the Italian legislator has opted for the so called *"one-track" system*. It means that adjustments to income statement bottom line are so few that economic revenue and taxable revenue can be considered almost equal, since both of them are calculated in the same way and according to the same accounting rules, but some exceptions. This method ensures, with no doubts, a greater attention to the business factors, including the substance over form principle, which becomes relevant for tax purposes, too. Moreover, it reduces the huge burden upon IAS adopters in terms of compliance costs, removing the disadvantage they suffered before, in comparison with no-IAS adopters. Anyway, this choice brings with itself various moot matters, which have been noticed by Italian doctrine.

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[186] Art. 2, par. 2 of decree 48/2009: "IAS adopters are subjected to the provisions of the Income Tax Act about quantitative limits (or even prohibition in whole) to the deduction of negative components or even to provisions permitting the spread of the component over more accounting periods[186], as well as to those provisions which partially or totally exclude positive components from the taxable income and that establish cash-basis relevance of them".

[187] Another doubtful case is the paid interests case. In fact, art. 96 if Income Tax Act provides for limits to their deduction. The doctrine is divided, at the point. Some think that the qualification of interests at art. 96 is so detailed that it must be applied to IAS adopters, too (G. FALSITTA, *Manuale di diritto tributario*, cit., p. 447). Some others think that the reinforced dependency principle prevails on art. 96, whose criterion of interests qualification would be not applicable to IAS adopters (G. SCIFONI, *Derivazione rafforzata, ma non troppo: le rettifiche fiscali al bilancio "IAS/IFRS compliant"*, in *Corr. Trib.*, 2011, p. 1137).

[188] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 28-29.

First of all, this approach involves constitutional matters[189]. In fact, IAS accounting rules are established by private bodies, such as IASB, and then endorsed by European Union. Therefore, they are not included under the legislator control. The one-track system gives indirect tax relevance to foreign rules, so that a potential conflict with art. 23 of Italian Constitution could be revealed, since it establishes that "personal and monetary obligations can be imposed only by law", and not by any other acts, as well European Union acts. Moreover, considering that IAS and no-IAS accounts are different one each other, in terms of calculation of enterprise's wealth, the IAS tax relevance introduces a discrimination between taxpayers, since companies could pay different amount of taxes depending on the standards, either national or international[190], they apply in calculation of income. This discrimination could also violate the art. 3 of Italian Constitution, which provides for the principle of equality.

Secondly, IAS accounts have own scopes, which radically differ by tax law aims. IAS accountings want to show the real business wealth and, as often as not, they give a big discretion to accounting drawers, whose decisions are arbitrary to some degree. Tax scopes are deeply different from IAS ones, instead. They are inspired to principle of certainty, which clashes with the flexibility of substance over form principle, preferring specific and well-detailed rules. We must also consider that the violation of tax duties is punished with high fines, whose fairness is guaranteed by certainty of tax provisions, indeed.

Moreover, the risk of manipulation of accounting principle at tax aims is even higher than the same in national system and tax inspectors are automatically authorized to check and criticize the appliance of accounting principle, since they are direct tax relevance. This way, the Revenue Agency has a more complex role and the danger of its interference in business matters is surely greater then with national accounts. In fact, the qualification, classification and allocation in time has direct relevance on taxable income amount, but their application it totally a

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[189] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 31.; E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

[190] Because, as described in previous chapters, the calculation of the same substantial wealth can result different in amount, depending on applied standards. This is also linked to the different scopes of IAS accounts, compared to national ones.

director's task. The strict link between accounts and tax returns allows tax inspectors to directly criticize this commercial appliance, anyway. The circular n. 7/E of 2011 even specifies that "if the IAS give the possibility of purely discretionary choices without providing for a guiding standard, tax inspectors can judge the options taken, on the basis of specific facts and circumstances, which show the only purpose of achieving undue tax benefits"[191]. The same principle is provided for by art. 3, par. 3, of decree 48/2009, even if in other words. The moot point consists in the limits of this interference, since it is not clear what facts must be intended as "specific facts and circumstances, which show the only purpose of achieving undue tax benefits". This uncertainty will surely raise tax litigation between tax payers and tax inspectors.

Finally, the fact that two different accounting systems[192] are in force could give raise to tax avoidance practices. In fact, companies which can electively opt for IAS/IFRS could opt for them only to receive fiscal benefits. Or even worse, they could opt for IAS/IFRS and transfer to a new company which is no-IAS adopter all those assets which are fiscal disadvantageous under IAS accountancy and fiscal advantageous under the no-IAS system. As a result, less taxes would be paid and the Treasury would receive less revenues[193].

All these problems have been noticed by Italian literature. Various general solutions have been proposed, but no one has been applied yet, at the state of art[194]. With decree 48/2009 and even with the newer decree 134/2011[195]**,** the legislator has introduced a detailed particular solution for each specific matter

[191] Circular n. 7/E of 2011, par. 3.2. The same provision is repeated in par. 2.8.2, specifically in case of tax assessment.

[192] Moreover, art. 3 of the decree 48/2009, after having forbidden double deductions, establishes at par. 2, that even "in case of transactions between IAS adopters and no-IAS adopters, each one must apply its own accounting system, anyway". Even this provision could create incongruence in the tax system, as a whole.

[193] I. VACCA, *L'impatto degli IAS sul principio di derivazione dei redditi d'impresa dalle risultanze di bilancio*, in *Corr. Trib.,* 2007, p. 3562.

[194] I.e., tax responsibility could be legally given to auditors, which should guarantee the absence of the only purpose of achieving undue tax benefits, when check through the accounts. For this suggestion, I. VACCA, *L'impatto degli IAS sul principio di derivazion edei redditi d'impresa dalle risultanze di bilancio*, cit., p. 3564.

[195] This decree punctually solves some problems of qualification and classification, by coordinating tax rules and IAS principles (i.e., in matter of fixed assets in IAS 16 and 40, at art. 3 of the decree, or even in matter of provisions and contingent liabilities in IAS 37, at art. 9 of the decree). For a deeper analysis of the decree, M. LEO, *Le imposte sui redditi nel Testo Unico*, Milano, 2011, p. 134.

which has been revealed, so inserting in a problematic general system various specific derogatory remedies. In fact, the government has introduced many limits and adjustments to IAS/IFRS accounts for fiscal aims, most of which have been described in previous paragraphs.

Anyway, nevertheless all these moot points, the choice of Italian law is clear and must not be minimized, even because it shows the attention to European Union outlook: giving tax relevance to IAS/IFRS could even constitute the first step for a common European companies' tax base[196].

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[196] E. RUGGIERO e G. MELIS, *Pluralità di sistemi contabili, diritto commerciale e diritto tributario: l'esperienza italiana*, cit., p. 1624.

CHAPTER 5 - COMPARISON BETWEEN DOMESTIC TAX BASE AND COMMON CONSOLIDATED CORPORATE TAX BASE (CCCTB)

Before starting a comparative analysis between the Italian tax system and the CCCTB Proposal, a preliminary remark is necessary. The Italian tax law provides for two different tax systems, depending on the accounting standards (either national of international) adopted by the enterprise[197]. In the following paragraphs, we are going to compare the CCCTB rules with tax principles and criteria which are applied to enterprises adopting national accounting standards for their accounts.

So being stated, we can add that, in matter of accounting standards, the Commission has often repeated in its documents that principles and criteria adopted in the CCCTB Proposal are inspired to IAS/IFRS[198] ones, since these are very widespread all around Europe and reproduce the best accounting practices, too. Maybe that, if the directive is approved, the Italian choice of opting for a so wide adoption of IAS/IFRS could reveal advantageous effects, since most of the CCCTB problems will have been already analyzed and solved at the moment of IAS introduction.

5.1. GENERAL PRINCIPLES

	Domestic tax base: **Income Tax Act**	**CCCTB:** **Directive Proposal**
General principles	Art. 83: it is interpreted in the following sense: profits and losses shall be recognized only when *realized.* Art. 83 + art. 2423 bis n. 5-6: Transactions and taxable events shall be measured *individually.* The calculation of the tax base	Art. 9: in computing the tax base, profits and losses shall be recognized only when *realized.* Transactions and taxable events shall be measured *individually.* The calculation of the tax base shall be carried out in a

[197] For a wider analysis of these two systems, see chap. 3 and 4.

[198] A. VISCONTI, *L'introduzione degli IAS/IFRS nel sistema delle imprese Italiane: scenari interni e prospettive di sviluppo*, in www.innovazionediritto.it.

	shall be carried out in a *consistent manner* unless exceptional circumstances justify a change. Art. 76: the tax base shall be determined *for each tax year* unless otherwise provided[199]. A tax year shall coincide with the *accounts period*[200]. If its length is not determined or if it lasts two years or more, the tax period coincides with the calendar year.	*consistent manner* unless exceptional circumstances justify a change. The tax base shall be determined *for each tax year* unless otherwise provided. A tax year shall be any *twelve-month period*, unless otherwise provided.

General principles are very similar, in both systems. Anyway, a difference between the two systems is the *length of the tax year*. According to Italian tax law, the tax period coincides with the accounting period, therefore it can even be longer or shorter than twelve months (with the maximum limit of two years) whereas in the CCCTB proposal the tax year shall be a twelve-month period (even if it must not necessarily coincide with the solar year). The approach is carried on in order to reduce the companies' compliance costs, since the principle of dependency fixes a deep connection between commercial accounts and tax return.

5.2. Calculation of the tax base: revenues and expenses

	Domestic tax base: **Income Tax Act**	**CCCTB:** **Directive Proposal**
Profits	Art. 83: it is interpreted in the following sense: 'profit' means an excess	Art. 4.9: 'profit' means an *excess of revenues over deductible*

[199] An exception is represented by art 84, about the losses carry-forward.
[200] As determined by law or by articles of incorporation.

	of revenues over deductible expenses and other deductible items in a tax year, as resulting from the bottom line of the income statement after all tax adjustments provided for (*principle of dependency*).	*expenses* and other deductible items in a tax year.
Revenues	Art. 85: *revenues*: proceeds of sale[201] of goods, semi-worked goods, goods which are bought to be immediately used or re-sold, non-fixed financial instruments and ordinary subsidies[202]. Art. 86: *gains on disposal of fixed assets*: proceeds of sale of all items which are not listed in the previous article[203] (fixed assets, in general). Art. 88:	Art. 4.8: *'revenues'* means proceeds of sales and of any other transactions, net of taxes, whether of a monetary or non-monetary nature, including proceeds from disposal of assets and rights, interest, dividends and other profits distributions, proceeds of liquidation, royalties, subsidies and grants, gifts received, compensation and ex-gratia payments. Revenues shall also include

[201] Revenues are produce even if are paid damages for the loss of those goods, or even if goods are freely assigned to shareholders. The same happens for assets which are regulated by art. 86.

[202] Subsidies, which are contributions coming from public authorities, can be divided in three categories:

a) Ordinary subsidies, paid to the enterprise to let it sustain ordinary management costs. They are revenues, in Italy. They shall be recorded when occurred (accrual principle) in both the systems.
b) Extraordinary subsidies, disbursed in order to increase an enterprise wealth. They are contingent assets , in Italy. They shall be recorded at the moment of the payment (cash-basis principle), in the Italian system. On the contrary, in the CCCTB Proposal there is not an exception to the accrual principle, in matter of subsidies. So we can conclude that they are taxed at the moment of accrual, differently from what happens in Italy;
c) Subsidies directly linked to the acquisition, construction or improvement of fixed assets. In Italy, if they are recorded in commercial accounts as advance revenues, they are taxed as positive components of the taxable basis, and if they are accounted as decrease of the asset cost, they reduce the depreciation rates. In the CCCTB Proposal, they are subject to depreciation in accordance with Articles 32 to 42.

[203] Financial instruments sale generates capital gains regulated by art. 87, which is about the participation exemption rule. Anyway, it provides for particular conditions of application.

	contingent assets: revenues corresponding to expenses which have been recorded in the previous period, decrease of expenses previously recorded, gifts, extraordinary subsidies and other positive components which are not linked to previous tax periods.	non-monetary gifts made by a taxpayer. Revenues shall not include equity raised by the taxpayer or debt repaid to it.
Exempt revenues	Art. 87, 88, 89, 91**:** exempt from corporate tax: a) subsidies directly linked to the acquisition, construction or improvement of fixed assets, which directly reduce the cost (and consequently the depreciation rates) of the relative asset; b) received profit distributions (95% excluded); c) proceeds from a disposal of shares (95% exempt); d) revenues which are qualified as exempt by law (i.e., for relief aims); e) revenues otherwise taxed (i.e., by a final withholding tax); f) Shareholder contributions, share premium paid by shareholders, difference	Art. 11: exempt from corporate tax: a) subsidies directly linked to the acquisition, construction or improvement of fixed assets, subject to depreciation in accordance with Articles 32 to 42; b) proceeds from the disposal of pooled assets; c) received profit distributions; d) proceeds from a disposal of shares; e) income of a permanent establishment in a third country.

	between cancelled treasury shares and the corresponding equity amount[204].	
Deductible expenses	Art. 109: expenses are deductible only if they have been *previously recorded as expenses in the income statement*. Expenses are even deductible if tax law expressively provides for it, and even if they have been recorded in the income statement of previous accounts periods. Expenses are deductible only if they incurred *in relation with assets which generate taxable income or even excluded*[205] *income*, up to a maximum of the amount of the relative occurred income. Art. 108: Costs for research and development are deductible in	Art. 12: deductible expenses shall include all costs of sales and expenses net of deductible VAT, incurred by the taxpayer with a view to obtaining or securing income, including costs of research and development[206] and costs incurred in raising equity or debt for the purposes of the business. Deductible expenses shall also include gifts to charitable bodies at art. 16, up to a maximum of 0.5% of revenues in the tax year.

[204] In other words, all contribution coming from inside the organization (from shareholders, precisely) and not from outside (such as sales) are not taxable. G. FALSITTA, *Manuale di diritto tributario*, cit., p. 383.

[205] Both excluded and exempt incomes do not concur to the taxable basis. Anyway, there is a conceptual difference between them: excluded income is not index of ability to pay on its own (it happens, i.e., when that ability-to-pay source has been taxed, yet, so that taxing it again would cause a double taxation); on the contrary, exempt income shows ability to pay at its source, but the legislator opts for not taxing it, i.e. for relief aims (but not only for this aims). I. MANZONI, G. VANZ, *Il diritto tributario,* cit., p. 49.

[206] In the explanatory memorandum of the proposal, the Commission underlines that "supporting research and development has been a key aim of the proposal. Under the CCCTB all costs relating to research and development are deductible. This approach will act as an incentive for companies opting in to the system to continue to invest in research and development".

	the accrual period or even in this and in the following four, in equal rates. Art. 100: Gifts and donation are deductible with limits (in most cases, up a maximum of 2% of taxable income).	
Non deductible expenses	Art. 99, 108, 109: the following expenses are not deductible: a) profit distributions and repayments of equity or debt; b) entertainment costs, if they respect requirements indicated in a decree, up to a maximum amount proportionate to revenues[207]; c) income tax; d) costs incurred for the purpose of deriving income which is exempt, but not excluded[208]; e) costs otherwise deducted, i.e. when their amount is added to the fixed asset	Art. 14: the following expenses are not deductible: a) profit distributions and repayments of equity or debt; b) 50% of entertainment costs; c) the transfer of retained earnings to a reserve which forms part of the equity of the company; d) corporate tax; e) bribes; f) fines and penalties payable to a public authority for breach of any legislation; g) costs incurred by a company for the purpose of deriving income which is exempt pursuant to Article

[207] Deductible amount: 1,3% of revenues up to 1 million EUR; 0,5% of revenues from 10 mill. up to 50 mill. EUR; 0,3% of revenues exceeding 50 mill. EUR.
[208] See annotation 8.

	value and depreciated with it[209]; f) All taxes which are charged on customers, even optionally.	11; such costs shall be fixed at a flat rate of 5% of that income unless the taxpayer is able to demonstrate that it has incurred a lower cost; h) monetary gifts and donations other than those made to charitable bodies as defined in Article 16; i) save as provided for in Articles 13 and 20, costs relating to the acquisition, construction or improvement of fixed assets except those relating to research and development; j) taxes listed in Annex III, with the exception of excise duties imposed on energy products, alcohol and alcoholic beverages, and manufactured tobacco.

In regard to a comparative analysis of revenues and expenses, some preliminary remarks are necessary. Italian tax system, as described in chapters 3 and 4, is inspired to the *principle of dependency*. On the contrary, as underlined even by the European Commission, "as not all European companies use the same accounting rules, the continuation of 'dependency' of tax accounts on financial accounts and/or 'reversed dependency' is conceptually impossible"[210]. Afterwards,

[209] Otherwise, a double deduction would occur.
[210] COM/2006/157, ANNEX 2. In the same act, the Commission even underlines that "Even though many companies now prepare their financial accounts in accordance with International Accounting Standards and International Financial Reporting Standards (IAS/IFRS) many are still required to use national accounting standards instead of IAS/IFRS", for their annual accounts. It

the fundamental relevance of the principle of dependency in Italian system is opposed to its irrelevance in the CCCTB system: a deep, sweeping difference between the two legal structures is determined, this way. Moreover, in consequence of the lack of dependency, the CCCTB Proposal does not establishes how to adjust the bottom line of income statement for tax aims[211] (as provided for in art. 83 of Income State Act). It just analytically and individually defines individual positive and negative components of taxable income[212], regardless of the accounting qualification, so that more differences between "taxable income" and bottom line of income statement will be probably revealed[213]. It means that, in Italy, a taxpayer opting for the CCCTB should individuate, evaluate and algebraically sum all taxable elements, in order to calculate the tax basis. Anyway, Italian literature has noticed that taxpayers can also refer to the bottom line of the income statement, by making all adjustments which are relative to those *key elements* which are differently regulated by the CCCTB Proposal than by Italian law[214].

In matter of *revenues and expenses*, we can underline that most of the concepts in the Proposal are not well defined. We can just think about the meaning of entertainment costs or market value[215]. On the contrary, Italian tax law does not leave any margins of uncertainty in defining all items and concepts in respect of the principle of tax certainty.

Moreover, even their tax treatment is different, in certain cases. Among revenues, the main difference is about received profit distributions and proceeds from

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lets us think that, if and when there is complete uniformity in Europe in matter of accounting principles, maybe by spreading IAS/IFRS wider appliance, even a common consolidated tax base will be more simple to be introduced (by States) and applied (by operators). On the argument, MINISTRY OF TREASURY COMMISSION, examinations of 25/5/2011 and 8/6/2011.

[211] L. KOVAKS, *Le prospettive della CCCTB*, in *Rass. Trib.,* 2008, p. 699.

[212] Anyway, CCCTB rules are contained in e Directive Proposal and, when adopted, directives give
Member States a timetable for the implementation of the intended outcome, with compliance laws (as established by art. 288 of Treaty on the Functioning of the European Union). When States keep these laws in place, they could specify all adjustments to the bottom line of income statement that are required to calculate the CCCTB. A. DENARO, *Dal Working Group stretta finale sulla CCCTB*, in www.fiscooggi.it, 2012.

[213] MINISTRY OF TREASURY COMMISSION, examination of 8/6/2011.

[214] C. SACCHETTO, *Gli IAS/IFRS come punto di partenza per un imponibile comune europeo*, in *Corr. Trib.,* 2007, p. 3567; P. VALENTE, *Base imponibile europea: lo stato dell'arte in previsione della direttiva,* in *Riv. Dir. Trib. Int.*, 2008, p. 102;

[215] MINISTRY OF TREASURY COMMISSION, examinations of 8/6/2011.

disposal of shares, which are totally exempt in the CCCTB proposal, unlike what Italian legislator provides for. In Italy, received profit distributions are 95% excluded and proceeds from disposal of shares are 95% exempt. The difference emerges in reference to treatment of relative costs, as will be demonstrated at once.

In matter of *deductible costs*, the difference is relevant.

The general principle[216] is the same: expenses incurred by the taxpayer with a view to obtaining taxable income for the purpose of the business are deductible (it is the so-called *business purpose test*[217]). All costs incurred by a company for the purpose of deriving exempt income are not deductible. Anyway, the calculation of this last costs is different, in the two systems. The art. 14 of the CCCTB Proposal establishes that such (not deductible) costs shall be fixed at a flat rate of 5% of exempt income (unless the taxpayer is able to demonstrate that it has incurred a lower cost). The art 109, par. 5, of Income Tax Act establishes that such costs must be specifically calculated, without providing for any flat rates. In particular, according to Italian tax law the exact amount of costs which are incurred with a view to obtaining exempt income shall not be deducted. Costs incurred in order to produce both taxable and non taxable income can be deducted up to the maximum percentage which is the ratio of taxable income to the whole (both taxable and exempt) income. As a result, we can conclude that, in matter of deductible cost, the CCCTB provision is in favor of the taxpayer, more than Italian provision. In fact, in most cases, the percentage of non-deductible costs resulting from the exact calculation by art. 109 of Italian Income Tax Act shall result higher than 5% of exempt revenues, which is the CCCTB flat rate. Moreover, the CCCTB provision is plainer to apply, because the flat rate saves the taxpayer from the specific calculation of non-deductible costs.

This provision has an implication on all costs incurred for the purpose of deriving dividends[218]. Dividends are totally exempt in the CCCTB proposal, as in Italy

[216] MINISTRY OF TREASURY COMMISSION, examination of 24/05/2011.

[217] P. VALENTE, *Vantaggi fiscali per le società nella proposta di direttiva UE sulla base imponibile comune*, in *Corr. Trib.*, 2011, p. 1361.

[218] A little more complex is the case of disposal of shares. In fact, ever remembering that art. 109 establishes that expenses are deductible if they incurred in relation with *assets which generate taxable income or even excluded income*, the costs arisen by the administration of the share are deductable, since they generate profits, which are excluded. The costs arisen by the sale of the

they are 95%[219] exempt. The difference emerges in matter or relative costs, indeed. In fact, the CCCTB system does not tax dividends but it forbids the deduction of relative expenses, by establishing a flat rate percentage (5% of exempt revenues) to calculate them (even if the taxpayer can proof that occurred relative costs are less). In the Italian system, all costs incurred for the purpose of deriving dividends are deductible, just because, according to art. 109, par. 5, expenses are deductible if they incur in relation with assets which generate taxable income or even excluded income (and received profits are excluded, and not exempt, from tax base, indeed). Anyway, the 5% of the dividend concurs to the taxable basis, since it is only 95% excluded. As a result, we can observe that, even if the juridical structure of the two systems is different, the economic consequence is the same. In fact, in Italy all costs incurred to receive dividends are deductible, but the 5% of dividend is taxed. In the CCCTB system, all costs incurred at the same aim are not deductible, but their amount is fixed at 5% of the taxable income, which is 5% of dividend, indeed. To summarize, in both cases 5% of dividend is taxed: in Italy as part of income, in the CCCTB as not deductible cost.

Among costs, entertainment and donation costs and development expenses are differently regulated in the two systems. In matter of bribes and fines, there are not any provisions[220] in the Income Tax Act. This lack of regulation has requested an interpretative attempt by administration, literature and case law. Most of them[221] retain that fines are not deductible, since their deduction would "fully neutralize the punishing aim of fines, by turning it in a tax advantage[222]". Bribes

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share are not totally deductable, since the sale generates a capital gain, which is 95% exempt, and not excluded. P.C. CARDINALE, *Plusvalenze e dividendi: proventi esenti ed esclusi*, in www.fiscooggi.it, 2005.

[219] For the difference between exclusion and exemption see annotation 9.

[220] This is one of the few cases of uncertainty, since Italian tax legislator aims to apply the principle of certainty and to avoid gaps.

[221] A minority part of literature still retains that illegal costs are deductible if they are inherent to the business activity, but expressively established exceptions (Criminal sanction, i.e., are expressively not deductible, as established by law 537/1993, art. 14). G. FALSITTA, *Manuale di diritto tributario*, cit., p. 411; G. TINELLI, *Il principio di inerenza nella determinazione del reddito,* in Riv. dir. trib., 2002, p. 437; G. FICARI, *L'inerenza delle sanzioni antitrust e la loro conseguenzialità inversa rispetto ai ricavi imponibili*, in *Boll. Trib.*, 2010, p. 1005.

[222] Supreme Court, tax division, decision n. 5050/2010. In the same sense, Supreme Court, tax division, 600/2011; Revenues agency, Circular 98/E 2000 and Resolution 89/E 2001. Among literature, A. CAZZATO, *Le sanzioni nel reddito d'impresa. I percorsi dell'indeducibilità*, in www.nuovofiscooggi.it, 2010. L. MIELE, G. FERRANTI, *Si deduce la sanzione «inerente»*, in *Il Sole 24 Ore*, 17/5/2010.

cannot be deducted, too, because an illegal behavior can never determine advantages, for a general principle of coherence of the whole legal order[223].

As seen before, the general principle in matter of costs is the same: all costs incurred by the taxpayer with a view to obtaining or securing income are deductible. Obviously, in the CCCTB Proposal there is not a refer to the costs previously deducted in the income statement, as in art. 109 of Italian Income Tax Act, because, as underlined at the beginning of this paragraph, the Directive Proposal does not fix any links to accounts.

5.3. TIMING AND QUANTIFICATION

	Domestic tax base: Income Tax Act	**CCCTB: Directive Proposal**
General timing principle	Art. 109, par. 1: *accrual* principle, unless otherwise provided for.	Art. 17: *accrual* principle, unless otherwise provided for.
Accrual of revenues and expenses	Art. 109, par. 1: revenues and expenses incur if their *existence is certain* and their amount can be *objectively quantified*. Art. 109, par. 2: Revenues and expenses incur at the date of *delivery or shipment*, for movable *goods*, and when the *agreement* is drawn up, for buildings and firms. and businesses, or, if different, and later, the date on that is experiencing the effect of translational or constitutive properties' or other real rights.	Art. 18: revenues occur when the *right to receive* them arises and they can be *quantified with reasonable accuracy*. Art. 19: a deductible expense is incurred when the *obligation* to make the payment has arisen and its amount can be *quantified* with reasonable accuracy. In the case of trade in ***goods***, the *significant risks and rewards* of ownership shall have been transferred and, in the case of supplies of ***services***, the latter have been

[223] Supreme Court, tax division, decision n. 2001/1994.

	In case *services*, they incur at the *date in which the services are completed*. In case of *services depending on long term contracts,* which provide for periodic payments, revenues and expenses occur at the *date of accrual of periodic payments*.	*received* by the taxpayer. Art. 24: revenues relating to a *long-term contract* (concluded for the performance of services and whose term exceeds 12 months), shall be recognized at the amount corresponding to the part of the contract completed in the respective tax year. The *percentage of completion* shall be determined either by reference to the ratio of costs of that year to the overall estimated costs or by reference to an expert evaluation of the stage of completion at the end of the tax year.
Pensions	Art. 105: provisions for severance pay and pensions of employees, if recorded in individual accounts of individual employees, *are deductible within the limits of accrued amount* of the tax period, in accordance with laws and contracts regulating the employment of those employees[224].	Art. 26: in case of pension provisions actuarial techniques shall be used in order to make a *reliable estimate of the amount* of benefits that employees have earned in return for their service in the current and prior period.
Provisions	Art. 107:	Art. 25:

[224] According to art. 2120 of civil code, the formula to calculate the amount of the yearly provision for pensions that must be recorded in the income statement is the following:
(annual gross salary/13,5) + (pensions debt fund*[1,5%+(75% of ISTAT revaluation)].

	apart from pension pensions provisions at art. 105, *only provisions for* future expenses against prize competitions ships and plain maintenance and construction of public works are deductible, with any quantitative limits. *All other accounted provisions* deducted in the financial statement *are not tax relevant*.	notwithstanding Article 19, *any amount rising from future legal obligation*, either certain or probable, *shall be deductible* if it can be reliably stated, provided that the expected amount is a deductible expense. In calculating the tax base in future years account shall be taken of amounts already deducted as provisions.
Stock and work-in-progress	Art. 92: the difference between the value of stocks and work-in-progress at the end of the tax year and the value of stocks and work-in-progress at the beginning of the tax year concur to compose the taxable base. End stocks (which are not evaluated by individual costs) must be grouped into categories, on the basis of their nature or value, and must be evaluated by a minimum value, as described by the following provisions. Long term contracts are differently regulated by art. 93. In the first tax year of occurrence, they are evaluated by dividing their whole cost by their quantity. In the following	Art. 21: the total amount of deductible expenses for a tax year shall be increased by the value of stocks and work-in-progress at the beginning of the tax year and reduced by the value of stocks and work-in-progress at the end of the same tax year. No adjustment shall be made in respect of stocks and work-in-progress relating to long-term contracts. Art. 29: valuation: individual cost, *FIFO or weighted-average cost method*. A taxpayer shall consistently use the same method for the valuation of all stocks and work-in-progress having a

	tax periods, the new occurred ones are evaluated in the same way but they are autonomously recorded. Their decrease is subtracted by the amount resulting in the next previous tax period. For enterprises using the *FIFO* or *weighted-average cost method*, this method is tax relevant, too. In all previous cases, if the average value as determined with those methods is higher than their fair value, the minimum value must be calculated by multiplying the quantity of goods by their fair value.	similar nature and use. The cost shall include all direct costs incurred for the goods or services. The valuation of stocks and work-in-progress shall be done in a consistent way. Stocks and work-in-progress shall be valued on the last day of the tax year at the lower of cost and net realizable value (which is the estimated selling price less the estimated costs necessary to make the sale).
Bad debt deduction	Art. 101, par. 5: a deduction shall be allowed for a bad debt if the fact that the debt will not be wholly or partially satisfied results from *certain and precise proofs.* Art. 106: Depreciation of credits which are not covered by insurance warranty and which are related to sale of goods and performance of services in art 85, *can be deducted with limits*.	Art. 27: a deduction shall be allowed for a bad debt receivable where the taxpayer has taken all reasonable steps to pursue payment and *reasonably believes* that the debt will not be satisfied wholly or partially. Art. 41: if, in *exceptional circumstances*, a taxpayer demonstrates that the value of a fixed asset not subject to depreciation

		has permanently decreased at the end of a tax year, it may deduct an amount equal to the decrease in value.
Valuation	Art. 110[225]: it is interpreted in the following sense: transactions shall be measured at: a) the *monetary consideration* for the transaction, such as the price of goods or services; b) the *fair value* where the consideration for the transaction is wholly or partly non-monetary. Art. 94: financial instruments are valued *as goods*, in general. Their historical cost concurs to the taxable base and, if they are not sold within the end of the year, they are valued as stocks. Moreover, capital gains deriving from their accounts evaluation at the price that they are presumed to be sold do not concur to taxable base, but some exceptions.	Art. 22: for the purposes of calculating the tax base, transactions shall be measured at: a) the *monetary consideration* for the transaction, such as the price of goods or services; b) the *market value* where the consideration for the transaction is wholly or partly non-monetary; c) the market value in the case of a non-monetary gift received by a taxpayer; d) the market value in the case of non-monetary gifts made by a taxpayer other than gifts to charitable bodies; e) the *fair value* of financial assets and liabilities held for trading; f) the value for tax purposes in the case of non-monetary gifts to charitable bodies. The tax base, income and expenses shall be measured in

[225] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 345.

		euro.

As seen in the table above, CCCTB principles about timing and qualification are not identical to national ones. In most cases, the differences between the Italian tax law and the CCCTB systems are substantially the same that exist between national standards and IAS/IFRS, since timing principles in CCCTB are established in regard for most widespread accounting practices and IAS/IFRS[226].

In both cases, revenues and expenses must be *certain in existence and reliably quantified in amount*, and both systems adopt the *accrual* timing principle. Anyway, the meaning of accrual is different, because the CCCTB accrual is linked to substance over form principle, unlike the national accrual. Since the CCCTB accrual have the same meaning of IAS/IFRS system, the description at Chap. 2 can clarify this difference.

The exact moment in which revenues and expenses occur is also different. The Italian system provides for specific criteria (at art. 109, par. 2 of Income Tax Act) whereas CCCTB Proposal does not fix it. Sales of goods, performance of services and long-term contracts are differently treated in the two systems, as shown above.

In matter of deductibility, differences can be revealed in rules about provisions, pensions and bad debts[227].

There is quite a difference in the tax treatment of *provisions*[228]. Italian tax system opts for a pattern which is he opposite of the CCCTB one[229]. Italian tax law

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[226] P. VALENTE, *Base imponibile europea: lo stato dell'arte in previsione della direttiva,* cit., p. 103; A. SACCONE, *La base imponibile consolidata comune (Common Consolidated Corporate Tax Base): una sfida per la fiscalità europea,* in www.innovazionediritto.it.

[227] R. RIZZARDI, *CCCTB: la base imponibile europea del reddito di impresa,* in *Riv. Dott. Comm.,* 2006, p. 895.

[228] Provisions must not be confused with reserves. In fact the CCCTB Working Group has cared about both the definitions: provisions are "liabilities of uncertain timing and amount" and reserves are “appropriations of retaining earnings which form part of equity”. The former are deductible (art. 25). The latter are not deductible, instead (art. 14). Working document CCCTB/WG/011 “*An overview of the main issues that emerged at the first meeting of the subgroup on reserves, provisions and liabilities*”, 2005; P. VALENTE, *Base imponibile europea: evoluzione della fiscalità d'impresa tra coordinamento sovranazionale e competizione interstatuale,* in *Riv. Dir. Trib. Int.*, 2006, p. 78; A. SACCONE, *La base imponibile consolidata comune (Common Consolidated Corporate Tax Base): una sfida per la fiscalità europea,* in www.innovazionediritto.it.

[229] CCCTB Working group had individuated two different approachs about provisions: *positive list of deductible examples* according to whom only listed provisions can be deducted and *negative list*

provides for the *principle of typicality* of deductible provisions: it means that only provisions which are expressively provided for by tax law can be deducted by taxable basis, independently on all provisions which have been recorded in the income statement. This outline gives a restricted possibility of deducting provisions, in order to avoid that they are recorded in accounts only in order to reduce the company's taxable basis and to pay less taxes, since this behavior would damage Treasury revenues. The opposite approach is adopted by CCCTB. It only provides for a general condition (provisions must be referred to any amount rising from future legal obligation, either certain or probable, which is reliably stated), occurring whom all provisions can be deducted by the taxable base[230]. This approach is clearly less restrictive than the Italian one.

The same flexibility is allowed by CCCTB Proposal in matter of *bad debts*[231]. A bad debt deduction is deeply restricted in national system, by law, at first, and by administrative practice[232] and case law[233], secondly, since the company must give indisputable evidence to qualify that credit as a "bad" one. In the CCCTB provisions, a reasonable valuation is enough[234]. Even in case of credits provisions, Italian law limits the deduction, although exceptional circumstances are not requested. On the contrary, the CCCTB provision requiress exceptional circumstances, although no limits are fixed to deduction[235].

The tax treatment of *pensions* is different. The Italian system imposes to deduct provisions for lump-sum payments and pensions of employees only if they have been recorded in individual accounts of individual employees, in accordance with

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of non-deductible examples, according to whom all provisions are deductable, but exceptions expressively established. The CCCTB opts for this second approach, differently from Italian one, which opts for the first one. P. VALENTE, *Base imponibile europea: evoluzione della fiscalità d'impresa tra coordinamento sovranazionale e competizione interstatuale*, cit., p. 78. A. SACCONE, *La base imponibile consolidata comune (Common Consolidated Corporate Tax Base): una sfida per la fiscalità europea,* in www.innovazionediritto.it.

[230] MINISTRY OF TREASURY COMMISSION, intervention of A. Betunio, 25/5/2011, p. 4.

[231] P. VALENTE, *Common Consolidated Corporate Tax Base (CCCTB). Soggetti, consolidamento e ripartizione della base imponibile*, in postilla.it.

[232] Resolution of Revenue Agency of 23/01/2009, n. 16.

[233] Supreme Court, tax division, decision 13181/2000, 12381/2002, 8592/2006.

[234] Moreover, in the CCCTB provision there is no distinction between banks and other companies' treatment. Italian system, instead, provides for exceptions, in case of banks, since their business purpose is credit giving, indeed. These exceptions are established by art. 106, par. 3 and 3-bis. This difference has been noticed by MINISTRY OF TREASURY COMMISSION, examination of 24/05/2011.

[235] MINISTRY OF TREASURY COMMISSION, examinations of 25/5/2011.

labour law and employment contracts, within the limits of amount accrued in the tax period. The CCCTB Proposal, instead, imposes to use actuarial techniques in order to make a reliable estimate of the amount of benefits (it does not request individual accounts for each employee) that employees have earned in return for their service in the current and previous period. Actuarial techniques involve, in each period, the detection of different components (interest cost, service cost and actuarial gains and losses) generally not coinciding with the occurred amounts, in contrast to what is provided for by Italian law[236].

In matter of *stocks and work in progress*, we can see that both the systems, as well the IAS/IFRS one, deny the use of LIFO method, since it has the effect of reducing the value of the stock, because stocks are valued on the base of the cost of older goods, which is, in general[237], lower[238].

5.4. TREATMENT OF LOSSES

	Domestic tax base: Income Tax Act	**CCCTB: Directive Proposal**
Losses	Art. 84: the loss incurred by a taxpayer, determined with the same rules that are applied to determinate the income, can be deducted in subsequent tax years up to a maximum of 80% of the taxable income of each tax period. The losses occurred in the first three tax years from the date of the company's incorporation may be deducted in the	Art. 43: a loss incurred by a taxpayer or a permanent establishment of a non-resident taxpayer in a fiscal year may be deducted in subsequent tax years, unless otherwise provided by this Directive. A reduction of the tax base on account of losses from previous tax years shall not result in a negative amount.

[236] I. VACCA, A. GARCEA, A*ssonime, guida all'applicazione dell'ires e dell'irap per le imprese IAS adopter*, p. 77.
[237] Because, in general, price of goods increases in time, because of inflation.
[238] G. FALSITTA, *Manuale di diritto tributario*, cit., p. 498.

	following tax periods up to the amount of the whole income occurred in each tax year (without the limit of 80%), provided that these losses refer a new business activity.	The oldest losses shall be used first.

In matter of losses, the most important difference between the two systems is the amount of losses which can be carried forward. Italian tax system restricts this amount to the 80% of taxable income of each following period[239], with the only exception of losses which have been produced in the first three periods of business activity[240]. This limit is not fixed by the CCCTB which is, in this case, more flexible and advantageous.

5.5. FIXED ASSETS AND DEPRECIATION

	Domestic tax base: Income Tax Act	**CCCTB: Directive Proposal**
Fixed assets	Art. 65, 102 of Income Tax Act and art. 2424 and 2426, n. 1-6, of the Civil Code: fixed assets means all tangible and intangible assets which are owned and *used in the production of income for a long limited time* and are not expected to be consumed or converted into cash. They also include financial assets, which are subjected to a specific	Art. 4.14: 'fixed assets' means all tangible assets acquired for value or created by the taxpayer and all intangible assets acquired for value where they are capable of being valued independently and are *used in the business in the production, maintenance or securing of income for more than 12 months*, except where the cost of their acquisition,

[239] The discipline has changed in 2011. In fact, before the law change, losses could be carried forward only in the following four tax periods, but no limits to the deductible amount were fixed, for each following tax year.
[240] This less restrictive treatment is justified by the awareness that at the beginning of a business activity the probability of producing high losses and low revenues is higher.

	discipline. If the unit cost of assets less than EUR 516,46, depreciation is not requested.	construction or improvement are less than EUR 1,000. They also include financial assets.
Entitlement to depreciate	Art. 65, par. 3[241]: fixed assets are linked to the owner by a "belonging" link, which is intended to mean a *juridical right* of property or even real rights (such as usufruct)[242].	Art. 34: depreciation shall be deducted by the *economic owner*. The economic owner is obliged to depreciate. Art. 4.20: 'economic owner' means the person who has substantially all the benefits and risks attached to a fixed asset, regardless of whether that person is the legal owner.
Depreciation base	Art. 110: the depreciation base shall comprise any cost directly connected with the acquisition, construction or improvement of a fixed asset, net of subsidies directly linked to the acquisition, construction or improvement and of general	Art. 33: The depreciation base shall comprise any cost directly connected with the acquisition, construction or improvement of a fixed asset, net of VAT and of subsidies directly linked to the acquisition, construction or improvement of the asset (art.

[241] It is specifically referred to partnerships. Anyway, Italian literature extends the rule to companies, too, with no doubts, even because art. 85 of Income Tax Act, which is referred to companies income, expressively remands to art. 65. G. FALSITTA, *Manuale di diritto tributario*, cit., p. 332

[242] G. FALSITTA, *Manuale di diritto tributario*, cit. p. 332.

	expenses and interests (but some exceptions[243], for this last case). For produced assets: indirect costs incurred in production. For asset received as a gift: fair value. Revaluation does not cause taxable capital gains.	11.a). For produced assets: indirect costs incurred in production in so far as they are not otherwise deductible. For asset received as a gift: market value.
Improvement costs	Art. 102, par. 6: improvement costs[244] shall be *depreciated in accordance with the rules applicable to the fixed asset which has been improved*. If this rule is not applied, they are deductible under the limit of 5% of the whole cost of all fixed tangible assets, in the period of occurrence. The surplus is divided in five equal rates and deductible in the following five tax periods.	Art. 4.18: 'improvement costs' means any additional expenditure on a fixed asset that materially increases the capacity of the asset or materially improves its functioning or represents more than 10% of the initial depreciation base of the asset. Art. 35: improvement costs shall be depreciated *in accordance with the rules applicable to the fixed asset* which has been improved as if they related to a newly acquired fixed asset.
Non-depreciable	Art. 2426, n. 2, of the Civil Code:	Art. 40: fixed tangible assets not

[243] Interests are included in the depreciation base if it is expressively provided for by law and, moreover, if they are referred to a buildings which constitute the product of the business activity, in which case the building is not a fixed asset.

[244] In Italy, accounting rules distinguish improvement costs in ordinary maintenance costs and extraordinary ones. The former are sustained in order to restore the initial value of an asset, when it has decreased in time because of its use: these shall be all deducted in the accounting period of accrual. The latter are useful to increase the original asset value: these shall be depreciated in accordance with the rules applicable to the fixed asset which has been improved. In order to avoid a dangerous and costly mix up of the two categories, tax law does not distinguish between them. G. FALSITTA, *Manuale di diritto tributario*, cit., p. 474.

assets	it is interpreted in the following sense: if the useful life of an asset in unlimited, it must not be depreciated (such as land). Financial assets are not depreciable, too, since they have an own discipline.	subject to wear and tear and obsolescence (such as land, fine art, antiques, or jewellery) and financial assets are not depreciable.
Individual depreciable tangible assets	Art. 102: depreciation rates of tangible assets, as recorded in accounts, are deductible starting from the taxable period of the item start-up. They are deductible in respect *of rates which are defined by a Treasury Minister decree*, reduced by one half in the first tax period. In order to establish the rules of depreciation, the decree distinguishes on the base of homogeneous categories of assets and of business sectors. The amount of rates that exceeds the decree limit can be deducted in the following periods, never violating the limits established by the decree itself.	Art. 36: but exceptions provided for, fixed tangible assets shall be depreciated individually over their useful lives on a *straight-line basis*. The useful life of a fixed asset shall be *15 years, 40 years for buildings*. The same period is established for second-hand assets, unless the taxpayer demonstrates that the estimated remaining useful life of the building is shorter, in which case they shall be depreciated over that shorter period.
Individual depreciable intangible	Art. 103: *different rules for each category* of items are provided	Art. 36: but exceptions provided for, fixed intangible assets shall be

assets	for. a) Industrial patents and intellectual property rights: deductible rates cannot be higher than 50% of the cost; b) Brands and goodwill: deductible rates cannot be higher than 1/18 of their cost c) Royalties differing from the previous ones: deduction depends on the length of time established by law or contract.	depreciated individually *over their useful lives* on a straight-line basis. The useful life shall be the period for which the asset enjoys legal protection or for which the right is granted or, if that period cannot be determined, *15 years*. For second-hand assets, the period is even 15 years unless a shorter period is proved, as well for tangible assets.

In matter of depreciation, several differences can be revealed in the two systems. The first one is upstream: in the CCCTB system, the owner of the fixed asset is obliged to depreciate; in Italy, on the contrary, depreciation is an elective choice.

The *definition of fixed assets* is equal: in both cases, fixed assets are all tangible (in particular, buildings and machinery) and intangible assets (as patents) which are owned and used in the production of income for a limited useful life. The limit of non depreciable assets value, anyway, is higher in the CCCTB Proposal (1000 EUR instead of 516,28 EUR).

The first important difference regards the *entitlement to depreciation* of asset: entitled to depreciate is the economic owner in the CCCTB system, and the legal owner in the Italian one. It is a consequence of the IAS/IFRS influence upon the CCCTB regulation, so that all reasons and consequences of the difference are the same than those described in chap. 2. This difference is even significant in matter of leasing, as will be explained in the following paragraph.

The CCCTB rules are simpler than Italian ones, in certain cases. Art. 36 of the CCCTB Proposal specifically identifies three categories of individual depreciable

goods (tangible assets, intangible assets and buildings), by determining general rules of spreading costs over more tax periods, for each of them. The individual depreciable asset is depreciated with a *straight-line method*, that is at equal amounts by a fix rate (2.5% for buildings and 4% for other intangible assets)[245]. On the other hand, in the Italian system the rules in matter of depreciation are set out by a *decree of the Ministry of Treasury*, which establishes different depreciation rates for each category of assets, distinguishing them on the base on business sectors, too. Moreover, in the CCCTB system there are not any limits to the first deductible rate; in Italy the first rate is reduced by a half. For all these reasons, the CCCTB rules application is surely plainer than Italian one[246].
The depreciation base is equal. Even provisions about non-depreciable assets are the same in both systems.
In matter of *improvement costs*, the CCCTB Proposal establishes that they are deductible "as if they were related to a newly acquired fixed asset". In Italy, they increase the cost of the asset or otherwise the specific rule at art. 102, par. 6, is applicable.

5.5.1. SPECIAL RULES: ROLLOVER RELIEF, ASSET POOL AND THE LEASING CASE

	Domestic tax base: Income Tax Act	**CCCTB: Directive Proposal**
Rollover relief	Art. 86, par. 4: gains on fixed assets concur to the taxable income in the tax year in which they are realized. Anyway, if the asset has been owned for a minimum period of three years, the taxpayer can even choose to charge the gains to more tax periods (from one to five, starting from the period of	Art. 39: where the proceeds from the disposal of an *individually depreciable asset are to be re-invested*, within the following two tax periods, in an asset used for the same or a similar purpose, the amount by which those proceeds exceed the value for tax purposes of the asset

245 A. DENARO, *Dal Working Group stretta finale sulla CCCTB*, cit., 2012.
246 MINISTRY OF TREASURY COMMISSION, examinations of 25/5/2011.

	accrual), by dividing the gain in equal amounts.	shall be deducted in the year of disposal. The depreciation base of the replacement asset shall be reduced by the same amount. An asset which is disposed of voluntarily must have been owned for a minimum period of three years prior to the disposal.
Asset pool	*No dispositions* are provided for by Italian tax law.	Art. 39: fixed assets other than those referred to in Articles 36 and 40 shall be depreciated together in one *asset pool* at an annual rate of 25% of the depreciation base. The depreciation base of the asset pool at the end of the tax year shall be its value for tax purposes, with adjustments in respect of operations on assets which increase or decrease this amount but never reducing it below zero.
Leasing	Art. 102, par. 7: the lessor (who is the *legal owner*) depreciates the item and records the rents as revenues. The lessee deducts the rents as expenses, with any limits that depend on the type of asset[247]. The implicit paid interests are	Art. 34: depreciation shall be deducted by the *economic owner*. In the case of leasing contracts in which economic and legal ownership does not coincide, the economic owner shall be entitled to deduct the interest

[247] For the lessee who records leasing rents in the income statement, the deduction is permitted provided that the duration of the contract is not less than 2/3 of the depreciation time; a specific rule is provided for in case of buildings.

	ruled by art. 96[248], which regulates paid interests, in general.	element of the lease payments from its tax base. The interest element of the lease payments shall be included in the tax base of the legal owner.

Differently from what happens with individual depreciable assets, the *asset pool* is depreciated according to the *reducing balance method*[249] (there is not the straight-line method, as in case of individual depreciation), aimed to depreciate those assets which have a medium-short residual useful life. All goods flow together in a pooled basis, adjusted for assets entering and leaving the pool during the current year and in respect of acquisition, construction or improvement costs of assets (which shall be added) and the proceeds of disposal of assets and any compensation received for the loss or destruction of an asset (which shall be deducted). In the Italian Income Tax Act, no similar provisions are established. It will be a novelty in tax fields.

Either in the case of *rollover relief* there is not a specific identical provision, in Italian tax law. Anyway, the aim of the CCCTB norm is clear: it wants to incentivize the substitution of old assets (as machinery) with newer ones, by avoiding that the higher value of the substitutions raises taxable gains[250]. If we think about this aim, the most comparable Italian rule is probably provided for by art. 86, par. 4, in matter of gains on disposal of fixed assets. This provision establishes that, if the asset has been owned for a minimum period of three years, the taxpayer can choose to charge the gain to more tax periods (from one to five, starting from the period of accrual), by dividing it in equal amounts. It is a

[248] In particular, art. 96 establishes that paid interests are deductible up to a maximum limit for each tax period. This limit corresponds to the amount of received interests plus the 30% of gross operating profit (which is the operating profit before depreciation and deduction of leasing rents on fixed assets).

[249] The 20% rate is applied on the whole value of the pool in the first tax year. In the follofing periods, the same rate will be applied on the residual value (the original value net of depreciated amounts). This way, depreciation amounts are lower and lower, year by year. A. DENARO, *Dal Working Group stretta finale sulla CCCTB*, cit., 2012; P. VALENTE, *Base imponibile europea: lo stato dell'arte in previsione della direttiva*, cit., p. 104.

[250] This is why time limits to substitution are provided for: in fact, the CCCTB Proposal wants to avoid that taxpayers could elude this rule applying it for scopes which are different from substitution, by having the same advantages anyway.

possibility, for the tax payer, to avoid to charge the gain on a sole tax year income, by determining an high increase of the taxable basis (and consequently higher taxes to pay) in the period of the asset disposal, since it could deter from disposing of assets. The fact that the rule is applied in case of assets which have been owned for three years, at least, could be interpreted as an incentive to substitution of older assets, indeed. This coincidence of scopes between art. 86, par. 4, of Italian Income State Act and art. 39 of CCCTB Proposal could validate the comparison between these two provisions.

In matter of *leasing*, the Directive Proposal is not very exhaustive[251]. Anyway, par. 1 and 2 of art. 34 share the same of the IAS/IFRS principle: the economic owner depreciates the asset and deducts paid interests and the legal owner adds receipt interests to his taxable income. Consequently, the CCCTB Proposal raises the same problems of interpretation and coordination with Italian law that have been already examined in chapter 4**,** so that we can remand to it for a wider analysis of the matter.

5.6. CONCLUSION

As highlighted in this chapter, there are several differences between Italian tax base and Common Consolidated Corporate tax base.

The Directive provides for a set of rules which is complete, self-sufficient and autonomous from the national one, even based on innovative principles which are not included in the Italian system. In most cases, these principles are more pragmatic and plainer than Italian ones[252]. Let's think about costs: in the CCCTB system there are not any rules which provide for flat rates of deducibility (except for entertainment costs and donations to charitable entities). Italian Income Tax Act is full of provisions in matter of costs which bind taxpayers to make complex calculations, often requesting the necessary clarifying intervention of revenues agency acts. The same observation can be made in regard to revenues, since the

[251] In fact, the art. 34, par. 4, entrusts the Commission the task of specifying any concept about the leasing (such as "economic and legal owner", "capital and interests" and "deductible value").

[252] Even the language in plainer: most of concepts are clear, pragmatic and straightforward. As pure curiosity, we could notice that, in the 34 articles of the Proposal which provide for taxable income, there are only 36 remands to other rules. In the corresponding 31 articles of Italian Income tax Act there are 223 remands to other provisions of the same law (and other remands to other laws). MINISTRY OF TREASURY COMMISSION, examinations of 24/05/2011.

definition of revenues provided for by the Directive corresponds to three definitions of Income Tax Act, at least (art. 85, 86 and 88) and to three sets of rules, too. Even depreciation provisions in the CCCTB Proposal are an example of greater plainness, as underlined in par. 4.

There are several reasons justifying the higher complexity of Italian tax legislation. First of all, it is inspired to principle of certainty, then it does not leave any margins of discretion to economic operators. Secondly, it wants to avoid elusion, as demonstrated by the very precise dispositions about costs. The Proposal, on the contrary, is more flexible in the specific dispositions because it contains a general anti-abuse clause[253], so that it is not necessary to care about anti-abuse in every provision. Anyway, it is less detailed even because it is a European Directive Proposal which aims to harmonize all European States' legislation (which are all different each other), and such acts are never too technically detailed[254].

For all these reasons, Italian doctrine has supposed that the Proposal would win favor with Italian taxpayers. Maybe that they would opt[255] for the CCCTB scheme in crowds, not only because of its greater plainness and lower compliance costs[256], but even because its rules are expected to be less changeable in time than Italian rules (since they are established by European Bodies and not by the national Parliament). Therefore, the European Tax Base could constitute a benchmark for Italian legislation, which will suffer the competition with European system. In time, this strict comparison in matter of taxable base could even turn into an influence of European approach[257] on Italian legislator, which could lead to higher plainness of internal rules, too.

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[253] It is art. 80: "artificial transactions carried out for the sole purpose of avoiding taxation shall be ignored for the purposes of calculating the tax base. The first paragraph shall not apply to genuine commercial activities where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts." For a wider analysis, see P. VALENTE, *Base imponibile comune consolidata: disciplina anti-abuso e prevalenza delle norme CE*, in *Corr. Trib.*, 2011, p. 1991.

[254] Moreover, it is a Directive, therefore it needs to be applied by internal State law.

[255] Let's remember that the application of CCCTB system is elective.

[256] As underlined in the press release of 16/3/2011, "the Commission estimates that, every year, the CCCTB will save businesses across the EU €700 million in reduced compliance costs". P. VALENTE, *Vantaggi fiscali per le società nella proposta di direttiva UE sulla base imponibile comune*, cit., p. 1359.

[257] MINISTRY OF TREASURY COMMISSION, examinations of 24/05/2011.

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