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"Impact of taxation on European and global mobility of persons and capital"

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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 Osnabrück dal 21 al 28 marzo 2013 – il tema dell'"Impatto della fiscalità sulla mobilità, a livello europeo e globale, di persone e capitali", così articolato:

1. Trasferimento all'estero e dall'estero di un'attività di impresa;
2. Tassazione dei finanziamenti di fonte estera;
3. Tassazione del lavoro prestato all'estero;
4. Tassazione degli investimenti esteri delle persone fisiche;
5. Pensioni;
6. Scambio di informazioni vs ritenute alle fonte.

I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti da: Giulia Trabattoni (Subtopic 1), Alessandro Siragusa (Subtopic 2), Sabrina Tronci (Subtopic 3), Federico Franconi (Subtopic 4), Francesca Pacchione (Subtopic 5) ed Enrico Fleres (Subtopic 6).

Il dott. Alessio Persiani, il dott. Federico Rasi e la dott.ssa Federica Pitrone hanno assistito gli studenti nella preparazione dei lavori e nella successiva discussione presso l'Università di Osnabrück.

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

Elenco dei contributi

1. Emigration and immigration of a business (including: individuals, corporate entities and non-corporate entities (e.g. partnerships); transfer of assets from head office to permanent establishment, from permanent establishment to head office and form one permanent establishment to another permanent establishment);
2. Cross-border financing of business activities (including: debt versus equity; financing of subsidiaries and permanent establishments);
3. Taxation of cross-border employees (including: residence; taxation of incentive scheme arrangements (bonuses, stock options, deferred remuneration etc.);
4. Taxation of cross-border investment income of individuals (including income from immovable property; interest; dividends; capital gains; received via foreign trusts; taxation of the rich: Buffet rule and progressive taxation, if relevant);
5. Pensions (including: emigration and immigration of workers and retirees; deduction of contributions, payments, private retirement plans, government retirement plans, social security systems);
6. Exchange of information versus withholding taxes (including: automatic exchange of information; implementation of OECD standards; Savings Directive; FATCA; The Rubik model in Swiss; taxpayer's rights; use of information; European idea on exchange of information and transparency).

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Immigration and Emigration of a Business

Giulia Trabattoni

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INTRODUCTION

Business today has no longer geographical boundaries. Business no longer belongs to a single State: there is a complex web of relationships, that could not be merely identified as international because this web represents the new reality without territory.

A fundamental impulse in this direction derived from European Union, as protection and promotion of mobility (in its quadruple declension: goods, persons, capital, services) play a key role to ensure the basic aim of E.U: the unity of the internal market.

However, this is a general trend, which goes further than the E.U., as a consequence of business' natural inclination to grow and to search for new markets. This inclination leads to a loss of territorial characterization.

Nevertheless, it took a long time for States to lay down the law about immigration and emigration of business, resulting a complete regulation only in the E.U. area (with major interventions of the Court of justice of the European Union – ECJ); States developed deeply different ways to allow this natural evolution, protecting themselves, at the same time, with regard to fiscal matters.

In order to analyze how a national tax system influences European and global mobility of persons and capital, this paper is about immigration and emigration of business as regulated by Italian tax system on income, including also company law matters and accounting provisions. In Chapter 1, the concept of residence for tax purposes in Italy and the differences between resident and non-resident person with respect to taxation on income are analyzed. Then, Chapter 2 is about the constitutive elements of residence for tax purposes, with respect to individuals (as it is relevant for the entrepreneur) and to persons other than individual who are liable to income tax.

Chapter 3 is focused on operative aspects of the transfer of residence, in the immigrant and emigrant business perspective, involving private international law, accounting provision and the exit tax.

In conclusion, Chapter 4 is about the concept of permanent establishment for Italian income tax purposes.

CHAPTER 1

1.1 RESIDENCE FOR TAX PURPOSES AS PERSONAL ATTACHMENT CRITERION IN ITALY

Immigration and emigration of business for tax purposes have to deal with the criteria by which States justify their claims to tax income, those deemed reasonable and genuine links that tie up the right to levy taxes with the claimant State's territory. Immigration and emigration presuppose the transfer of the attachment criteria on the base of which a State levies taxes, from this State to another, materially changing its constitutive elements and build them up again in the new State.

Italy, in 1971[1], choose residence for income tax purposes as the personal attachment criterion for both individuals and other than individuals. This choice was a natural completion of the income tax reform in '70s, which marked the abandonment of a system dominated by taxes on property. The reform introduced a system based on taxes levied on persons and on progressive taxation, fully implementing article 53[2] of the Italian Constitution.

Furthermore, the implementation of article 53 marked the fading of citizenship as the form of personal attachment on which taxes were levied[3]. Thus, the distinction between citizen and non citizen wanes, and it is replaced with resident-non resident for tax purposes, fastening taxation to actual territorial

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[1] L. delega 825/71, implemented with D.P.R. 597/1973

[2] "I. Tutti sono tenuti a concorrere alle spese pubbliche in ragione della loro capacità contributiva.

II. Il sistema tributario è informato a criteri di progressività"

[3] G. Melis – *Il trasferimento della residenza fiscale nell'imposizione sui redditi*, Roma, 2008, pag.31

premises and effective membership indications, that are adequate to legitimize worldwide taxation[4].

1.2 THE CONCEPT OF RESIDENCE FOR TAX PURPOSES

The concept of residence for tax purposes is laid down in Articles 2 co. 2 (individuals) and 73 co. 3 (persons other than individuals) of D.P.R. n.917/1986 (Unified body of laws on income tax on individuals[5] and on corporate income tax[6], from now on *breviter* , T.u.i.r.), rephrasing the D.P.R. 597/73 version.

Article 2 co.2 provides that individuals are deemed to be resident (for tax purposes) in Italy when they are registered in the civil register of resident population or have their domicile or the residence as ascertained in the civil code in Italy. Then the legislator chose a formal criterion (registration in the civil registry) , quite simple to apply, and two other substantive forms of attachment with reference to these concepts as ascertained at any time in the civil code.

Article 73 co.3 states that for income tax purposes, persons other than individual who are liable to Ires (as determined in Article 73 co.1 and co.2 [7]) are deemed

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[4] G. Melis, *op.cit*, pag 31

[5] From now on, Irpef.

[6] From now on, Ires.

[7] T.u.i.r. , 73 co. 1- lett. a) companies, limited partnerships limited by shares, limited liability companies, cooperative companies, mutual insurance companies, *Societas Europaea* Reg (CE) no. 2157/2001, Cooperative *Societas Europaea* Reg. (CE) no. 1435/2003 that are resident in the State's Territory.
lett. b) public and private legal entities other than lett.a, *trusts* that are resident in the State's territory which carry on a business, exclusively or prevalently.
lett. c) public and private legal entities other than lett.a, *trusts* that are resident in the State's territory which do not carry on a business, exclusively or prevalently.
lett. d) non resident entities, including *trusts*, with or without legal personality
co.2 Public and private legal entities other than lett.a, including all entities with legal personality, clubs, *consortia*.
Co.2 also includes organized combinations of persons and other resources, pursuing their aim individually and not belonging to other persons explicitly liable to Ires so that the consequences of their actions (with respect also to income) are directly ascribable to them, as they realize the taxable premises in an autonomous and unitary way.
Letter d includes also non resident partnerships, professional partnerships, *società semplice* (civil partnership).

to be resident in Italy when they have in the State's territory their legal seat or their place of management or their main object. Also with respect to Ires, the legislator chose a formal criterion (the legal seat) and other substantive two (place of management and the place were the main object is located); these criteria shall be interpreted in the sense to endorse the effective localization , in spite of formal findings[8]. As a result, the historical criteria of the place of incorporation and of the applying law were dismissed.

Both Articles 2 co. 2 and 73 co. 3 establish that a requisite of time is required for a person to be resident : the constitutive elements must be existent in the State's territory for the most part of the taxable period[9].

1.3 DIFFERENCES BETWEEN RESIDENT AND NON-RESIDENT (FOR TAX PURPOSES) PERSONS LIABLE TO INCOME TAX

The essential difference between resident and non-resident (for tax purposes) persons liable to Irpef or Ires consists in the tax liability: resident persons have unlimited liability, non-resident persons have limited liability to tax.

Italy, like most States do, taxes its residents in respect of all the income they receive, whether it has its source in that state or elsewhere. Thus, taxes are levied on the worldwide income of the resident persons [10].

On the other hand, Italy levies taxes on non-residents' income only in respect of income derived from a source based in its own territory. Non-resident persons, as the word says, do not have that kind of personal reasonable link with the

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[8] See chapter 2, par 2.2.2

[9] T.u.i.r, Art. 7 (Irpef) – solar year; Art 76 (Ires) accounting period, as determined by the law or by the articles of incorporation; if it is not determined by the law or by the article of in corporation, or it is determined but refers to two or more solar year, the taxable period is the solar year. See chapter 2 par 2.3

[10] T.u.i.r, Art 3 co.1 (Irpef), about the tax basis and Art.83 (Ires) about the global business corporate income.

territory which is adequate to justify a worldwide taxation; income, instead, has an economic attachment with the territory that represents a reasonable link to allow Italy to levy taxes on that income. As a result, non-resident persons , have limited tax liability in Italy[11], based on the sourcing rules stated in Articles 23 T.u.i.r (Irpef), 151 co.2 T.u.i.r (Ires, about companies and commercial legal entities), 153 co. 2 T.u.i.r (Ires, about non-commercial entities). In first instance, income has to be characterised in the categories provided in Article 6 T.u.i.r, in order to find the appropriate source rule. Therefore, the source is located where the payer is resident, where the property has its situs, where the activity is carried on.

Article 23 co.1 letter e) ascertains that business incomes derived to a non-resident through a permanent establishment located on the Italian territory are taxed in Italy.

Along these lines, a permanent establishment located in Italy constitutes that kind of genuine and reasonable link on which the State could justify its claim to tax business income derived to a non-resident , as it is, according to literature, the necessary and adequate subjective premise to tax a business carried on in the State's territory[12].

Therefore, P.E. only represents an income's economic form of attachment, a sourcing rule linking income and Italy's right to tax; it is never a person liable to tax on itself[13]. This conclusion derives from the literal interpretation of Articles 23 and 73 T.u.i.r but also from Articles 5 and 14 D.P.R. 600/1973 concerning the duty to file the tax return and accounting duties.

[11] T.u.i.r, Art. 3 co.1 (Irpef) and Articles 151 and 153 (Ires)
[12] P. Valente, *Stabile organizzazione e modello OCSE*, in *Corr. Trib*, 32/1997, 2337
[13] V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *Diritto Tributario Internazionale*, Padova, 2012, p.2 29.

Literature also highlighted the fact that keeping a P.E. in the territory of the States means something more than just an economic attachment: it is a quasi-person liable to tax[14], because it can change the ordinary criteria by which income is localized, allocating to it also income that did not derive from the P.E. In other words, the concept of permanent establishments "skims over the problem of the subjectivity but it does not touch it".[15]

Nevertheless, a further and proper analysis of the concept and the role of permanent establishment in Italy will be up to discussion in chapter 4.

[14] G. Melis*,* *op.cit*, p. 233

[15] F. Gallo, *Contributo all'elaborazione del concetto di "stabile organizzazione" secondo il diritto interno*, in *Riv. Dir. Fin.* , 1985, p. 385 ss.

CHAPTER 2

2.1 CONSTITUTIVE ELEMENTS OF RESIDENCE FOR INCOME TAX PUROSES – INDIVIDUALS

Individuals are deemed to be resident for tax purposes in Italy when they are registered in the civil register of resident population or have their domicile or the residence as ascertained in the civil code [16] for the most part of the taxable period, showing that reasonable and genuine kind of personal attachment with the territory, adequate to justify tax claims on residents in respect of all the income they receive, whether it has its source in that state or elsewhere.

2.1.1 CIVIL REGISTER OF RESIDENT POPULATION

The registration in the civil register of the resident population is a formal criterion. The civil register is an archive in which persons who fixed their residence (as habitual place of abode) or domicile (when there is no a fixed place of abode) in the territory of a municipal district are filed, having statistical, financial requirement and mandatory public disclosure purposes[17].

Also immigration and emigration are object of the mandatory disclosure to be recorded in the civil register.

As this formal criteria and the other substantive two (residence and domicile) are non-concurrent and alternative[18], an individual who moved *de facto* his or her residence (for civil purposes) abroad and at the same time has maintained the registration in the civil register, is deemed to be still resident for tax purposes and is, as a result, taxed on the worldwide income.

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[16] T.u.i.r. Article 2 co. 2
[17] See Law dec, 24th 1954, no. 1228
[18] G. Melis, *op cit*., p. 115

Hence, for tax purposes, in this case form prevails over substance, in contrast with the civil well established case law. According to this tendency, civil register records are deemed to be presumption unless counterproof[19], in order to prove that records are based on sham or false statements.

Afterwards, registration in the civil registry of resident population is a sufficient but non-necessary condition to give rise to residence for tax purposes in Italy; *ergo*, an individual who fixes his or her habitual place of abode abroad will have to ask the cancellation of his records and, if he or she is an Italian citizen, the registration in the registry of Italian citizen who are resident abroad[20] (AIRE)[21].

On the opposite, an individual who moved *de facto* his or her residence (for civil purposes) in Italy, even if there is not a registration in the civil registry, substance will prevail over form and he or she will be a deemed resident for tax purposes when residence in Italy took place for most part of the taxable period.

This rule has given rise to considerable questions about its compliance with Article 53 of the Constitution, as interpreted in the sense to justify Italy's claim to tax worldwide income of an individual deemed to be resident just on the base of the formal registration, notwithstanding any inquiry on the actual residence or domicile. According to the interpretation in compliance with the Constitution given by Corte di Cassazione in an *obiter dictum* [22], substance must prevail over form when counterproof against formal registration exists, as it happens in civil matters[23].

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[19]Ex pluribus, Cass., Sept., 27th 1996 no. 8554, in Giust. Civ. mass, 1996, p. 1338; Cass. Civ., Jul. 22nd 1195, no. 8049, in Giur. It., 1996,I,p.338 ss.; see also L. Giampaolino, *Anagrafe della popolazione*, in *Enc. Giur*., Roma, II, 1988.

[20] G. Melis, *op cit*., p.117.;

[21] Registration in Aire is not deemed to be a presumption without counterproof for an individual not to be resident; in fact, it can be proved that the individual maintained his residence or domicile in Italy. See Circolare Min. Fin., Dec, 2nd 1997 , n.304/E/I/2/705. See also Chapter 3.

[22] Cass., sez. I civ., Feb. 6th 1998, no. 1215 in foro.it, 1998,I,1128

[23] See note 20.

It is without prejudice that registration in the civil registry of the resident population gives in to a provision of a double taxation convention that, with regard to residence, follows Article 4 of the OECD model.

2.1.2 DOMICILE

Article 43 co. 1 of the civil code[24] provides that an individual's domicile is where he or she established his or her main centre of affairs and interests; co. 2 provides that an individual's residence is where he or she has the habitual place of abode. Thence, there is a plurality of forms of personal attachment, in contrast with the concept of seat for persons other than individuals (Article 46 c.c.).

According to a certain tendency in case law and in literature, domicile could be identified as *res juris* and residence as *res facti* , being the first concept a mere creation of the legislator, dominated by the individual's intention to fix in that place the main centre of affairs and interest, and the second concept a *de facto* matter, dominated by the actual presence in that particular place.

This tendency was criticized by several authors: both the concepts express actual situations, in which individual's intention is of course relevant but is the fact of the presence to prevail, as these are effective situations[25].

With respect to the concept of affairs and interests, according to a well established case law, this concept gathers both economic and vital (moral, social) interests, mainly related with the presence of the family[26]. Effectively, as those different kinds of interests could not be in the same place at the same

[24] From now on c.c.
[25] G. Melis, *op. cit.*, p. 149.
[26] Cass., Oct. 26th 1968, no.3586; id, Feb. 12th 1973, no. 435; id. , May 5th 1980, no. 2936. However in Cass., Nov. 17 th 2010, no. 23249 and 23250 a famous actress' transfer of residence was declared not sham; according to the Revenue agency, the transfer of residence was sham because her son continued living in Italy.

time, case law has always preferred, in order to determine the domicile, the place in which the vital (non economic) interests were located. Also the Revenue agency adhered to this tendency[27].

Contra, the literature affirms that in order to preserve the independency of the concepts of domicile and residence, domicile should only represent the centre of economic interest. As a matter of fact, taxation affects an individual's economic and patrimonial sphere and it could appear unreasonable basing Italy's claim to tax only on the presence of the family in the territory when the individual's most part of the activity is carried on abroad[28]. On the other hand, also ECJ confirmed the pre-eminence of vital interests in order to determine residence for tax purposes[29].

In order to establish domicile, art. 43 co.1 c.c. requires the centre of affairs and interests to be "main", from a quantitative point of view as a *de facto* matter, where the sole intention cannot be decisive. Domicile has also to be intentionally constant and recognizable. These considerations bring to identify domicile as unique.

2.1.3 RESIDENCE AS ASCERTAINED IN THE CIVIL CODE

Article 43 co.2 c.c. states that an individual's residence is the place of habitual abode.

In conformity with case law, two requisite are necessary: the objective, constant permanency in a determined place and the intention to stay. There could not be deemed residence *solo animo* , apart from the fact of permanency.

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[27] Circ. Min. Fin. No. 304/E-1997

[28] V. Uckmar *et alii* , *op. cit*., p.231

[29] ECJ, Jul. 12th 2001, C-262/99; follows this case law Cass., Nov. 7th 2001, no. 13803.

When an individual carries on an activity outside the municipality in which is deemed to be resident, the fact that the place of abode is habitual does not recede if the individual "maintains there a home, returns there when it is possible and shows his or her intention to keep there the centre of family and personal relationships"[30](so called *animus* of the individual's abode).

Moreover, the fact that the place of abode is habitual means that it must have a grade of stability, in the sense of intentional non-temporary nature[31]. Afterwards, in order to identify residence in cases of cross-border mobility, when the internal situation of intentional non-temporary abode has to be compared with a situation of the same nature abroad, the individual's various and constant permanency in different municipalities must be summed together and then compared with the foreign situation[32].

Permanency does not mean continuity or conclusiveness, unless absences are such as to make the abode no longer habitual. However, the duration represents only a symptom of the intentional non-temporary nature of the abode and it will be decisive only in order to determine residence for tax purposes, when the most part of the taxable year will be covered[33].

2.1.4 RESIDENCE PRESUMPTION FOR INDIVIDUALS

Art. 2 co. 2 bis T.u.i.r establishes a presumption in relation to residence of individuals. Hence, when an Italian citizen transfers his residence to a tax haven, the burden of proof that he had actually transferred his residence to this country is up to the taxpayer himself.

[30] Cass., Mar. 14th 1986, no. 1738
[31] G. Melis, *op. cit.*, p. 159
[32] Cass. SSUU, Oct. 28th, no. 5292
[33] See Chapter 1, par. 1.2 and Chapter 2 par. 2.3

More deeply, this anti-avoidance rule inverts the burden of proof whether: *1)* an Italian citizen cancels his registration in the civil register of the State*; 2)* thus, emigrates to a tax haven. As Italian citizens emigrating shall register themselves in the Register of Italians resident abroad (AIRE), also the verification of the second requirement to apply this rule depends on a formal control: the registration in the AIRE. Therefore, through these formal obligation, this inversion of burden of proof shall apply[34].

It is debated whether this presumption shall apply in case an individual who emigrates to a State other than tax havens, and after transfers his residence to a tax haven. An anti-avoidance interpretation imposes to extend the application area of this rule: if the temporary emigration was done aiming to circumvent the law, the *ratio* of this rule impose that it shall apply[35].

With regard to emigration to Countries other than tax havens, but having a favourable regime for emigrated[36], the burden of proof is up to the tax inspector as usual.

2.2 CONSTITUTIVE ELEMENTS OF RESIDENCE FOR INCOME TAX PURPOSES – PERSONS OTHER THAN INDIVIDUALS

As it is stated in Articles 5 co. 3 letter d (for partnerships, professional partnerships, *società semplice*) and 73 co. 3 T.u.i.r [37] , those persons are deemed to be resident in Italy when they have in the State's territory their legal seat or

[34] See G. Melis, *op. cit*, p. 339-340
[35] See Ibidem, p. 341-343
[36] .I.e. Countries adopting the remittance base taxation, according to which foreign income is taxed only when it is remitted in the State of residence. With respect to these Countries the double taxation conventions stipulated by Italy do not seems to be adequate in most cases. See V.Uckmar, G. Corasaniti., P. De' Capitani di Vimercate, C. Corrado Oliva, *op. cit.*, p. 233
[37] For the persons included see note 7

their place of management or their main object for the most part of the taxable period.

Therefore, for tax purposes not only is relevant the formal linkage of the legal seat, but also the effective localization of the place of management and the main object in the State's territory, as those forms of attachment represent adequate elements in order to recognise a company's actual vitality[38].

Those forms of linkages with the Italian territory are considered to be genuine and reasonable to justify tax claims, in compliance with the fundamental principle of the ability to pay expressed in article 53 of the Constitution; indeed, they have the ability to localize actual and determined economic relations[39].

2.2.1 LEGAL SEAT

The legal seat is the place stated in the articles of incorporation and in the bylaws *ex* Article 2328, no. 2 c.c. as it is recorded in the companies registry book.

Hence, the legislator eliminated the connection with the place of incorporation that, on the contrary, is relevant as the attachment criterion in transfer of resident matters for the purposes of the international private law[40].

2.2.2 PLACE OF MANAGEMENT

The link based on the place of management has been interpreted as the place of effective management, looking at the high decision-making power, at the place

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[38] See Cass. Sez. III, Dec, 10th 1974, no. 4172. According to this case law, in order to determine a company tax liability as a resident in Italy, the places stated in the article of in corporation, in the bylaws and in other official documents are not necessary conditions since the actual and substantive situation is decisive.

[39] G. Melis, *op. cit.*, p 226

[40] Law no.218/1995. A further and proper analysis on this topic will be up to discussion in Chapter 3.

where key-decisions are taken and where the strategy for the company to act as a whole are determined, in line with the tendency proper of international tax law.

In this manner, the actual situation must be evaluated, not just looking at whom, formally, the articles of incorporation or the bylaws assigned the power to manage, but also the role played by those who, among the inert others, effectively give rise to the business volitional pulses[41].

For these reasons, there could be only one place of effective management.

Nevertheless, this criterion could be quite hard to identify in various occasions, e.g. when managers decide to meet in different places on a rotational basis or, above all, because of the development of communication technology. E-mails, video-conferences make it not necessary for the managers to be physically located in the same place at the same time; as a consequence, directors are independent from the location of the company and the will of the board can shape itself simultaneously in more than one place or, when via-web, in none of them[42].

Further problems arise when it comes to groups, when the parent company and its subsidiaries are situated in different states. Generally, the subsidiary's management is strongly directed from the parent, the management of which impresses the common industrial, financial, accounting and administrative strategy; the subsidiary is appointed of the day by day running.

In these cases is important to identify the boundary that separates a common strategy and the complete deprivation of the subsidiary's volitional pulses, that could justify the parent's State's claim to tax the subsidiary as a resident too.

[41] F. Gallo, *L'applicazione d'ufficio del diritto comunitario da parte del giudice nazionale nel processo tributario e nel giudizio di Cassazione*. Relazione al Convegno sull'applicazione del diritto tributario, Corte di Cassazione, Dec. 12th 2002
[42] G. Melis, *op. cit.*, p.229

With respect to this matters, Article 73 co. 5-bis and 5-ter[43] establish two presumptions with the possibility to counterproof: the place of effective management of companies or other entities[44] that control *ex* Article 2359, co.1 c.c.[45] other companies or entities included in letters a) and b) of Article 73, co. 1 T.u.i.r, is deemed to be existent in Italy if, alternatively,

a. are in turn controlled, even indirectly, by resident persons

b. are managed by a board of directors whose members are mainly resident in Italy[46].

If one of the above-mentioned condition occurs, the burden of proof is shifted to the company. Indeed, it has to demonstrate that the effective residence of the company is not in Italy but abroad and, notwithstanding the cited occurred conditions, that there are facts, situations or other elements to prove the effective existence of the place of effective management in the foreign country.

On the other hand, the CFC rule established by article 167 T.u.i.r applies when a resident company controls a non-resident company. This rule does not regulate the non-resident company as a resident but it is based on a look through approach, in order to avoid tax deferral. In fact, income of non-resident controlled companies that are resident in a tax haven (a black list State), even if they have not been distributed, are imputed to the resident controlling subject,

[43] As amended with d.l. 223/2006 converted in Law 248/2006

[44] See note 7

[45] Article 2359 co. 1 c.c. – companies are deemed to be controlled when: a) another company has the majority of the voting rights in the general meeting; b) another company has sufficient voting rights to impress a dominant influence on the general meeting; c) another company impresses on that company a dominant influence due to particular agreements.

[46] Article 73 co.5ter T.u.i.r.- For the purpose of verifying the existence of control relevant for co. 5-bis, it shall be considered the situation at the end of the accounting year or management period of the foreign controlled entity. For the same purpose, with respect to natural persons, voting rights appertained to relatives (see Art. 5, co. 5 T.u.i.r), are taken into account.
Article 73 co. 5quater - Except when differently proved, companies or entities which assets are prevalently invested in shares of estate closed-end funds (see Art. 37 of Decreto Legislativo 58/1998), and controlled, directly or indirectly, through a trust company or a third person, by a person resident in Italy are deemed to be resident in the State. Control exists in compliance with Art. 2359, co.1, no. 1 and 2, even for participation owned by entities different than companies.

granting a tax credit for taxes paid abroad. Income is re-determined according to Italian rules and it is computed in the resident's taxable base proportionally to the participation held in the foreign company. The same provision applies to participation in non resident entities with respect to income deriving from their permanent establishments in tax havens. These provision shall not apply if the taxpayer proves that:

- the C.F.C. is carrying on an effective business activity in the market of the State or territory in which it is placed;
- the participation in the C.F.C. does not give rise to localization of its income in the tax haven. This condition is existing if C.F.C. income arose at 75% in State which are not tax havens. The Revenue Agency has stated[47] that this hypothesis is realized when the C.F.C. derived foreign income through a permanent establishment in a State with an ordinary taxation system. If income are dividends from companies resident in a State with an ordinary level of taxation, as the source of these income is the capital owned by the C.F.C. this condition does not seem to occur. But a recent *Circolare*[48] by Revenue Agency itself reconsidered this position.

The possibility not to apply this provision is strictly connected with the European Union principle of freedom of establishment as stated in the *Cadbury Schweppes*[49] case, that allows the tax advantages due to a foreign establishment if and only if the controlled foreign companies are not wholly artificial arrangements intended to circumvent national law. In compliance with *Cadbury Schweppes*, the C.F.C. regime shall not apply if the taxpayer proves that the

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[47] Revenue Agency, Risoluzione 18/E/2003

[48] Revenue Agency, Circolare 51/E/2010

[49] ECJ, Sep. 12th 2006, C-196/04.

foreign establishment is not an artificial arrangement directed to an undeserved tax advantage.

To conclude, Art. 4 par. 3 of OECD Model ascertains that persons other than individual's residence for tax purposes is in the place where its place of effective management is situated. Before the change done in November 2008, OECD Commentary stated that the place of effective management shall be deemed to be in the place where directors and managers meet in order to take strategic decisions. However, it must be remembered that Italy placed an observation to the Commentary, according to which the place where "the most senior persons or group persons" cannot be considered the only criterion to find the place of effective management. I.e., it should have been considered also the place where the main activity of the company is carried on. The OECD commentary, as previously said, was modified in 2008: with respect to these matters, indeed in the new edition of the Commentary the place of effective management is found with regard to some concurrent criteria, not only with regard to the meeting place of the most senior persons or group persons.

2.2.2.1 CONTROL AND PERMANENT ESTABLISHMENT

A person or a company resident abroad could control a company in Italy that could be considered as a permanent establishment. With respect to the possible contrast and/or duplication of attachments to the States, Art. 5, par. 7 of the OECD Model convention states that "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". In order to clarify this provision, a recent modification to the OECD commentary explains that "in relation to the test of legal dependence, it should be noted that the control which a parent company exercises over its subsidiary in its capacity as shareholder is not relevant in a consideration of the dependence or otherwise of the subsidiary in its capacity as an agent for. This is consistent with the rule in paragraph 7 of Article 5. But, as paragraph 41 of the Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies"[50]. Thus, this amendment could be seen as a reaction of the OECD to the interpretation by the Italian Supreme Court of Art.5, par. 7 in the Philip Morris case[51].

The Supreme court ruled that an Italian company could be considered a permanent establishment of foreign associate companies which pursue a homogeneous strategy, pointing out the activity of controlling the correct execution between a resident person and a foreign company should not be considered an auxiliary activity according to Art 5, par. 4 of the Model Convention and that the participation of directors and managers of the Italian company to a phase of the stipulation of an agreement between the associate foreign companies and a resident person can be considered an example of the power to conclude contracts in name of the foreign enterprise. Nevertheless, this interpretation seems to be paradoxical, as usually a subsidiary is directed by the parent company, which has the power to appoint the directors and is the majority (or sole) shareholder.

As aforesaid, the OEDC Commentary repulses this interpretation. The OECD seems to consider the subsidiary as a permanent establishment in case it represents a *longa manus* of the head office business, in the sense that the

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[50] See OECD Commentary, Art. 5, par. 38.1
[51] See Cass, 3367/2002, 3368/2002, 7682/2002, 10925/2002

subsidiary's assets are at disposal of the parent company in order to carry on its business, or when the subsidiary has the power to conclude contracts in name of the foreign parent (being a dependent agent), or whether the subsidiary carries on functions that can be considered complementary (not merely auxiliary) to the foreign company business. Therefore, the fact that the subsidiary activity is directed by the parent is not sufficient to consider the first a permanent establishment[52].

Furthermore, this problem could intersect the residence, as, according to the criterion of the place of effective management, the subsidiary could be considered resident in the State of residence of the parent company, because of lack of management autonomy[53].

In this case, the problem of the permanent establishment endures, as the subsidiary or the parent, both resident in the State of residence of the latter, can be considered carrying on a business in the host State through a permanent establishment[54].

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[52] OEDC Commentary, Art. 5, par. 41: "A parent company may, however, be found, under the rules of paragraphs 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company... and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraphs 3 and 4 of the Article... Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent ... unless these activities are limited to those referred to in paragraph 4 of the Article or unless the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of the Article applies".

[53] G. Melis, *op. cit.*, p. 235.

[54] Ibidem, *op. cit.*, p 240

2.2.3 MAIN OBJECT

The attachment criterion based on the main object indicates the place in which the activity is carried on in order to reach the aim of the entity and where the will of the company finds its actual implementation[55].

Article 73 co. 4 ascertain that the main object is the essential activity carried on in order to achieve directly the primary aims as determined by the law, the articles of incorporation or the bylaws. The main (or exclusive) activity of the resident entity is determined by the law, the articles of incorporation, the bylaws if these documents exist as public deed or notarized private deed. Moreover, if these two documents do no have that required form, the resident entity's main activity is determined on the base of the activity that is actually carried out in the territory of the state[56].

The formal verification through the documents shall not be relevant in order to qualify a person as resident, but only to qualify the main object as commercial or non-commercial, as the rule in Article 73 co.5 T.u.i.r itself assume that the entity has been already qualified as resident[57].

Noticeably, identifying the main activity involves a *de facto* verification, with respect to the activity that is actually carried on in the territory of the state. In addition, the fact that it has to be main involves the importance of quantitative parameters – e.g. gross profit, localized assets value, number of employees – and qualitative parameters when the activity is multiple, in order to identify which of them is accessory and which, instead, is the typical one.

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[55] Ibidem, *op. cit.*, p 240

[56] Article 73 co. 5 T.u.i.r that also states that this provision applies in any case to non resident persons.

[57] G. Melis, *op. cit.* pag 247. G. Falsitta, *Manuale di diritto tributario, Parte speciale* , Padova, 2010 pag. 270

Problems can arise when it comes to the relation between the object of the main activity and the main assets of the company.

For instance, with respect to companies that do not carry on any genuine commercial activity the line between the activity that is carried on and the main assets could be hard to find when their major asset consists in immovable property with its situs in Italy or in participation in entities that are resident in Italy. In these cases, the only activity consists in the purchase and transfer of those assets that could easily entail a "convenient" localization. This kind of practice based the presumptions established in Article 73 co. 5-bis, 5-ter[58]. Consequently, the word "object" stated in Article 73 shall be interpreted as the activity carried on by the company; and this activity (in this case, participation holding) and the asset (the participation) are clearly different and the requisite on which the presumptions are based in order to attract the foreign' s holding residence in Italy is the place of effective management, not the fact that the object (assets) are detained in a resident company.

With respect to the consideration of a real estate as a permanent establishment, the Italian Supreme court stated that ownership of an immovable property is not sufficient to form a permanent establishment if the possession has the only aim to administrate the estate. Otherwise, in case the property is instrumental to the business or is the object of the business itself, it could be considered a permanent establishment in the host State[59]. The existence of mere immovable property, if the business of the foreign enterprise is carried on by means of this, could be a reasonable link in order to found a permanent establishment[60].

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[58] d.l 223/2006. See chapter 2 par. 2.2

[59] See Cass., 8820/1987

[60] See G. Melis, *op. cit*, p. 243

2.2.4 TRUSTS

Trusts are deemed to be resident in Italy on the base of the same corporate income tax rules[61] stated in Article 73 co. 3 T.u.i.r.

However, with exclusive respect to trusts, two presumption of residence in Italy are established by art. 73 T.u.i.r. Hence, trust settled[62]in tax havens are deemed to be resident in Italy if:

- at least one of the settlors and one of the beneficiaries are resident in Italy;
- after the trust institution, a person resident in Italy attributes to the trust a right on an estate.

These presumptions were provided for the purpose to contrast tax elusion and evasion. Even if the possibility of counterproof is established only for the first presumption, the Revenue Agency, in order to interpret the rule in compliance with Constitution, considers this possibility to exist also with regard to the second one[63].

2.3 TIME REQUISITE – MOST PART OF THE YEAR

According to Art. 7 T.u.i.r. income tax applies tor taxable periods. This is a legal fiction, as income is a flow which can increase or decrease the stock of wealth belonging to the taxpayer. The stock may fluctuate during the whole taxpayer's existence: the actual flow of wealth earned by a person or a company should be measured only with regard to the starting and the ending point.

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[61] V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *op. cit.*, p. 377-379

[62] The word "settled" was considered by the Revenue Agency (see Circolare 48/E/2007) as referred to a "formal resident for tax matters". In order to have an explanation of the main problems due to this expression, V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *op. cit.*, p. 379-380

[63] Circolare 48/E *cit.*

Otherwise the necessity of contributes of the State does not allow to defer taxes at the end of the taxpayer's existence; therefore, the notion of taxable period is indispensable[64].

With regard to time requirement, in order to consider a person resident in the State it is necessary that the relation between the person and the State is stable. Indeed the material requirement provided by Art. 2 and 73 T.u.i.r. in order to qualify a person, a company or everything in between as a resident shall exist for almost the most part of the taxable period for the purpose to consider that taxpayer resident in the State.

If the time requirement has occurred, the taxpayer shall be taxed as a resident for the whole taxable period, even if he became a resident after the taxable period beginning. Instead, if this requirement has not matured, the taxpayer is not resident for the whole taxable period. As a consequence, the effects of the fact that the time requirement accrued are retroactive[65]. It is not necessary that the relevant period is continuous: many different periods could form "the most part of the taxable period"[66]. Hence, it is not necessary the physical permanence in the State, as this requirement is not necessary with regard to residence for civil matters[67].

[64] G. Melis, *op. cit.*, p. 277
[65] See Ibidem, p.293
[66] See Ibidem, p.296
[67] See Ibidem, p.298

CHAPTER 3

3.1 COMPANIES' TRANSFER OF SEAT – INTERNATIONAL PRIVATE LAW ISSUES

Companies' transfer of seat is a really complex matter for the reason that, as it was stated in the *Daily mail*[68] case by ECJ, those entities are created by a national legal order and they exist due to its rules.

Hence, the possibility to transfer the legal seat in legal continuity depends on the choice a single legal order takes about the linkages on the base of which its *lex societatis* applies to a company.

With respect to Italy, Article 25 of law no. 218/1995 was the first rule to be introduced in Italian legal order to regulate entities with legal personality having strangeness elements with regard to the Italian legal order itself.

Article 25 co. 1 ascertains that companies, clubs, foundations and all the other entities, both public and private… shall be regulated by the law of the state where the incorporation proceeding was completed. Nevertheless, Italian law shall apply in the case the place of effective management or the main activity of these entities are in Italy.

Afterwards, Italian legal order incorporates entities according to its own rules and recognize entities incorporated under a foreign legal order's rules. Italy so adheres to the *Grundungstheorie* , or place of incorporation theory, even though it is tempered by the place of effective management and the main activity criteria. As a consequence, Italian law, under the force of which an entity was incorporated, applies permanently to that entity, wherever it carries on its activity or its place of effective management is located. On the other hand,

[68] ECJ, Sep.27th 1988, C-81/98

foreign entities that transfer their legal seat in Italy shall be recognized and regulated by their own incorporation law, as the legal order who adheres to the *Grundungstheorie* bares the risk to import the law of another State[69]; of course these entities should not be pseudo foreign companies.

3.1.1 EMIGRATION FROM ITALY AND IMMIGRATION TO ITALY

Article 25 co. 3 of Law 218/1995 establishes that transfers of legal seat abroad and mergers with entities having their seat abroad shall be operative only if they had been implemented in compliance with the law of the involved states.

According to the *Grundungstheorie* , when a company incorporated under Italian law transfers its legal seat abroad should not give rise to any legal problem, as they are free to move their seat without incurring in a winding-up. The transfer of the legal seat constitutes a bylaws modification[70]. In general, according to *Grundungstheorie*, an entity could not back out of its legal order's force. The emigrant company remains regulated by the incorporation legal order's rules, wherever its activity takes place[71].

Formerly, case law established that the transfer of the legal seat abroad could be assimilated to a winding-up of the entity ; it would cause its pay-off and its extinction and, then, a new incorporation proceeding abroad. *Contra,* according to the literature opinion, emigration should not cause the extinction of the entity if implemented in compliance with the law of the involved states, that is what was stated in 1995 in Article 25 co. 3., disregarding the winding-up rules even for tax purposes[72].

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[69] G. Melis, *op. cit.*, p. 194, nt.173

[70] Articles 2328, co. 2 no.2 (articles of incorporation) 2365 (extraordinary meeting for bylaws modifications), 2369 no. 4 (majority).

[71] C. Licini, *Persone giuridiche*, in *La condizione di reciprocità*, by Ieva, 2001, p 161.

[72] See Chapter 3 par. 3.3

As a consequence, when an Italian entity transfers its legal seat abroad, in a state which adheres to the incorporation theory too, emigration occurs in legal continuity, without winding-up in Italy an without the need of a re-establishment, as also the foreign country recognize the immigrant entity as regulated by its incorporation law.

Sed, emigration can be operative only if it had been implemented in compliance with the law of both the involved states. Legal continuity, then, hinge upon the compatibility with the rules of the new seat's State [73]. Thence, differences occurs when an Italian entity moves its seat in a E.U. country or in a non-E.U. one[74].

When emigration is *intra*-E.U., the company deliberation about the transfer of legal seat shall be registered in the companies registry as an articles of incorporation's modification and any further mandatory disclosure regarding the transfer of seat is not required, unless the company intends to cut any attachment with Italy, so that a cancellation request is required[75]. In other words emigration *intra*-E.U. is unconditional (see *infra)* so that Article 25, co. 3 in these cases is unusable.

On the other hand, when emigration is *extra*-E.U., the notary who receive the deliberation concerning the transfer of seat has to verify that it is actually in compliance with the rules of the new legal order (e.g. verify if the transfer of seat is permitted, which forms of public disclosure are mandatory, if a re-establishment is needed).

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[73] See Cass, SS.UU., Jan 23rd 2004, no. 1244 in Giur. It. , 2004, p.2103. Cass, Sep. 28th 2005, no. 18944.

[74] A. Righini, *Il trasferimento di sede all'estero. Valore fiscale dei beni trasferiti e iscrizione nel registro delle imprese*, in *Il Fisco*, 2008, no. 9 fasc.1, p. 1551 ss.

[75] The cancellation from the registry will be completed when the company will be registered abroad or re-established abroad in compliance with the new legal order.

On the contrary, when an Italian entity emigrates to a country which adheres to the *Sitztheorie*, or the real seat theory, there could not be legal continuity.

Effectively, according to the *Sitztheorie*, the country that adheres to it does not recognize entities which have not an actual linkage with the country itself, otherwise the real or effective seat. Therefore, as they consider the emigration of national entities as a winding-up, they do not recognize foreign entities who belongs to different legal orders with respect to the place where their legal seat is located so that these entities are forced to set up a re-establishment.

With respect to *intra*-E.U. migration, as ECJ ruled in the *Überseering BV*[76] case, the host country shall not ignore the legal personality created under the force of the law of the home country and compel a company to a re-establishment in its own territory, in compliance with its own law, as, otherwise, freedom of establishment is violated. According to this case law, the *Sitztheorie* should not be in compliance with the freedom of establishment as a discrimination (in the host country perspective) but maybe also as a restriction[77] , in the home country perspective, can occur.

This question, in the home country perspective, is still hanging, as in the *Daily Mail*[78] case, ECJ ruled that freedom of establishment is protected with exclusive regard to secondary freedom of establishment, not involving transfers of seat that home countries could regulate in different ways, even if they cause the moving company's winding-up.

However, twenty years after ruling *Daily Mail*, the ECJ said over this matter again in the *Cartesio*[79] case. From the departure State perspective, two

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[76] ECJ, Nov, 22nd 2002, C-208/00

[77] F.M. Mucciarelli, *Libertà di stabilimento comunitaria e concorrenza tra ordinamenti societari*, in *Giur. Comm.* , 2000, II, p. 566

[78] ECJ, Sep. 27th 1988, C-81/87

[79] ECJ, Dec. 16th 2008, C-210/06

hypothesis must be distinguished: the case of a moving company that wants to maintain its original *lex societatis* and the case of a company that does not want to maintain its original *lex societatis*[80].

In the first hypothesis, according to its well established case law, ECJ said that Treaties do not prevent States to choose the criteria on which the necessary bonds between the company and the incorporation State are based and, therefore, they do not prevent States to impede the conservation of the original *lex societatis.*

On the other hand, when a company wants to move its place of management in another E.U. member State which adheres to the *Grundungstheorie,* and it wants to change its *status* adopting the host State's *lex societatis,* the departure State shall not limit the transfer of seat in any way, as a restriction of the freedom of establishment can occur. Consequently, the home State shall not compel the company to wind-up as it can establish itself in the new State, if it is possible in compliance with the host state law.

As a result, freedom of establishment and the companies' willingness to move prove to be strengthen. Hence, the criteria on which States adhering to the real seat theory base the application of their *lex societatis* shall permit the *status* transformation and those State shall not consider companies' willingness to emigrate (moving the place of management) in another E.U. member State as a winding-up cause[81]

In *extra*-E.U. migrations, article 25, co.3 shall regularly apply. Consequently, when a company immigrates in Italy, the transfer of seat is deemed to be legitimate when it is in compliance with the essential requisites of the articles of

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[80] *Cartesio, cit.,* (nt. 80), p111

[81] P. Manzini – F.M. Mucciarelli, *Rivoluzione Cartesiana? La fine del vincolo necessario tra società e legislazione nazionale*, in *Giur. Comm*., 2009, fasc. 4, pp.614-629

incorporation, required for each form of doing business (e.g. the paid-up capital shall be sufficient and the object shall be licit). Afterwards, the immigrating company has to register in the companies registry. If the company does not comply with all those requisite, it is not deemed to be non existent but only irregular, whit consequences on the limited liability regime so that whomsoever acts in behalf of and in name of the company has unlimited liability for any obligation.

None of these conditions shall be imposed to immigrant E.U. companies, also with respect to the paid-up capital rule[82] (see *supra)* .

3.2 EVALUATION CRITERIA OF INBOUND ASSETS

The recognition of the fiscal value of inbound assets, subject to the business tax regime, when a company or enterprise transfers its residence to Italy, is a major issue. The case of a non-resident company which has a permanent establishment in Italy and then moves its residence to Italy does not give rise to such a question. In fact these assets are still subjected to the Italian tax regime and are evaluated at their "historic" value[83].

T.u.i.r does not state any specific provision about inbound assets evaluation; the law only regulates the opposite case, that is the exit tax (see *infra).*

The main issue is that a fiscal value is missing, as assets already belong to the entrepreneur so that there is not a purchase value. Indeed, these assets are entering Italy for the first time and it is necessary to find a value for the purpose of calculating capital gains in case of (future) realization.

[82] G. Petrelli, *Lo stabilimento delle società comunitarie in Italia*, in *Riv. Not.* , 2004, pag. 378
[83] T. Tassani, *Transfer of residence and exit taxation in EU law: the italian approach*, in *Studi Tributari Europei*, 1/2009

The only clues of the existence of law rules with regard to these matter were written in some double taxation treaties. In particular, DTTs with Canada and Germany established that entering assets shall be evaluated with respect to their fair value in case of exit tax paid in the previous home State at the moment of the emigration[84]. The Revenue Agency used the same solution in Risoluzione 67/E/2007, as the aforementioned clause included in the DTT with Germany did not apply in that case. This interpretation was justified by the fact that when an exit tax applies, this is the only possible criterion to correctly subdivide the power to tax between the two Countries involved, also for the purpose to avoid transfer of residence aimed to fiscal elusion. If assets have already had a value (for tax purposes) in Italy (i.e., they belonged to a permanent establishment of the enterprise immigrating in the State) they continue to be subjected to the same rules applied before with the same value.

Recently, the Revenue Agency said over the matter again[85]. It specifies that the cost criterion could be used in cases, such as a transfer of seat or a merger, characterized by the lack of realization of asset and by the necessity to maintain the same value (for tax purposes) than before. The fair value criterion, instead, is more suitable to represent phenomena of juridical and tax discontinuity and realization of the assets, as well as to avoid double taxation in case of exit tax in the previous home State.

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[84] V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *op. cit.*, p 245

[85] Revenue Agency, Risoluzione 345/E/2008

3.3 EXIT TAX

According to international practises, Italy applies an exit tax in case of transfer of residence abroad, for the purposes to prevent tax evasion and to maintain its tax system coherent[86]. Thus, with regard to enterprise assets, the taxation of unrealized capital gains is provided. In this manner, the possibility for Italy to tax accrued capital gain, even if they are not realized at the time of transfer, is preserved, and the related tax revenues is not lost forever. The *ratio* of this rule justifies also the exception to the rule itself: when enterprise assets are owned by a permanent establishment in Italy of the non resident enterprise, tax shall not be paid.

In compliance with Art. 166 T.u.i.r., all the enterprise assets that are not linked to a permanent establishment in the territory of the State, as a result of the transfer of residence, shall be considered realized with respect to their normal value determined according to Art. 9 T.u.i.r.

The subjective requirement, in order to apply the exit tax, is constituted by the transfer of residence abroad of persons and entities carrying on a business activity, which entails the loss of resident in the departure State. This rule must be intended in the sense that the transfer abroad of the requirements to be considered resident is sufficient to apply the exit tax, otherwise the tax is dependent on the effective loss of residence in Italy[87]: indeed, it is possible that the taxpayer comes back to Italy before the accrual of the time requirement from which the loss of residence derives[88].

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[86] V. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *op. cit.*, p 241-242; T. Tassani, *Transfer of residence and exit taxation in EU law: the Italian approach*, in *Studi Tributari Europei*, 2009, 1.; G. Melis, *op. cit.*, p. 516

[87] Considering the actual lost of residence in the State as a condition has an important consequence: the exit tax due shall be computed with regard to the moment when the enterprise moved abroad and not to the moment when the lost of residence matured.

[88]G. Melis – *Art. 166 t.u.i.r,* in *Commentario breve alle leggi tributarie,* Tomo III. *TUIR e leggi complementari (*diretto da A. Fantozzi), Cedam, Padova, 2010

With respect to shareholders, this rule seems to be neutral, as it is stated in Art.166 co. 2-ter. Nevertheless, it is possible that the State of destination does not recognize the Italian company transferred abroad, because of the real seat theory. In this case, the mandatory winding-up in Italy would bring to the taxation of the shareholders. However, after the ECJ ruling in the *Überseering* case, this eventuality is limited to the case of extra-E.U. emigration[89]. In relation to partnerships, Art. 166 T.u.i.r. gives to the partners the possibility to obtain the separate taxation (in order to avoid progressivity with regard to income accrued in a long period of time), as the exit tax is imputed to the partners according to the look through approach.

The values to be considered in order to apply the exit tax shall include goodwill (as the enterprise value is made up also by goodwill)[90] and capital losses. Instead, assets not included in the enterprise shall not be considered[91], even if the Revenue Agency seems to include them in the taxable base of the exit tax[92].

Any question should not rise with respect to income earned in the taxable period: it should be taxed or not depending on the moment in which the time requirement accrued[93].

The losses accrued in Italy, in case of permanency in Italy of the transferred enterprise, could be carried forward according to Italian law in proportion to the net asset owned by the permanent establishment. Instead, as it is not possible to compensate losses derived from business with income of other sources, they would be definitely lost[94].

[89] Ibidem, p.3
[90] G. Melis, *op. cit.*, p. 530
[91] Ibidem, p.534-537
[92] Circolare 36/E/2004
[93] G. Melis, *Art. 166…cit.*, p. 5
[94] Ibidem, p. 6-7

As aforesaid, assets belonging to the permanent establishment of the emigrated enterprise shall not be taxed. Literature noted that the notion of permanent establishment provided by Italian law after the 2003 reform is merely internal, and there is not a link with definitions expressed in DTCs. This may bring problems in case of differences in the two notions[95]. Furthermore, the rule requires the "confluence" of the enterprise asset in the permanent establishment. The meaning of this term was discussed, as it was thought either it refers to an accounting link or to a functional and actual link. It was also stated that the force of attraction of the permanent establishment leads to apply this rule to all the enterprise assets in Italy[96]. Excluding the latter interpretation, the problem should be resolved as follows: the application of the accounting link is preferable as it is easier, but tax inspector could verify the existence of the functional connection with the State. Thus, also assets abroad could be referred to the permanent establishment[97].

With respect to permanent establishment abroad, the general rule is to consider capital gains related to them realized at the normal value. With regard to permanent establishment in other E.U. member States, it is provided that a notional tax credit (that is the tax that should be paid in the foreign State in case of realization of all the asset of the permanent establishment) shall be granted.

It is important to remember that the ECJ ascertained the incompatibility of exit taxes with regard to the freedom of movement of persons protected by the Treaty[98], as the transfer of residence is limited by the fact that a tax on a fictional income is levied.

[95] Ibidem, p. 11-12
[96] Ibidem, p. 12
[97] G. Melis, *op. cit.*, p. 568
[98] ECJ, Mar. 11th, 2004, *Lasteyrie du Saillant*, C-09/02; *N*, Sept. 7th, 2006, C-470/04.

With respect to the freedom of establishment, a tax system, to be considered in compliance with the Treaty, can provide the calculation of the due taxes on unrealized gain at the time of the emigration but shall differ the payment until the realization[99]. This system presupposes an adequate exchange of information and assistance in the collection of taxes between the Member States, and with regard to those the E.U. legislation seems to be sufficiently developed.

In order to respect the conditions imposed by the ECJ, D.L. 1/2012 has recently inserted in Art. 166 T.u.i.r. two new commas (*2-quater* and *2-quinquies*), according to which entrepreneur transferring residence in a white listed State that concedes assistance in the collection of taxes are allowed to ask a payment deferral. Nevertheless, a future decree by the Ministero dell'Economia e delle Finanze shall define the condition to exercise this right. These conditions seems to be very important, as, according to *National Grid Indus BV* case, the State of departure could ask guarantees to the taxpayer and, in compliance with some interpretation, also interests[100].

The Italian system, with regard to exit taxes, seems to be compatible also with Art. 13 of the OECD Model convention. An important ruling by the Supreme Court of The Netherlands[101] stated that exit taxes are not in breach of Art. 13, as the article itself does not prohibit taxation of accrued, not realized income.

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[99] ECJ, Nov. 29, 2011, *National Grid Indus BV*, C-371/10.

[100] V. Russo, *Exit taxes e diritto comunitario: quale "modello" compatibile*?, *not published yet*, D. Smit, *The National Grid Indus Case: a Pirrhic Victory*?, in *Studi Tributari Europei*, 2012, 1, p 24-25

[101] Supreme Court of The Netherlands, Feb. 20/2009, 07/12314; V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *op. cit.*, p. 243-244.

3.4 FORMAL OBLIGATIONS

In the matter of the formal obligations related to immigration or emigration in/from Italy, we should distinguish those regarding civil aspect between those concerning tax matter.

With respect to the first:

- In case of transfer of residence from Italy to another E.U. member State, if the company does not want to maintain the Italian law applicable, the company shall register the transfer act to the register of company, through a notary or a director, in case of partnerships, until 30 days from the stipulation of the act, including the articles of incorporation and the bylaws. Some stamp taxes are requested: their amount varies in case of partnerships or companies. Thus, after that mandatory disclosure in the host State is complete, the notary/director shall present a form and a certificate attesting the compliance with rules of the host State.
- In case of transfer of residence from Italy to another E.U. member State, if the company wants to maintain the Italian Law applicable, the procedure is the same, but the company shall not cancel its registration in the register of companies, and all the modification of articles of association or bylaws and those related to the balance sheet shall be deposited in the register of companies, according to Italian law (Art. 2436 civil code).
- In case of transfer of residence in Italy from another E.U. member State, until 30 days from the deposit of the transfer act upon a notary and not later than 30 days from the stipulation of the act, a Form, the articles of association and the bylaws shall be deposited upon the register of companies.
- In case of transfer of residence from Italy to a State other than E.U. members, if the company does not want to maintain the Italian law applicable,

the company shall register the transfer act to the register of company, through a notary or a director, in case of partnerships, until 30 days from the stipulation of the act, including the articles of incorporation and the bylaws. Some stamp taxes are requested: their amount varies in case of partnerships or companies. Thus, the notary shall verify the compliance of the decision with the host State legislation. Therefore, if the foreign legislation follows the incorporation theory, the obligation are the same, after that mandatory disclosure in the host State is complete, the notary/director shall present a Form and a certificate attesting the compliance with rules of the host State. If the host State follows the real seat theory, the company shall be winded up in Italy and incorporated in the foreign State.

- In case of transfer of residence from Italy to a State other than E.U. members, if the company wants to maintain the Italian Law applicable, the procedure is the same, but the company shall not cancel its registration in the register of companies, and all the modification of articles of association or bylaws and those related to the balance sheet shall be deposit in the register of companies, according to Italian law (Art. 2436 civil code).
- In case of transfer of residence in Italy from a State other than E.U. members, until 30 days from the deposit of the transfer act upon a notary and not later than 30 days from the stipulation of the act, it shall be deposit a Form, the articles of association and the bylaws, upon the register of companies.

With respect to formal obligations for tax purposes, individuals carrying on a business have to register for VAT by filling in model AA9/11 in order to start carrying on their business in Italy. Persons other than individuals have to register for VAT too, by filling in model AA7/10 in order to start carrying on their business in Italy[102]

3.5 REGISTRY TAX

The transfer of seat in Italy is relevant for Registry tax purposes *ex* article 4 D.P.R no.131/1986 when:

- the departure State is a non-E.U. member, and both the legal seat and the place of management are not in the E.U. territory
- the departure State is a E.U. member, when a company transfers its place of management and in that State the capital duty *ex* directive CEE 1969, no. 335 was not paid
- the departure State is a E.U. member, when a company transfers its legal seat while the place of management is located in a non-E.U. member State and in the first State the capital duty *ex* directive CEE 1969, no. 335 was not paid.

Hence, according to the general principle, this kind of operations shall be taxable only in the State where the company has its real seat at the moment of the setting-up, ensuring a sole capital duty[103]. However, the transfer act, in order to be accepted in Italy, must be deposited among a functionary.

The Revenue Agency[104] stated that the transfer act of a company's legal seat in Italy when this company already paid the capital duty in the departure state is not obliged to register this act; the public deed of deposit, instead, shall be registered[105]

[102] http://www.agenziaentrate.gov.it/wps/portal/entrate/home
[103] Consiglio Nazionale del Notariato, *Study no. 152-2008/T* written by P. Puri
[104] Ris. Min. Jan 30th 1988, Prot. 301046
[105] Article 11 D.P.R. no 131/1986

CHAPTER 4

4.1 THE NOTION OF PERMANENT ESTABLISHMENT

The notion of permanent establishment in the Italian law was recently stated by the legislator, as before there was not a definition of this concept and case-law reconstructed it referring to Art. 5 of the OECD Model Convention. The law delegating the government to enact the 2004 tax reform established that the criteria in order to state the internal notion of permanent establishment had to be found in Art. 5 itself. Nevertheless, the word "criteria" was interpreted in the sense to give discretional power to the legislator in order to make the internal rule different from the OECD Model, even if the rules should have been in compliance with the criteria inferable from the Model.

This connection with Article 5 leads literature to consider that, for the purpose to interpret the internal notion of permanent establishment, it is impossible not to take into account the OECD Commentary[106].

According to Art. 162 T.u.i.r., the permanent establishment is a fixed place of business through which a non resident enterprise carries on partially or totally its business in the territory of the State. The notion of permanent establishment *ex* Art. 162 T.u.i.r. shall be considered applicable for both the foreign permanent establishment of an enterprise that is resident in Italy and the Italian permanent establishment of an enterprise that is resident in a different State.

This kind of permanent establishment (defined material permanent establishment) is in compliance with Art. 5 of the OECD Model. So it is necessary the presence in the State of a place of business, which shall be fixed

[106] E. Della Valle, *La nozione di stabile organizzazione nel nuovo Tuir*, in *Rassegna Tributaria*, 2004, 5, p. 1597; v. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *op. cit*, p. 248.

and through which the business is carried on. Therefore, it is possible to cite OECD Commentary, according to which the condition for the existence of a permanent establishment in the host state are three:

the existence of a place of business;

the fact that the place is fixed;

the business carried on through the place itself.

Other facts, such as independent management and accounting, are not conditions for the existence of the permanent establishment[107].

In the matter of the place of business, according to the OECD commentary, it shall consist in every kind of premises, buildings, area used to carry on the business[108]. It is not necessary the presence of work force[109] in the host State[110]. Intangibles and receivables are not sufficient to constitute a place of business. Both Art. 162 T.u.i.r. and Art. 5 of the Model Convention do not require that the enterprise is the owner of the place itself. The sufficient condition is the mere availability of the place, even if *de facto* or against the law.

Fixity is unanimously deemed to have a dual meaning, temporal and spatial. Hence, fixity exists when, on one hand, there is a link between the place of business and a definite place, and, on the other hand, when this link is not merely temporary[111].

In the matter of the spatial profile, it is possible for the same enterprise to have more than one fixed place of business and therefore more than one permanent establishment in Italy.

[107] E. Della Valle, *op cit*.
[108] I.e. a machinery can be considered as a place of business
[109] OEDC commentary, Art. 5, par. 10
[110] Under European law, for the purpose to identify the VAT permanent establishment, the ECJ considers necessary the presence of work force. See ECJ, *Aro Lease*
[111] Art. 5 OECD commentary

With regard to the permanency, it is not so easy to determine the minimum period of time in order to recognize its occurrence , aside the case of building activity ruled explicitly by Art. 162 co. 3 T.u.i.r. The answer depends on the circumstances of the case. Hence, for this purposes, the features of the business and the kind of installations used.

In conclusion, in relation to the fact that the permanent establishment should be the structure through which the business is carried on, we must notice that the OECD commentary considers sufficient that the fixed place could be also the object of the business itself. It does not matter the kind of business, which could differ from the business of the enterprise[112].

Thus, Art. 162 co. 2 provides a positive list, similar to that written in Art. 5 par. 2[113] of the OECD Model convention, of cases in which a permanent establishment exists. Art. 162 adds a new hypothesis, with respect to the extraction of natural resources from zone beyond the territorial sea of the state but on which the legislation gives to the state rights in relation to the seabed, the subsoil and its natural resources. This addition could be seen as an extension of the territoriality of the State[114].

This list should be consider as explicative: it is possible to form a permanent establishment in other manners. Nevertheless, it should be taken into account that Italy placed an objection to the Commentary, as our State interprets this rule in the sense that these hypothesis shall be considered in any case permanent establishment. Mirroring this interpretation in the internal rule, in order to save the compliance with Constitution and the ability to pay principle, it is necessary to consider that provision as establishing a presumption *juris tantum*.

[112] E. Della Valle, *op. cit.*. See also Chapter 2.2.3
[113] Art. 5 par. 2 mod. OECD
[114] E. Della Valle, *op. cit.*

Moreover, Art. 162 co. 4, it is designed on Art. 5 par 5 of the OECD model. Indeed this rule provides a negative list: a list of cases in which a fix place of business that would have the requirements to be considered a permanent establishment is not deemed to be so[115].

In this case the OECD model is reproduced *in toto*. However, all this hypothesis are related to activities considered to be auxiliary or preparatory to the business of the enterprise, as it is stated by the residual rule of comma, in letter e). There is a mere addiction, with respect to the availability of computers and auxiliary installations consenting to collect and to transmit data and information aimed to sale of goods and services. In relation to this provision the legislator seems to diverge to what is written in the OECD commentary[116] according to which a server could be considered sufficient to constitute a permanent establishment in the host State. Instead, for Italian law, it is also necessary that the server is used in one or more essential phases of the operative cycle of the enterprise[117].

With respect to the rules about the dependent agent (so-called personal permanent establishment), the influence of the OECD Model is evident but not total. In compliance with the convention, the definition of personal permanent establishment consists in the presence of an agent in the territory of the State who regularly concludes contract in name of or in behalf of a non resident enterprise. Nevertheless, a first difference could be noted with respect to the contracts stipulated by the agent, that shall be others than purchases of goods, and not with regard to all the auxiliary activities established by comma 4. In this manner, the internal rule seems to refer to the 1963 Model. Therefore, it is

[115] Art. 5 par .5 mod. OECD
[116] Par 46 co. 2
[117] E. Della Valle, *op. cit*.

possible to consider as a personal permanent establishment the depending agent concluding contracts related to activities ex co. 4 other than purchases of goods.

According to Art. 162 co. 4 T.u.i.r., an independent agent, that is a mediator, a general broker or a person having an independent status, acting in the ordinary course of business is not deemed to be a permanent establishment.

The independence shall be evaluated in a juridical and economic perspective. In relation to the first profile, the powers and the duties of the agent acting in behalf of the company have to be taken into account. Instead, for the latter, the economic risk shall: if it is suffered just by the enterprise, it is clear that is the case of a depending agent.

The last rule, established with regard to personal permanent establishment in the comma 8, provides that a sea ship's agent or intermediary who has the power to manage enterprise's boat shall not be considered a permanent establishment.

4.2 TRANSFER OF ASSETS

A form of attachment with the Italian territory can occur not only in case of transfer of residence but also when assets are transferred in the territory[118]. The most important case is the transfer of assets between the Italian permanent establishment of a foreign enterprise and the head office. However, the case may be resolved applying the general principles regarding exit tax and value of inbound assets.

In first instance, we should consider the case of a transfer of asset from the head office to the Italian permanent establishment. With respect to this hypothesis, according to the above mentioned general rule, the value attributable to the assets is the fair value, in compliance with Article 9 T.u.i.r.

[118] Par. 21 OECD commentary on Article 7 OECD model.

Hence, the opposite case of transfer of assets from the Italian permanent establishment to the head office should be resolved considering the capital gain in relation to the assets as realized, as also in this case the asset loses its link with Italy.

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Cross-border financing of business activities

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PART I

NATIONAL ASPECTS

1. Debt and equity in the company law.

The Italian system of stock companies financing through securities has traditionally been structured according to a typicalness principle[1].

Under this principle the only forms of securities admitted were shares, issued against a contribution to the capital, and granting the partner the right to take part to the managing of the company and to its economic results, and bonds, incorporating a loan to the company. These securities respectively represented the only possibility of equity and debt financing and were subject to a mandatory discipline, ruling rights and duties of the subscriber and of the issuer.

In this clear context, the Italian legislator set up a minimum threshold of capital[2], and a limit to the possibility to issue bonds, in order to protect the position of the subscribers and to avoid an imbalance between equity and debt. This limit is expressed in article 2412 of the Italian Civil Law Code (hereinafter "ICLC"), which, in its original formulation, allowed companies to issue bonds only within the amount of the capital subscribed and actually paid up.

This clear-cut division has been progressively overtaken, in order to allow more flexible forms of securities that would have increased the companies' ability to attract investments, and that would have made it easier for them to get the financing needed.

The first step of this process was the creation, still within the boundaries of the distinction between shares and bonds, of particular categories of these securities[3].

The second step, taken with the 2003 reform of company law, with "the fundamental aim of promoting the creation, growth and capacity to compete of

[1] G. Visentini, *Principi di diritto commerciale*, Padua, 2006.

[2] Art. 2327 ICLC "Stock companies shall be incorporated with a minimum capital of 120.000 euros".

[3] Such as tracking stocks, which represent a participation to a specific deal.

companies, also easing their access to the internal and foreign capital market", weakened the typicalness principle, providing the companies the freedom to issue a wide range of financial instruments.

First of all article 2348 ICLC leaves the companies free to create and rule, in the articles of association and granting the respect of some mandatory rules[4], new categories of shares. Also Article 2411 ICLC now allows bonds whose capital return is conditioned to the repayment of the other creditors, and bonds whose remuneration is linked to the economic results of the company or other objective parameters.

The most significant innovation made by the reform is anyway represented by Article 2346 ICLC, which introduces a category of financial instruments other than shares and bonds. Such instruments are issued against an "attribution" not reflected in the capital, and their content in terms of rights of the subscriber is established by the issuer, the only limit being they cannot grant the right to vote in the general shareholders meeting.

This wide range of possibilities now offered to Italian companies blurred the distinction between debt and equity financing, making it hard for the legislator to rule the ratio between these two factors, and making it necessary to insert specific provisions, used to simplify and clarify the distinction between these two categories.

An example of this necessity is represented by Article 2411, para. 3, ICLC that explicitly extends the bonds' discipline, included the quantitative limit of Article 2412 ICLC, to all the instruments whose capital return is linked to the economic results of the issuer, granting that the mandatory discipline ruling debt financing is not circumvented through the use of the wider freedom given by the reform.

The threshold fixed by Article 2412 has anyway been modified, as it was considered too disadvantaging for Italian companies. First of all, some companies have been excluded from its range of application (listed companies, banks); furthermore, companies are now allowed to issue bonds for an amount not

[4] For instance, it is forbidden to issue shares granting to their subscribers more than one vote in the general shareholders meeting.

exceeding "*twice the subscribed capital, the legal reserve and the available reserves resulting from the last approved balance sheet*"[5].

The widening of the limit of Article 2412, and its application only to debt coming from securities[6], proves how Italian company law grants an almost complete freedom for the companies to choose the kind of financing they prefer, without imposing a strict measure to the equity/debt ratio.

2. The tax treatment of interests and dividends for the financed company.

From a tax perspective, despite the importance, both in economic[7] and juridical sense[8], of tax neutrality among the ways available to finance a business, the Italian tax system still produces a bias in favour of debt financing that encourages the resort to debt financing contributing to cause the thin capitalization of companies[9].

The main cause of this issue is that passive interests are considered, unlike dividends' payments, as an expense that the financed company bears and are therefore, at least in principle, deductible for tax purposes in the hands of the company paying them.

2.1. The inherence principle.

In order to deduct interest expenses, the company has to ensure the respect of the general principles ruling the costs' deductibility. In particular they will have to be

[5] According to the Italian literature, the rule has now lost his aim of protection of the subcribers, and it is now only intended to fight the excessive use of debt financing. See G. F. Campobasso, *Manuale di diritto commerciale*, Turin, 2003, p. 309-310.

[6] The Italian financial market has traditionally been dominated by bank lending, while the capital markets are traditionally small.

[7] S. Giannini, *Gli interessi passive nel quadro della tassazione societaria internazionale,* in *Dial. Trib.,*2008, p. 14.

[8] The so-called Biasco Commission, established with decree of the Vice Ministry of Economy on 27 June 2006 for the study of corporate income taxation, clarified that the principle expressed by Article 53 of the Italian constitution, according to which *"Every person shall contribute to public expenditure in accordance with their ability to pay"* is *"breached whenever enterprises with similar characteristics and potential ability to pay are taxed differently depending on their financial decisions".*

[9] F. Marchetti, F. Rasi, *Debt and equity financing: the Italian rules,* in *European Tax Studies,* Bologna, n. 1/2010, para. 1.

deducted in the years in which they accrued (article 109, para. 1, of the Income Tax Act, hereinafter "ITA"), to be accounted, in that same year, in the P&L (article 109, para. 4, ITA) and to respect the principle of inherence.

According to the current reading of this principle, the costs born by the company are deductible only if linked to the business carried out[10], hence interests will be deductible only if the principal from which they originate is used to finance such business.

The applicability of this principle to interest expenses has, anyway, been questioned, mostly by that part of Italian literature[11] and jurisprudence[12] that considers it as expressed in Article 109, para. 5, ITA, according to which "*the expenses and the other negative elements **different from passive interests** […] are deductible only if linked to activities or goods that contribute to the global amount of the taxable income or that are not computed because they are excluded*".

This assumed inapplicability would also be justified by the presence of Article 96 ITA, which fixes a threshold to interest deductibility that is considered, according to this steam of thought, as comprehensive of the inherence test[13].

This approach has been strongly criticized.

First of all it has been noticed that the inherence test represents a natural consequence of the analytical determination of the taxable income, according to which the notion of income is "*structurally net of the expenses that were necessary to product it*"[14], and a guarantee of the respect of the principle of the ability to pay[15].

Article 109, para. 5, ITA then, does not aim at establishing a principle that is already in the nature of the tax system, but at setting up a second level of control that will avoid the deductibility of costs that, even if inherent, should not be

[10] It's not necessary a linkage to a specific income, but only to an activity *"virtually capable of producing income"*, M.Beghin, *Disciplina fiscale degli interessi passivi, inerenza del costo e onere della prova*, in *Riv. Dir. Trib.*, 1998, p. 377.
[11] F. Tesauro, *Istituzioni di diritto tributario 2-parte speciale,* Milan, 2012, p. 128.
[12] *Ex multis,* Supreme Court decision no. 16286 of 30 July 2007.
[13] M. Zeppilli, *Inquadramento sistematico della disciplina degli interessi passivi, Corr. Trib.*, 2009, XXI, p. 1672.
[14] R. Lupi, *Limiti alla deduzione degli interessi e concetto generale di inerenza,* in *Corr. Trib.* 2008, X, p. 771.
[15] O. Nocerino, *Il problema dell'individuazione di un principio generale (inespresso) di inerenza,* in *Rass. Trib.*, 1995, II.

deducted because they are linked to tax exempt income[16]. In doing that, the provision excludes passive interests in order to simplify the tax assessment method, as it would be almost impossible for the tax authorities to verify how the principal giving rise to the interest has been distributed, within the business, between the activities producing a taxable income and those producing an exempt one[17].

The correctness of these arguments and the consequential applicability of the inherence principle to interest expenses is also confirmed by the second sentence of Article 109, para. 5, ITA, that explicitly considers exempt incomes as factors limiting the possibility to deduct costs, thus giving an univocal read to the first sentence, and also by article 61 ITA[18], that, in ruling the interest expenses deductibility from business income realized by taxpayers subject to individual income tax, states that *"Inherent passive interests are deductible for the portion corresponding to the ratio between revenues and other profits giving rise to taxable income and the overall amount of revenues and other profits"*, thus clarifying that the inherence principle is applicable to passive interests and setting up a second limit related to the possible presence of exempt incomes.

2.2. The former rule under Art. 63 ITA and the *thin capitalization rule* experience.

In addition to the aforesaid general conditions, the deductibility of interest expenses has always been subject to specific additional limits.

At first the legislator only wanted, through the creation of these additional conditions of deductibility, to replace the test of taxability of the income coming from interest expenses. As previously explained, it would be almost impossible to verify whether the capital producing interest expenses is used to generate taxable or exempt revenues, therefore the legislator stated, in the former version of art. 63 ITA, that *"interest expenses are deductible for the part corresponding to the ratio*

[16] G. Zizzo, *La determinazione del reddito delle società,* in G. Falsitta, *Manuale di diritto tributario, parte speciale*, Padua, 2008, pag. 372.

[17] As clarified also by the Italian Ministry of Finance in the Circulars no. 3 and 4 of 1976 and 1986.

[18] As amended by the Italian Buget Law for 2008.

between the amount of revenues and other profits that give rise to taxable income and the overall amount of revenues and profits" [19].

The lack of measures capable to significantly limit the deductibility of interest expenses created a strong bias in favour of debt financing, with the legislator tried to diminish, at first, through the introduction, in 1999 of the Dual Income Tax[20].

The Corporate Income Tax Reform of 2003 changed the approach to the matter, abandoning the rewarding mechanism of the DIT and establishing a more complex and limiting regime for the tax deductibility of interest expenses, that was ruled in articles 96, 97 and 98 ITA and which was applied between 2004 and 2008.

Articles 96 and 97 simply replaced and updated the limit of former article 63, in order to adequate it to the introduction of the participation exemption regime that exempts from taxation, at certain conditions, the income coming from capital gains on participations and from dividends.

Article 98, instead, represented a clear innovation, introduced with the specific purpose of *"fighting the tax use of thin capitalization"* and *"favouring the use of equity financing"* [21].

This rule established the non deductibility of interests remunerating loans granted or secured by qualified shareholders and/or by their related parties, whenever the total amount of such loans exceeded by at least 4 times the overall share of net assets attributable to said shareholder or to their related parties. The provision was not applicable the taxpayer was able to prove that the same loans would have been granted or secured by a third independent party on the basis of the borrower's own capacity to return them.

Despite its original intent, the rule of art. 98 turned out to be unfit to fight the thin capitalization of companies, as it was applicable only to debt financing linked to the company's partners and only above a high threshold[22].

[19] An identical rule is now set by art. 61 ITA, as explained in the previous paragraph, for the deductibility of interest expenses from business income realized by taxpayers subject to individual income tax.
[20] See para. 4.5.
[21] Ministerial report to legislative decree no. 344 of 12 December 2003.
[22] F. Marchetti, F. Rasi, *Debt and equity financing: the Italian rules,* cit., para. 2.3.1.

Furthermore, some literature[23] highlighted that the real nature of art. 98 ITA was that of an anti-avoidance rule, created to fight the behaviour of partners hiding what in substance was an equity financing under the form of a debt financing, in order to benefit of the more favourable tax treatment and, mostly, in order to be considered as creditors in case of crisis of the company[24], thus granting themselves a chance to get the investment back.

This conclusion was confirmed by the aforementioned possibility given to the taxpayer to prove that the loans had been granted because of a founded evaluation of his ability to repay them, which represents a mandatory feature of every anti-avoidance rule[25].

2.3. The rule of Article 96 ITA.

The current rule, introduced through the amendment of Article 96 ITA made by the Italian Budget Law for 2008, allows companies to deduct interest expenses and similar charges up to the amount of the interest income ad of similar incomes[26]. For the amount exceeding such incomes, interest expenses may be

[23] R. Lupi, *Prime osservazioni in tema di Thin Capitalization,* in *Rass. Trib.*, 2003, p. 1493.

[24] The same issue was also dealt with through the introduction, with the company law reform of 2003, of art. 2467 ICLC which establishes, for the limited liability companies, that the refund of shareholders' loans granted when the debt-to-equity ratio is not well balanced shall occur only after the repayment of all the other corporate creditors. For more on this subject see A. Palazzolo, *I finanziamenti dei soci nell'attività di direzione e coordinamento,* Rome, 2008.

[25] The so-called *"non application ruling";* art. 37-bis, para. 8, legislative decree 600 of 1973, "*The tax rules which, in order to fight tax avoidance, restrict deductions […] otherwise allowed by the tax system, shall not be enacted if the taxpayer proves that, given the circumstances, the tax avoidance effect that they intend to fight does not occur".*

[26] Article 96, para. 3, ITA considers as similar to an interest every income and expense deriving from "*Relationships having a financial aim"*. The Tax Authority, with the Circular 19/E of 2009, clarified that every transaction that grants to one of the parties involved the temporary availability of a capital shall be considered as *"having a financial aim"*. For more on this point see G. Escalar, *Gli oneri finanziari soggetti ai nuovi limiti di deducibilità dall'imponibile IRES e IRAP, Corr. Trib*., 2009, XXI, p. 1664.

Article 96 explicitly excludes passive interests deriving from commercial debts, while active interests arising from commercial credits fall within the determination of interest income. Also interest expenses included in the cost of the goods according to art. 110, para.1, lett. b) ITA are expressly excluded from the scope of application of art. 96 ITA.

deducted in the limit of 30% of the EBIDTA[27] net of the depreciations of assets and the financial lease instalments for assets[28].

Interest expenses exceeding this threshold may be carried forward and deducted in subsequent years up to the amount of the EBITDA not used to deduct that year's interest expenses exceeding interest income. Art. 96 ITA also allows to carry forward the part of the 30% of the EBIDTA not used in the given year, and to use it to increase the amount of deductible interests in the subsequent years.

This regime does not apply to banks, insurance companies, financial intermediaries and holdings of banking or insurance groups, as their ordinary business, that implies a fund-raising activity, inevitably produces a relevant amount of interest expenses. Art. 96, para. 5-bis, ITA allows them to deduct interest expenses within the 96% of their amount.

Despite the unanimous appreciation for the simplification brought to the discipline concerning the deductibility of passive interests, art. 96 ITA has been, for different issues, target of many critics from Italian literature.

First of all, the inclusion in its scope of application of the holdings of industrial groups[29] strongly disadvantages them, as they bear, deriving all their income from dividends, capital gains and other financial revenues that are not taken into account in the determination of the EBITDA, an almost absolute impossibility to deduct their interest expenses.

In order to diminish this burden, art. 96, para. 7, ITA allows the companies taking part to a domestic tax consolidation regime to use *"any excess of interest expense and similar charges arising in the hands of a participant to the consolidation regime to reduce the overall income of the group, if and to the extent that other participants to the consolidation regime register, for the same tax period, an EBITDA not fully exploited for the purpose of deducting interest expenses"*, in

[27] The EBITDA is defined by art. 96, para. 2, ITA as the difference between the value and the cost of the production as resulting from the yearly profit and loss account (art. 2425 ICLC).
For the companies following the IAS/IFRS accounting system the determination of this threshold is made *"pursuant to the corresponding items of the profit and loss account"*.

[28] These exclusions guarantee an equality of tax treatment whether the company chooses to lease an asset or to get a separate loan in order to buy it, as in the first case the rents paid will not reduce the amount of deductible interest.

[29] According to the Circular 91 of 2009 of the Italian Tax Authority, this category is formed by all the companies having their balance sheet asset represented for at least its 50% by participations in industrial companies.

addition art. 96, para. 8, ITA states that *"for the sole purposes of the application of para. 7, the participants to the domestic tax consolidation regime shall virtually include also foreign companies meeting the requirements and the conditions"* necessary to opt for the tax consolidation regime[30].

The main disapprovals to the regime set up by art. 96 ITA concern anyway its capability to effectively reach its goals and, moreover, the same nature of such goals.

According to art. 96's explanatory report, its aim is to *"favour the capitalization of companies without irreversibly handicap those characterized by a thin capitalization financial structure"*. The linkage between interest deductibility and the EBITDA seems anyway inadequate to reach this goal.

The EBIDTA is, as a matter of fact, an indicator of the company's capability to generate revenues, while it is unfit to reflect the financial structure of the company. That could cause an unjustified handicap for those companies, such as those working in the mass retail channel, characterized by a low profitability, even if not thin-capitalized[31]. Also, the rule of art. 96 ITA would make it heavier, for a company who is in the doldrums, to get the financing needed to improve its competitiveness, as the condition of difficulty in producing income would also make such choice costly from a tax perspective. On the other hand a company whose only source financing is represented by low rate loans granted by its partners would not be affected, even if extremely low-capitalized, by the rule of art. 96 ITA[32].

In order to correct these distortions, some literature[33] suggests, in the perspective of an amendment of art. 96 ITA, to link the deductibility of interest to more meaningful elements such as the amount of the company's own capital, or of the

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[30] Stated in articles 117, para. 1, 120 and 132, para.2, lett. b) and c), ITA.
This provision guarantees and equality of treatment between companies controlling domestic subsidiaries and companies controlling foreign subsidiaries.

[31] D. Stevanato, *La norma sull'indeducibilità degli interessi passivi e la sua interpretazione in chiave antielusiva,* in *Dial. Trib.*, 2008, I, p. 22.

[32] Aware of these issues, the Biasco commission established in 2006 had proposed, in its final report, to link the deductibility of interest expenses to the ratio between capital and debt.

[33] E. M. Bagarotto, *Osservazioni critiche sulla disciplina degli interessi passivi in ambito IRES,* in *Riv. Dir. Trib.*, 2009, X, p. 876.

investments made, or simply to allow it within a certain percentage of the interests paid.

Under the current regime, a partial solution to the objections raised against art. 96 ITA could be represented by the aforementioned *"Non-application ruling"*[34].

In particular, according to part of the Italian literature[35] the real target of the limitation set up by art. 96 ITA is not the thin capitalization of companies, but those forms of tax arbitrages perpetrated through the shifting of profits, under the guise of interest payments, to affiliated companies located in low taxation countries. The rule represents, in this interpretation, a specific anti-avoidance provision and, therefore, it must be granted to the taxpayer, as it was under the *thin capitalization rule* regime, the possibility to prove to the tax authority, through the non-application ruling, that the fraudulent circumstances that the rule intends to fight do not occur in that particular situation. Through this interpretation, the risks of an unjustified tax burden on physiological debt financing would be avoided, even if this interpretation would restrain the scope of application of the rule, making it almost completely loose its capability to reduce the tax bias between debt and equity financing.

2.4. The tax treatment of equity financing.

While interest expenses are deductible, even if within the aforesaid limits, dividend payments are entirely non-deductible for the issuer, and, moreover, fully taxed as they represent a participation to the remaining profits of the company, after the payment of taxes.

Such regime is applied not only to dividends, which are linked to shares, but also to that part of the remuneration, independently from the form of the security to which it refers, represented by *"A direct or indirect participation to the economic*

[34] D. Stevanato, *Indeducibilità degli interessi passivi e "genuinità" del finanziamento: istanza di disapplicazione preclusa?,* in *Corr. Trib.,* 2008, XXXIII, p. 2695.

[35] R. Lupi, *Gli interessi nei gruppi di imprese come principale riflesso della mobilità internazionale della ricchezza,* in *Dial. Trib.*, 2008, I, p. 25.

results of the issuer or of other companies of the same group or of the single deal relating to which the securities were issued"[36].

According to the illustrative relation to the legislative decree n. 344 of 2003, and as confirmed by the circular n. 26/E of 2004 of the Italian Tax Authority, the linkage has to be not only to the existence of profits, but also to their amount, so that it is not excluded, for instance, the deductibility of the remuneration of irredeemable bonds[37] issued by banks according to art. 12 of the Italian Bank Law.

The choice to include in the scope of application of the provision also revenues coming from security that are considered, under the civil law code and/or under the definitions given by Art. 44 ITA, as bonds or as similar to bonds, has an anti-avoidance nature, as through it the legislator wants to avoid that the great freedom granted to the companies in the structuring of securities is used to deduct from the business income also profit distributions under the guise of interest expenses[38].

Such provision has been strongly criticized by the Italian literature[39], not only for the asymmetry that it creates, and that will be explained in the following paragraph, with the tax treatment levied on the head of the percipient of such incomes, but also for being inconsistent and ineffective in its anti-avoidance function.

Inconsistent, as the link between the security's remuneration and the economic results of the company may not be considered as an indicative symptom of a fraud, as it is certainly possible[40] for a real bond to be so rewarded.

Ineffective, as it will be sufficient to present the security's remuneration as connected to the company's profits, and not as participation to them, to avoid its applicability.

[36] Art. 109, para. 9, ITA

[37] Such remuneration is represented by interests at a prearranged rate, whose payment may be suspended if the bank does not produce profits.

[38] F. Gallo, *Schema di decreto legislative recante "Riforma dell'imposizione sul reddito delle società" (Ires) – Audizione informale presso la Commissione finanze della Camera dei Deputati,* in *Rass. Trib*., 2003, p. 1661.

[39] G. Fransoni, *Scelte di fondo e criticità nel sistema impositivo degli strumenti finanziari,* in *Strumenti Finanziari e Fiscalità,* 2011, III.

[40] And explicitly allowed by art. 2411 ICLC.

3. The tax treatment of dividends and interest income.

3.1 Qualification issues.

The tax definition of dividend is given by art. 44, para 1, lett e) ITA which qualifies them as *"revenues originating from the participation to the capital or to the net worth of companies"*.

The tax treatment set up for dividends is also applicable to revenues coming from all the financial instruments *"whose remuneration is entirely represented by the participation to the economic performance of the issuer company or of other companies of the same group or of the deal in relation to which they were issued"*, as art. 44, para. 2, lett. a), ITA[41] qualifies them as similar to shares.

Mostly[42], the aim of this equalization has been found out in the need to balance the non-deductibility of such remunerations from the taxable income of the payor. However, part of the Italian literature[43] highlighted how the rule expands the measures used to avoid the economical double taxation of dividends, to an income that is not deriving from a participation to the company's business, but only from an external financing, thus creating a shift of the tax burden that should fall upon the recipient on the payor.

Also, the system is still not completely symmetric, because the provision of art. 109, para. 9, ITA has a wider scope of application, as it excludes the deductibility not only of the remunerations *"entirely"* represented by a participation to the economic results of the issuer, but also, on a pro rata basis, of those only partially connected to such parameter[44].

While it is possible to glean, from the definition of dividend given by art. 44, para 1, lett e), ITA a tax definition of "share"[45], a similar provision is missing for "bonds", for which is therefore relevant, for tax purposes, the ICLC definition.

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[41] As amended by the Corporate Income Tax reform of 2003.

[42] G. Corasaniti, *Diritto tributario delle attività finanziarie,* Milan, 2012, p. 132.

[43] G. Fransoni, *Scelte di fondo e criticità nel sistema impositivo degli strumenti finanziari,* cit.

[44] So that such part of the security's remuneration will result as both non deductible on the head of the payor, and not exempt on the head of the recipient.

[45] *"Participation to the capital or to the net worth of companies".*

Art. 44, para. 2, lett c), n. 2, ITA qualifies as similar to bonds all those "*Mass securities containing the unconditional obligation to pay at maturity an amount not less than that indicated in them, with or without the payment of periodic earnings, and which do not confer to the holders any rights of direct or indirect management of either the issuer or the deal in relation to which they were issued, nor any control right over the management itself*", thus extending to these financial instruments the bonds' tax treatment.

As clarified by art. 5 of the Minister of Finance decree of 8 June 2011, all these qualification rules are applicable also to the companies following the IAS/IFRS accounting system[46], as they waive from the general principle according to which for such companies the accounting qualification criteria prevail on the tax ones[47].

For what concerns the scope of this paper, it has to be immediately highlighted how such definitions do not always reflect the distinction between equity and debt financing[48]. For instance, a financial instrument which grants a long term capital return will be considered as similar to bonds, even if it presents a level of equity that is certainly higher than that of a financial instrument that that grants a short-term capital return whose remuneration is represented by a participation to the economic results of the issuer, and that will therefore be qualified as similar to a share[49].

The choice to use different criteria[50] to qualify the financial instruments as similar to shares or similar to bonds may also cause situations in which the two rules do not interlock precisely, giving raise to overlaps or gaps[51].

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[46] G. Corasaniti, *Il coordinamento tra le norme fiscali e principi contabili internazionali per gli strumenti finanziari,* in *Corr. Trib.* 2011, XXVII, p. 2198-2204.

[47] Art. 83 ITA

[48] S. Meroi, *La nuova normativa fiscale applicabile agli strumenti finanziari partecipativi e alle obbligazioni,* in *Dir. Prat. Trib.*, 2006, I, p. 3-46.

[49] This reflection seems consistent with para. 19 of the commentary to art. 10 of the OECD model, according to which the remuneration of the participating bonds, that are entirely or partially represented by a participation to the economic results of the issuer, should not be considered as a dividend unless the subscriber effectively participates to the business risk of the issuer.

[50] The remuneration for the first ones; the obligation to fully repay the principal and the granting of participation rights for the second ones.

[51] In order to avoid such issues the so called Gallo-commission, requested to work on the coordination of tax legislation with the changed company law background, had proposed to use symmetrical criteria, in order to create a bipartite system.

With regard to the firsts, the Italian Tax Authority[52] clarified that, for reasons of systematic coherence, it is necessary to interpret the definitions provided by art. 44 ITA in harmony with the provision of art. 109, para. 9, lett a), ITA.

More in detail, every time that a security's remuneration is non-deductible from the taxable income of the issuer, such remuneration shall be treated as a dividend also in the hands of the percipient, provided that it is fully represented by a participation to the issuer's profits. In the case of a security fulfilling both the requirements to be qualified as a share and as a bond, then, the first qualification will prevail.

On the other hand, securities similar neither to shares nor to bonds will be subsumed under the residual category of the atypical instruments[53]. The actual relevance of such additional class of securities is anyway limited, as, from the first of January 2012 their tax treatment is almost identical to the one levied on the remuneration of bonds and securities similar to bonds.

3.2. The tax treatment.

In order to achieve a neutral tax system, revenues coming from debt financing, and therefore deductible by the company paying them, should fall within the overall taxable income of the recipient and then be taxed at an ordinary rate. Dividends, instead, being already taxed as profits of the company paying them, and non-deductible for tax purposes from its income, should not be taxed on the hand of the recipient, in order to avoid any form of economical double taxation.

Art. 89[54] ITA represents the enactment of this pattern, as it establishes, in its paragraph 2, that the profits distributed, under any form and denomination, by other companies do not contribute to the taxable income of the receiving company for the 95% of their amount. The remaining 5% is subject to taxation as a forfeit

[52] Circular n. 26/E of 2004.

[53] Circular n. 10/E of 2005 of the Italian Tax Authority.

[54] As amended with the Corporate Income Tax Reform of 2003 that changed the tool used to avoid the economical double taxation of dividends, replacing the credit method with the exemption method.

amount taxed to balance the deductibility of the costs linked to the production of the relevant profits[55].

According to art. 89, para. 2-bis, ITA, the exemption is not granted, for the companies following the IAS/IFRS accounting system, to revenues coming from shares and securities similar to shares registered in the category of *held for trading*[56], such amounts will instead entirely contribute to the taxable income of the recipient.

On the other hand active interests, composed by revenues from loans, bonds and financial instruments qualified, under the definition of art. 44, para. 2, lett. c) ITA, as similar to bonds, contribute to the taxable income for the amount accrued in the tax period, according to the competence principle, at the rate agreed on written form or, in its absence, at the legal rate. The same treatment is applied, according to art. 89, para. 6, ITA, to the difference originating from REPO operations.

Due to the explained asymmetry between the formulation of art. 109, para. 9, and art. 44, para. 2, lett a) ITA, this tax treatment is levied also on revenues that are non-deductible from the taxable income of the payor, which creates a deviation from the complete enactment of the neutrality principle. It seems clear though, from the combination of the examined rules, that, except for this asymmetry, the Italian system almost completely answers the need of neutrality on the recipient side, by levying the same tax burden on both the revenues coming from debt financing, taxed upon the percipient, and those coming from equity financing, taxed upon the payor.

3.3. Natural persons.

In conclusion, it is necessary to point out that the evaluations so far made on the enacting of the neutrality principle, however, hold true only with referring to financing granted by companies. On the other hand, when the financing is

[55] Basically the Italian legislator extended the discipline of the Parent-Subsidiary directive to dividends paid by national companies.

[56] IAS 39 considers as *held for trading* those securities *"acquired or held for the purpose of selling in the short term or for which there is a recent pattern of short-term profit taking are held for trading"*.

conceded by individuals, more significant deviations from the relevant principle may be encountered.

First of all, with referring to debt financing granted by individuals, and not linked to the carrying out of a business activity, the Italian legislator, driven by constitutional oriented policies aimed at favouring the investments of savings[57], has always levied, normally through a final whithholding tax, a substitutive tax at a reduced flat rate on interest revenues, thus obstructing the complete enacting of the neutrality principle[58].

On the other hand, for what concerns equity financing granted by individuals, the legislator levies a higher global tax burden, as the taxation of dividends on the head of the payor, at the aforesaid rate of 27,5%, is accompanied an additional withdrawal on the head of the recipient.

More in detail, for individuals carrying on a business activity or holding a qualified participation[59], it is provided that the 49,72% of the amount received will be computed in their taxable income, while the remaining 50,28% will be exempt. For what concerns non-qualified participations hold by non-entrepreneurs instead, art. 27 of the Presidential Decree n. 600 of 1973 provides a substitutive tax levied on the entire amount of the payment received at a 20% rate[60].

The global tax burden levied on equity investments made by natural persons ranges then, for qualified participations and entrepreneurs, between 35,8% and

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[57] Art. 47 of Italian Constitution *"The Republic encourages and safeguards savings in all form*." According to eminent literature, the income coming from savings should not be taxed at all, see L. Einaudi, *"Saggi sul risparmio e l'imposta"*, Turin, 1941.

[58] Until 2012 the deviation from such principle was glaring, as this tax was levied at a rate of 12.5%. In order to diminish this difference, the law decree no. 138 of 13 August 2011 amended the applicable rate, increasing it to 20%, however still far from the rate of approximately 43% that bears, summing the taxation upon the company and that upon the investor, on equity financing coming from individuals.

[59] Which means a participation granting:

-a percentage of voting rights in the ordinary shareholders' meeting higher than 2% in case of listed shares and than 20% in case of non listed shares, or;

-a participation to the capital exceeding 5% in case of listed shares and 25% in case of non listed shares.

[60] It was 12,5% until 2011.

43%[61], while it is equal to approximately 42% in the remaining cases[62], anyway far, in both cases, from the one levied on debt investments.

4. Tax incentives to equity financing.

While there is, as so far illustrated, no tax bias on the recipient side, on the issuer side the difference remains significant, as interest expenses are, unlike dividends, deductible for tax purposes.

In order to reduce this bias, and to favour the capitalization of companies, the legislator, beside to the limits placed to the deductibility of interests, has employed, and still employs, other institutions, founded on a rewarding approach.

4.1 The Dual income tax

The first attempt to use this policy was made through the introduction, in 1997[63], of the so-called *"Dual income tax"* (DIT).

This institution levied a reduced tax rate of 19% on that part of the company's taxable income that could be considered as deriving from the increases made to the capital existing at the close of the tax period running on 30 September 1996, through the issuing of new shares or by the keeping at company level of part of the profits produced. Such portion of the taxable income was determined applying to the amount of the capital increases a *"coefficient of ordinary remuneration"* yearly determined by the Minister of Finance, taking into account the average financial results of government bonds.

Through this mechanism the legislator tried to favour the use of equity financing, granting to the company a reward intended to balance the deductibility of expenses coming from debt financing[64].

[61] The sum of the 27,5% rate on the company and the 23% or 43% levied on the 49,72% of the dividend payment, which represent the minimum and the maximum rate of the personal income tax.

[62] The sum of the 27,5% rate on the company and the 20% rate on the recipient.

[63] Legislative Decree no. 446.

[64] F. Pistolesi, *La "Dual Income Tax"- Commento al decreto legislativo 18 dicembre 1997, no. 446,* in *Dir. Prat. Trib.*, 1998, p. 701.

The efficiency of this institution was increased by the simultaneous introduction in the Italian system of the Regional Tax on Productive Activities (IRAP)[65] in replacing of the Local Tax on Income (ILOR).

While passive interests were deductible from the Ilor's taxable income, the Irap is levied on the value of the production of enterprises, before it's used to remunerate the providers of the factors necessary to obtain it. The tax base will therefore comprehend not only the profits of the entrepreneur, but also those of the workers (represented by the salaries paid by the enterprise) and of the investors (represented precisely by the interest expenses), in this manner discouraging the use of debt financing, as the amounts used as its remuneration will be computed in the taxable income[66].

The combined effect of the DIT and the Irap would have therefore been both a reduction of the cost of equity financing and an increasing of that of debt financing, in order to favour the capitalization of companies[67].

4.2. The ACE

With the Corporate income tax reform of 2003 the Italian legislator, as explained in the previous paragraphs, chose to abandon the rewarding mechanism of the DIT and to operate only in one direction, adding to the Irap the *thin capitalization rule*, in order to further discourage the use of debt financing.

This institution anyway, resulted inadequate to effectively favour the capitalization of companies and, in order to reform the subject, the so-called Biasco commission, established in 2006 for the study of corporate income taxation, suggested, next to the amending of the rules regarding the deductibility of interests, to reintroduce a *"Reward to the capitalization"* this time responding to the scheme of the Allowance to Corporate Equity (ACE)[68] which allows the company to exclude from the taxable income the amount corresponding to the

[65] For more on this topic see M. Procopio, *L'oggetto dell'Irap,* Padua, 2003.

[66] M. Iavagnilio, F. Trutalli, *Irap e dual income tax. Un approccio indiretto alla thin capitalization. Effetti della riforma fiscale sulle scelte di finanziamento delle imprese multinazionali,* in *Il Fisco*, 1998, p. 5038.

[67] For more on this topic see F. Cascone S. Lugaresi G. Oricchio E. Romaniello, *Gli effetti dell'Irap e della Dit sull'economia delle società di capitale e sul rischio di credito*, Turin, 1999, p. 104.

[68] Final report of the Biasco Commission, p. 54.

figurative return of the company's own capital[69], instead of taxing it at a reduced rate, as the Dit did.

The Italian financial business law for 2008 effectively changed the regime of the deductibility of interest expenses, abolishing the *thin capitalization rule*, but did not enact the suggestion regarding the introduction of the Ace, which was abandoned until 2011.

It was only with the Legislative decree n. 201 of 2011, and with the Minister of Finance implementing decree of 14 March 2012, that such institution has been introduced in the Italian tax system, with the aim of *"favouring the capitalization of enterprises through a reduction of the tax burden levied on revenues earned through equity financing"* [70].

The discipline of this new institution remembers the Dit's one. Once again it is taken into consideration the *"figurative return"* of the new equity financing[71], which is calculated applying to the equity increase[72] occurred from the 31 of December of 2010 a *"return rate of the capital"* which is established in the 3% for the first three periods of application of the rule, but that will then be determined with a decree of the Minister of Finance.

The relevant equity increase is calculated as the difference between:

-Money contributions, represented by capital increases, other forms of partners' contributions[73], partners' payments for share premiums, payments for the conversion of bonds[74] or for the exercise of warrant options, credits definitively given up by partners.

[69] The Biasco Commission anyway suggested to grant a minimum rate on the global tax base before such deduction not lower than 5 point from the ordinary rate.

[70] Illustrative relation of the Minister of Finance decree of 14 march 2012.

The measure is applicable not only to companies, but also to by individuals, partnerships and other legal entities carrying on an enterprise. It's also applicable to non resident companies having an Italian permanent establishment.

[71] The measure, as suggested by the final relation of the Biasco commission, is an incentive to new equity investments, not a reward for those already made.

[72] Produced through capital increases, capitalization of share premium, non-refundable grants received, capitalization of the company's profits.

[73] Such as non repayable loans.

[74] The illustrative relation clarifies that only payments related to the position of partners shall be considered as equity increasing. It expressly excludes, for instance, payments made to subscribe the financial instruments ruled by art. 2436, para. 6, ICLC, even if considered, under the discipline of the corporate income tax, as similar to shares.

-That part of the company’s profits which is kept at a company level[75], except for those not effectively collected, but only coming from evaluations and for those that, even if collected, are not usable for a capital raise or cannot be carried against losses.[76]

And:

-Any form of distribution of the company’s capital to the partners, such as capital reductions or the distribution of the company’s reserves

For the newborn companies the allowance is calculated on all the capital attributed to them.

Equity reductions will affect the calculation from the beginning of the tax period in which they occur, while equity increases will be relevant only from when they take place[77].

The amount so determined is not a static parameter, to be determined for each tax period, but a dynamic entity, whose amount changes calculating, yearly, the relevant equity’s increasing and decreasing. Such amount is yearly deductible from the tax base, with the possibility to carry it forward for the part that exceeds the taxable income of the period.

As it was for the Dit, the relevant capital increasing resulting from the aforesaid calculation can not exceed the amount of the net worth resulting from the balance sheet of the year[78], so that equity incomes used to balance losses are not taken into consideration.

For what concerns the relation between the Ace and the rule of art. 84 ITA, according to which the losses produced in a tax period may be credited against the income produced in subsequent years, but only in the limit of the 80% of such income, it is specified that the allowance will reduce the taxable income only after

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[75] Even if such destination is mandatory, such as for the legal reserve ruled by art. 2430 ICLC.

[76] Such as those destined for the purchase of own shares.

The change of regime of the reserve will represent a capital increasing or decreasing relevant for the allowance. If, for instance, an available reserve is then used to cover the purchase of own shares, that will reduce the allowance, conversely, the occurred availability of a reserve will increase it.

[77] For instance, a capital contribution made at the end of June will count only for 50%, while a capital reduction made at the same date will entirely count.

[78] With the only exclusion, due to the necessity to guarantee an equal treatment to those companies following the IAS/IFRS accounting system, of the reserves created for the purchase of own shares.

the deduction of the eventual losses carried forward from previous tax periods, so that its application could eventually even reduce to zero the taxable income.

The allowance is not granted to companies in bankruptcy, or under compulsory liquidation, or under extraordinary administration, from the beginning of the accounting period in which such procedures initiated.

If the transparency regime[79] is applied, the allowance shall, according to art. 7 of the implementing decree, be used to reduce the taxable income produced by the transparent company and, for the exceeding, to reduce the taxable income produced by the companies in the same proportion to which the transparent company's income is attributed to them[80].

Similarly, under the domestic tax consolidation regime[81] the allowance due to each company shall, at first, be used to reduce its own taxable income, then it may be attributed to the group, but only for that part of the exceeding that is deductible from the groups yearly global income, so that the part of the allowance which is not exploitable in the year when it is produced neither by the company nor by the group will be carried forward by the company to which it refers[82].

5 Anti-avoidance rules.

The still existing tax bias between debt and equity financing is often source of tax planning schemes, aimed at attenuating as much as possible the tax burden falling on financial operations.

Given the heterogeneity of these schemes, and their rapid development, the legislator finds it hard to prearrange an adequate normative context to fight them, and therefore this function is mostly devolved upon the hands of the judicial authority, which gleaned the anti-avoidance principle from our constitutional

[79] Art. 115 ITA. Under this regime the income produced by a company is attributed to its partners in proportion to their participation and taxed as part of their taxable income.

[80] Except for those exceeding of allowance that was produced by the transparent company before of the adoption of the transparency regime which are deductible only it's own taxable income.

[81] Art. 117 ITA. Under this regime the taxable income produced by the companies of a group is summed up and taxed upon the holding.

[82] See the tax authority circular n. 28/IR of 29 March 2012.

Conversely to what happens to losses exceeding both the income of the company to which they refer and the group's total income, which will be carried forward by the group as a fiscal unit.

system and which employs it to contrast any phenomenon of unjustified reduction of the tax burden.

5.1 Specific anti-avoidance rules.

As previously mentioned, in a limited number of situation, the tax planning schemes are avoided through a direct intervention of the legislator.

An example of such provisions is represented by article 10 of the Ace's implementing decree, which contains specific anti-avoidance rules[83].

According to such provision, the capital increase has no relevance to the extent of the amounts used to realize, within the group[84], some specific operations, which are:

- the purchase of participations or establishments;
- attributions;
- the increasing of the financing credits.

Such amounts will be deducted from the relevant capital increasing, as these operations could be used to obtain the calculation of the allowance also on the basis of capital otherwise not relevant[85], or an illegitimate multiplication of its amount[86].

This anti-avoidance rule is anyway subject to the aforementioned institution of the non application ruling, so that the taxpayer is allowed to prove to the tax authority that the relevant amounts are not used to adulterate the correct functioning of the allowance, thus avoiding their deduction from the relevant capital increase.

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[83] For more on this see G. Albano, L. Miele, *Le norme antielusive sterilizzano le moltiplicazioni dell'Ace,* in *Corr. Trib.*, 2012, XIV, p. 1052.

[84] Subjects which, in the tax period, could be considered as controlling, according to art. 2359 ICLC, the other party, or who share its same controller.

Such condition shall exist when the operation is realized, while it's not relevant the situation at the end of the tax period (when the allowance is calculated).

[85] For instance, an attribution which took place before the 31 of December 2010, and which is therefore irrelevant for the allowance's purpose, could be transferred through the sale of an establishment to another company of the group, which will use it to realize relevant capital increases.

[86] For instance, the amounts received through a capital raise, and therefore calculated in the relevant capital increase, could be used to increase the credit financing of another company of the group, that will use them to make new potentially relevant capital raises.

Another example of such kind of provisions is represented by art. 101, para. 6, ITA, which establishes that losses allocated to the company by its controlled partnerships[87] can be deducted against the income of the corporate entity only to offset profits allocated in the subsequent five years to the company by the same entity giving rise to the loss.

Aim of this rule is to prevent companies from having all their interest expenses borne by their controlled partnerships, in order to exploit the more favourable regime set up for them by art. 61 ITA, and to deduct such expenses under the guise of partnerships' losses, so circumventing the limits of art. 96 ITA[88].

Aware of the difficulties of a case by case approach to the fighting of avoidance practices, the Italian legislator entrusted the tax authority of dealing with such variety of circumstances through the use of a general institution, ruled by art. 37-bis[89] of the Income Tax Assessment Code.

Such provision lists some transactions[90] that the legislator considers as particularly capable of hide an illegitimate aim, and allows the tax authority to disregard their tax effects[91] if they are "*carried out without valid economic reasons, aimed at circumventing obligations or prohibitions provided by the tax system and aimed at obtaining tax reductions or refunds to which the taxpayer would not be otherwise entitled*".

For what concerns the scope of this paper, the provision is anyway relevant only with referring to cross-border interest payments.

5.2. The judicial approach.

Next to the legislator's intervention, a key role in the fight of tax avoidance is played by the Italian Supreme Court which progressively stated and enforced a general principle that forbids the abuse of law.

[87] Which are always taxed through the transparency regime.

[88] The position of the controller company is considered as that of a holding company. See Marchetti-Rasi, *"Debt and equity financing: the Italian rules"*, cit., para. 2.2.3.

[89] Introduced by art. 7 of Legislative Decree n. 358, 8 October 1997.

[90] Such as mergers, acquisitions, attributions to companies.

[91] Or the tax effects of the series of transactions in which they are employed.

Point of arrival of this process is represented by two decisions of 2008[92] which reaffirmed the presence of the principle, and clarified that it finds its source in the EU law, for what concerns the harmonized taxes, and in article 53[93] of the Italian Constitution for the national taxes.

The Supreme Court has fixed the content of such principle in a very severe way, as it will be sufficient for a transaction to have as its prevalent aim[94] the interest in having a lower tax burden, to be considered as abusive and be therefore disregarded for tax purposes.

The Supreme Court's decision n. 1372 of 2011 represents an application of the anti avoidance principle to the matter of the deductibility of interest expenses.

The under judgment transaction was a leveraged buyout[95] that the tax authority considered as realized only to achieve the tax advantage of the deductibility of interest expenses.

The Supreme Court stated that, in application of the aforesaid principle, such transaction may be considered as abusive if it is not backed up by *"convincing motives"* prevailing on the fiscal ones.

It is up to the taxpayer to prove the presence of such founded economic reasons, while the tax authority shall prove the eventual inadequacy of the chosen transaction to achieve them.

In this particular kind of transactions, the application of the anti-avoidance principle shall be guided by particular care, as the pursued economic reasons may sometimes be identified only in a long term analysis of the consequences of the transaction[96].

[92] N. 30055 and 30057, about dividend washing and dividend stripping operations, which are now explicitly contrasted through the provisions of art. 109, para. 3-bis, 3-ter and 3-quater ITA.
In the after commented decision 1372 of 2011, the Supreme Court also clarified that in such financial transactions the application of the anti-avoidance principle shall be particularly severe.

[93] That expresses the principles of the ability to pay and of the progressive taxation.

[94] And not exclusive, as in art. 37-bis.

[95] An acquisition financed through debt in which the cash flows or assets of the target are used to repay the debt.

[96] Such a functional and organizational improvement of the group's structure.

6. Conclusions in respect of the tax treatment of the national financing of companies.

It appears, from the description here provided, that the Italian tax system almost completely enacts the neutrality principle for what concerns the different forms of company financing[97].

Both the income revenues generated by equity and debt financing bear the same tax burden, represented by the Corporate Income Tax levied at a flat rate of 27,5%, and levied on the financed company's profits or on the interest income generated by the financing one.

The 1,375 % rate levied on the equity investments profits[98] of the financing company may be considered as not much relevant, both for its minimum amount and for being balanced by the chance to deduct the costs related to the investment.

In this context, the only significant, even if structural, element that creates a tax bias in favour of tax debt financing is represented by the possibility to deduct interest expenses from the taxable income of the company paying them. The effective relevance of this factor in the thin capitalization of Italian companies has anyway been strongly questioned by part of the literature[99].

Given this premises, the current rule of art. 96 seems anyway too intense and inaccurate to positively influence the companies' financing choices , as it applies to both physiological and pathological debt, without considering neither the overall financial structure of the company, nor the source and the conditions of the loans from which interest expenses originate, possibly causing an unjustified tax increase bearing on the business activity.

Another critical point is the trend, described in the previous paragraphs, to leave the judicial authority in charge of the fight to tax arbitrages.

While it is understandable, and maybe even appreciable, the legislator's choice to limit the specific interventions, that are inevitably inadequate to contrast such phenomenon, it is criticisable the decision to completely leave the structuring of

[97] Whilst such goal is not adequately achieved for what concerns the financing coming from individuals.

[98] Hailing from the levying of the Corporate Income Tax upon the 5% of the dividends received.

[99] R. Lupi, *Gli interessi nei gruppi di imprese come principale riflesso della mobilità internazionale della ricchezza,* cit., p. 25.

the general principle to the judicial authority, as it gives birth to unsolved legal certainty and separation of powers issues.

A direct position taken by the legislator, maybe with a reform and an extension of art. 37-bis would be highly preferable.

PART II

INTERNATIONAL ASPECTS

1 The tax treatment of interest and dividends paid to non-resident persons.

1.1 The concept of withholding tax in the Italian tax system.

The Italian tax system does not provide an explicit definition of withholding tax.
It is otherwise defined the role of the *tax substitute* who, according to art. 64 of the Italian law on tax assessment[100] (hereinafter ILTA), is the subject required by the law to pay taxes in substitution of others, for facts or circumstances exclusively referable to them. This is exactly the mechanism of the withholding tax, which is a tax levied on the payor, instead than on the recipient, of a certain income.
In order to fulfil his obligation, the payor will have to deduct the amount due to the tax authority from the income he pays, so that the tax's economic burden falls upon the recipient of the income, which is the actual taxpayer. Such separation ensures the collecting of taxes, as the formal taxpayer will not have any interest in not fulfilling his obligation[101].
Withholding taxes may be *creditable* or *final:* in the first case, the income will also be taxed on the head of the of the recipient, who will deduct from the amount due the sum he already paid through the substitute, in the second case the withholding tax ends the tax relevance of that income, that will not bear any other form of taxation. The first method allows to take into consideration also the expenses that were necessary to produce the taxed income and the taxpayer's personal circumstances, as he will have to fill a tax return to establish the additional amount he has to pay, or the credit is entitled to, after the levying of the withholding. Conversely, these elements will normally have no relevance if a final

[100] Presidential decree n. 600 of 1973.
[101] W. F. G. Wijnen, *Introduction to International tax law,* p. 23-25.

withholding tax is used, so that in this case the tax burden will definitively be levied on the gross amount of the income.
The Italian tax system frequently uses such tax collecting method, in particular, from a subjective perspective, with regard to income paid to non residents, as in these circumstances it would be almost impossible to enforce any tax claim levied on assessment directly on the recipient without breaching the sovereignty of another State, and, from an objective perspective, with regard to passive incomes, such as interest and dividends payments, as those categories of revenues are difficult to track and tax upon the recipient because of the high capital mobility.
Withholding taxes are normally levied at a flat rate.

1.2 National withholding taxes on interests and dividends paid to non-resident persons.

The levying of such taxes on interest and dividends payments made to non resident persons enacts the principle of taxation in the State of the source of the income, which is discouraged and strongly limited by the OECD model, which inspires the greatest part of the international conventions against double taxation signed by Italy.
Also, the taxation policies concerning such passive incomes are inevitably influenced by the capital mobility, which allows the investor to make tax driven choices on the allocation of his investments, hence obliging the states to keep the taxation at a competitive standard.
Such considerations influence the Italian’s legislator policies on this matter, and contribute to limit the entity of the withholding taxes levied on interest and dividends payments, which now tend to be levied at a significant rate only in the eventuality that the income will not be properly taxed in the State of residence of the percipient.

1.2.1. Interest payments.

The legislative decree 138 of 2011 uniformed the rate of the withholding taxes levied on interest incomes[102], setting up a general rate of 20%[103], which is waived[104], with the application of a rate of 12,5%, only with regard to bonds issued by Italy, by other States included in the white list drafted by the Minister of Finance according to art. 168 bis ITA[105], by other public territorial authorities or by international authorities, and to project bonds issued by companies created to realize or manage a single infrastructure or a public utility.

For what specifically concerns payments to non residents, first of all it is necessary to point out that art. 23, para.1, lett b), ITA states that interest payments originating from bank and postal deposits and current accounts are not considered, even if coming from residents, to have source in Italy, so that Italy does not levy any tax claim on them.

Also, art. 6 of the legislative decree n. 239 of 1996 excludes the applicability of the withholding tax to interests generated from bonds and similar securities issued by the so called "big issuer", comprehending banks, listed companies[106] and public bodies converted in stock companies, if the recipient is a resident of one of the States included in the aforementioned white list. In addition, the same provision excludes from any form of taxation interests deriving from bonds or securities similar to bonds, if the recipient is:

- an international entity created to implement an international agreement executive in Italy[107];

[102] Until 2011 the applicable rate was linked to the duration of the bond. Normally, for bonds lasting less than 18 months the withholding tax was levied at 27%, whereas for bonds having a longer duration, it was fixed at a 12,5 % rate. For more on the previous regime please see E. Mignarri, *La fiscalità degli strumenti di finanziamento delle imprese,* Milan, 2010, p. 220 ss.

[103] If the recipient is a company that represents a creditable withholding tax, and therefore only a part of the global tax burden levied on interest income which is, as explained in part I, equal to 27%.

[104] N. Arquilla, *Le deroghe relative all'unificazione dell'aliquota per la tassazione dei proventi dei titoli obbligazionari*, in *Corr. Trib.,* 2012, XXI, 1631.

[105] Such document lists all the states which ensure an adequate exchange of information and, among them, those which tax incomes at a proper rate.

[106] In the Italian market, or in the markets of other EU states or of states belonging to the Agreement on the European Economic Area.

[107] Reference is made to those listed in the Minister of Finance circular of the first of June 1994.

- a national bank, except for those of the low taxation States listed in articles 1 and 2 of the of the Minister of Finance decree of 23 of January 2002;
- an institutional investor resident in one of the States of the white list. This notion comprehends any entity who, irrespective of their juridical form and of the tax treatment they bear in the State of residence, make and manage investments on behalf of third parties[108]. As such provision could easily hide abusive behaviours, the Italian Tax Authority clarified[109] that the exemption shall be denied every time that the entity turns out to have been created only to allow its participants, resident in Italy or in States not included in the white list, to benefit of such favourable tax treatment.

According to article 7 of the legislative decree n. 239 of 1996, in order to apply the exemption regime, the payor of the interest income has to acquire and transmit to the Tax Authority a self-certification of the beneficial owner of such payments[110], in which he states the fulfilment of the requirements necessary for the application of this regime.

For what concerns interest payments originating from financial transactions different from the issue of securities, art. 26-bis ILTA excludes from the application of the withholding tax interest perceived by residents of States included in the white list and deriving from:

- deposits and current accounts different from postal and banking ones;
- life annuities;
- services of guarantee;
- REPO contracts and collateralized loans.

For what is not comprehended in the special regimes so far described, interest payments to non residents will bear the general withholding tax, normally levied at a 20% rate, unless specific international rules establish differently.

[108] G. Corasaniti, *Diritto tributario delle attività finanziarie,* cit., p. 350.

[109] Circulars 20 and 27/E of 2003.

[110] The provision clarifies that the institutional investor, even if non recognizable in the Italian system as an autonomous legal entity for tax purpose, is considered as beneficial owner of the income.

1.2.3. Dividend payments.

According to art. 27, para. 3, ILTA[111] dividend payments to non resident persons bear a withholding tax levied, from the first of January 2012, at a rate of 20%[112]. The same treatment is levied on the remuneration of the securities qualified as similar to shares under the definition of art. 44, para 2, lett a), ITA.

The recipient[113] has right to a refund, up to one fourth of the withholding's amount[114] of the tax he proves, through a certificate of the tax authority of his State of residence, that the relevant revenue has already born in that foreign State. Such chance is still not granted to revenues originating from preferred shares, even if the elimination of the reduced rate on such incomes makes such difference unjustified. The refund request may be presented either by the resident payor of the income or by the non resident percipient until 48 months after the date in which the non resident paid in his State of residence, entirely and definitively, the tax that is object of the refund request.

This regime was also applied[115], until 2008, to dividend payments to non resident companies and other legal entities subject to the corporate income tax in their State of residence, thus giving rise to a significant difference in respect of the tax burden levied on dividend payments to resident subjects of the same nature which was, as previous explained, reduced to 5% with the corporate income tax reform of 2003.

With the decision C-170/05, *Denkavit*, of the 14 of December 2006, the European Court of Justice clarified that the creation of such differences between the tax treatment applicable to national dividends payments, and the one applicable to similar payments concerning residents of other EU member States, obstructs the free movement of capital, therefore breaching the freedom of establishment's

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[111] As modified by art. 2, para. 6, of the legislative decree n. 138 of 2011. Until such reform the withholding was levied at a 27% rate.

[112] Until this date it was levied at a 27% rate.

The 20% rate is applicable also to preferred shares, which born, until 2012, a reduced rate of 12,5 %.

[113] Except for companies and other legal entities subject, in their State of residence, to the corporate income tax. Dividends paid to such entities are subject, as will be after explained, to a special tax treatment.

[114] It was four ninth until 2012.

[115] With a different rate of 27%, reduced to 12,5% in case of preferred shares.

principle[116]. Consequentially the EU Commission opened an infraction procedure against Italy, thus bringing the Italian legislator to a reform of such regime, which was accomplished with the Italian Budget Law for 2008.

The previous discipline, applied to dividends paid until 2007, anyway caused a decision of the European Court of Justice[117] against Italy, on the basis of which the State had to refund the non resident taxpayers to which the illegitimate regime had been applied.

According to the current formulation of art. 27, para 3-ter, ILTA the withholding is levied at a 1,375% rate on dividends paid to companies and other entities subject to the corporate income tax in a state of the European Union or of the Agreement on the European Economic Area included in the white list, thus equalizing the tax burden levied on similar national payments (27% rate on the 5% of the amount perceived).

1.3. International and European Law.

The regime so far described may be waived at a supranational level, first of all by the numerous conventions against double taxation signed by Italy which, in order to limit as much as possible the double taxation of passive incomes, further reduce the tax burden levied on payments to non resident persons.

The greatest part of these conventions[118] follows the OECD model, which rules the taxation on cross-border payments of passive incomes in its articles 10 and 11.

Such provisions fix a maximum withholding rate applicable to interest and dividends payments to non residents, leaving to the contracting States the freedom to bargain, within such thresholds, the exact amount of the tax burden.

In particular, the State of the source is entitled to levy a withholding tax up to the 10% of the gross amount of the interest payments and of the 15% of the gross amount of the dividends payments[119] so that, given the large number of these

[116] Articles 49 and 54 of the Treaty on the Functioning of the European Union. The same principle was stated by the European Court of Justice in *Amurta,* c-379/05.

[117] Decision of 19 November 2009, C-540/07, *Commission of the European Communities vs. Italy*

[118] 103 conventions at the 16/01/2013.

[119] The maximum rate is reduced to 5% if the percipient is *"a company (other than partnership) which holds directly at least 25% of the capital of the company paying the dividends".*

conventions, the national general withholding rate of 20% does not find frequent application.

For what specifically concerns Italian treaties[120], they normally establish a 10% withholding on dividends payments, except those signed with Italy's biggest trading partners[121] and with oil-producing countries[122], which further reduce the applicable rate to 5%, in some other cases[123], instead, the maximum rate allowed is the 15%. Also for interest payments, the medium rate is the 10%[124], which is sometimes increased to 15%[125] and sometimes reduced to 5%[126] or even to nil[127]

In addition, the national rules shall not be applied in the circumstances regulated by the EU regime of the Parent-Subsidiary and Interest-Royalties directives[128], which are fully enacted in the Italian tax system by articles 27-bis ILTA, for dividend payments and 26-quarter, for what concerns interest payments.

In particular according to these provisions, no withholding tax will be levied on cross-border dividends and interest payments between companies if the requirements requested by the two relevant directives are fulfilled[129].

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[120] For more on this point see P. Valente, *Convenzioni internazionali contro le doppie imposizioni,* 2012.

[121] Such as The USA, France, Russia, The United Kingdom, The Netherlands.

[122] Such as Kuwait or The United Arab Emirates.

[123] See the conventions signed with Austria, Belgium, Germany, Sweden, Switzerland.

[124] Established, for instance, by the conventions signed with Austria, The USA, Germany, Japan, Canada, China, Poland.

[125] Denmark, Brazil, Belgium, Sweden.

[126] Uzbekistan, Oman.

[127] See the convention signed with Hungary.

[128] Directives n. 90/435, as modified by the directive n. 2003/123, and 2003/49.

[129] More in detail, it is necessary that:

- both the companies are: incorporated in one of the forms listed by the attachment to the directives, resident in an EU member State and subject to the corporate income tax in their State of residence;
- that the parent directly owns at least the 20% of the capital of the subsidiary, for what concerns art. 27-bis ILTA;
- that either the payor or the recipient directly owns at least the 25% of the voting rights in the other company that is part of the transaction, or a third company owns the same percentage of voting rights in both the payor and the recipient company, for what concerns art. 26-quarter ILTA;
- that the relevant participation is held for at least a year. According to the Italian Tax Authority decision n. 131/E of the 27 of May 2009, the recipient has right to the refund of the withholding that had been levied before he reached such minimum period, once the condition is fulfilled.

For what concerns art. 26-quater ILTA, the presence of these requirements shall be stated by the taxpayer, through the filing to the Italian tax authority of a statement. Such document shall be accompanied by a certificate of the Tax Authority of the State of the recipient that states his residence.
For what concerns art. 27-bis ILTA it is also necessary a statement certifying the presence of such requirements which shall, this time, entirely come from the tax authority of the State of the recipient, except for what concerns the accomplishment of the minimum holding period, which shall be testified directly by the taxpayer.
The regime is also applicable, if the requirements are fulfilled, to interest and dividends payments received by Swiss companies, because of a convention signed by the EU and Switzerland in 2004, which extends the applicability of the two relevant directives.

2. Anti avoidance rules

The more favourable tax treatment granted by the so far illustrated national, European and International provisions to specifically characterized cross-border payments, inevitably implies the risk of abuses.
Such abuses consist in the artificial creation of the conditions of applicability of the relevant national and international rules, mostly through the setting up of a *conduit* company in a state whose residents benefit of such facilitations.

2.1. The *beneficial owner* clause.

With regard to the conventional regimes, such tax planning schemes are avoided through the introduction of a clause, considered by both articles 10 and 11 of the OECD model, according to which the more favourable tax regime will be applied only if the recipient of the payment is also the *beneficial owner* of the income.
Such clause expresses the principle of prevalence of substance over form[130], as it excludes from the benefits of conventional regime persons who are merely legal

[130] C. Garbarino, *Manuale di tassazione internazionale,* Milan, 2008, p. 889.

owners of an income that is not attributable to them from a substantial perspective.

Despite it is widespread, the conventional rules does not provide a definition of the meaning of the notion up for discussion[131], thus giving birth to an argument on this matter.

The Italian tax authority, in its circulars n. 167/E and 86/E of 2006, attributed to the clause a similar meaning to the one given by the Italy-Germany convention, establishing that the beneficial owner is *"the subject to whom the income is attributable for tax purposes; therefore, as noticed by the OECD Commentary, the requirement is not fulfilled when an intermediary is interjected between the payor and the beneficiary of the income"*[132] or *"the subject to whom the income is attributable for the potential tax liability"*[133].

Some literature[134], on the other hand, underlined that, in the lack of a conventional definition, according to article 3, para. 2, of the OECD model, it shall be given to the terms not defined by the convention, *"unless the context otherwise require"*, the meaning that they have *"under the law of the state"*[135].

The Italian legislator has, as a matter of fact, introduced a definition of beneficial owner in enacting the Interest-Royalties Directive and the Savings Directive[136], which both considers this quality of the income recipient as necessary for their application.

In particular, article 26-quater ILTA establishes that the no-withholding regime granted by the directive n. 2003/48 shall be applied only if the recipient is the beneficial owner of the income, meaning a subject who receives the income as its *"final beneficiary"* and not as *"an intermediary, an agent, a delegate or another*

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[131] Except for art. 9 of the protocol of the Italy-Germany convention, which states that *"the percipient […] is deemed to be the beneficial owner, if he claims a right to the relevant payments, and if the income that they originate is attributable to him under the tax law of the two states".*

[132] Circular n. 239 of 1996.

[133] Circular 167/E of 2006.

[134] F. Avella, *Il beneficiario effettivo nelle convenzioni contro le doppie imposizioni: prime pronunce nella giurisprudenza di merito e nuovi spunti di discussione",* in Riv. Dir. Trib., 2011, IV, p. 14.

[135] For more on these interpretative issues see G. Melis, *L'interpretazione nel diritto tributario,* Padua,2003.

[136] Directive n. 2003/48.

person's trustee", thus providing and explicit definition of beneficial owner[137], which has been interpreted by the Italian tax authority[138] as requiring for the recipient of the income, to obtain an *"its own economical benefit from the payment"*.

With regard to the compatibility of such interpretation with the context of a convention against double taxation, it has to be pointed out that, since the OECD Report of 1987 on conduit subjects, the notion of beneficial owner has progressively acquired an anti-avoidance connotation[139], that is now explicitly mentioned by article 10 of the Commentary[140], which is similar to the one that it indubitably has in the EU directives and which strengthens the applicability of the rule of art. 24-quater ILTA in the interpretation of the clause of the beneficial owner included in the conventions against double taxation.

That same conclusion was reached by the only judicial decisions which explicitly dealt with this issue[141], even if in that circumstances a different interpretation would have been preferable, as they concerned the Italy-Germany convention which, as previously explained, provides an its own definition of beneficial owner.

For what specifically concerns the requirement of the beneficial ownership of the income under the Interest-Royalties directive, its lack does not cause, at certain conditions, the application of the general regime of the 20% rate withholding.

In particular, art. 23 of the Legislative Decree n. 98 of 2011 introduced a new paragraph, para. 8-bis, in article 26-quarter ILTA, according to which, if the payment fulfils all the requirements needed for the application of the European regime[142], except for the beneficial ownership of the recipient of the payment, then the withholding tax will be levied at a 5% rate if:

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[137] In addition, art. 26-quater ILTA establishes that a PE is considered to be the beneficial owner if the income is related to its activity and taxed in the State in which the PE is located.

[138] Circular 45/E of 2005.

[139] P. Pistone, *L'abuso nel diritto tributario internazionale,* in V. Uckmar, *Diritto Tributario Internazionale,* Padua, 2005, p. 826.

[140] That states that *"The term beneficial owner is a narrow technical sense, rather, it should be understood in its context, and in the light of the object and purposes of the Convention, including avoiding of double taxation and the prevention of fiscal evasion and avoidance".*

[141] Decisions n. 14 and 124 of the Provincial Tax Commission of Turin.

[142] See the circular 41/E of 2011 of the Italian Tax Authority.

- the active interests received are used to finance the payment of passive interests and other kind of remunerations of bonds issued by the percipient;
- these bonds are traded in the market of a State belonging to the EU or to the Agreement on the European Economic Area and included in the white list, and granted by the payor of the interests or by the company controlling him or by a company sharing his controller.

2.2. Other anti-avoidance measures.

Next to the beneficial owner clause, the Interest-Royalties directive allows, in its article 5, the States enacting it to introduce the domestic provision required *"for the prevention of fraud or abuse"*, and, in particular, to withdraw the benefits of the Directive *"in the case of transactions having has their principal motive or as one of their principal motives tax evasion, tax avoidance or abuse".*
The Italian legislator exploited this concession, through the insertion[143] in the list of the transactions whose fiscal effects may be disregarded, drafted by art. 37-bis ILTA[144], of the cross-border interest payments that fulfil the requirements of art. 26-quater, if they are received by companies "*directly or indirectly controlled by persons not resident in an EU member state"*.
Such inclusion allows the tax authority to deny the application of the no-withholding regime, even if all the requirements of the directive are fulfilled, when:
- the payment is lacking of any business purpose;
- it circumvents a legal obligation;
- it grants a tax reduction otherwise not due.
It is up to the tax authority to prove the presence of such conditions.
The Parent-Subsidiary directive includes a similar provision in its article 1, para. 2, according to which *"This Directive shall not preclude the application of the domestic or agreement-based provisions required for the prevention of fraud or abuse"*.

[143] With the Legislative Decree n. 143 of 2005.
[144] See part. 1 para. 5.1.

Once again, the Italian legislator chose to use this freedom to fight the phenomenon of the conduit companies, hence establishing, in art. 27-bis, para. 2, ILTA, that the exemption regime may be applied to dividends paid to companies directly or indirectly controlled by subjects not resident in the European Union, only if they prove to detain the participation for exclusive or prevalent purposes different from the possibility to benefit of the no-withholding regime.

The shifting of the burden of proof upon the taxpayer does not determine a heavier treatment than the one provided by art. 37-bis ILTA, as in that case the tax authority's objection concerns a taxpayer that already proved, in order to benefit of the regime of art. 26-quater ILTA, to be the *beneficial owner*[145] of the payment. In this case, instead, the Directive does not provide an its own tool to fight the conduit companies phenomenon, thus making it necessary for the legislator to fully deal with such issue at a national level.

With regard to the numerous, and previously illustrated, deviations from the general withholding regime that have a purely national source, art. 37 ILTA establishes that the tax authority is entitled to ascribe to a taxpayer also the incomes that appear to be received by other subjects, when it is proved, even through qualified presumptions[146], that he is the actual owner of such revenues.

Some literature[147] anyway noticed how the restrictive interpretation given to such provision[148] by both the prevalent Italian literature[149] and the Italian Supreme Court[150] makes it unfit to fight the complex conduit schemes set up in this area.

Once again then, in the lack of international tools, the fight to tax avoidance is mostly held in trust, with the inevitable connected risks, to the judicial authority, and to the interpretative principle previously described.

[145] Meaning, as previously explained, a subject who effectively benefits from the interest payment received.

[146] They have to be clear, precise and concordant.

[147] G. Marino, *Titolare effettivo e possessori di reddito: sovrapposizioni, innesti e (probabili) mutazioni genetiche,* in *Riv. Dir. Trib.*, 2011, II, p. 183. On the same position C. Garbarino, *Manuale di tassazione internazionale,* cit., p. 893.

[148] Basically the provision is considered as applicable only to the cases of "pretended interposition", which is, in the circumstances concerning conduit subjects, rare to occur and almost impossible to prove, as it implies a position of mere formal holding of the income.

[149] F. Gallo, *Prime riflessioni su alcune recenti norme antielusione*, in *Dir. Prat. Trib*., 1992, I, 1761.

[150] *Ex multis,* Supreme Court decisions n. 3979 of 2000, 3345 of 2002, 8671 of 2011.

3. The deductibility of cross-border interest expenses.

The Italian tax system does not comprehend specific provisions limiting the deductibility of cross-border interest payments, so that the general regime of deductibility of this kind of negative elements, set up by art. 96 ITA, is applicable. Art. 96, para. 6, ITA, anyway, in regulating the deductibility of interest expenses, clarifies that its rules shall be applied only after the application of art. 110, para. 7 and 10, which concern the tax treatment of the expenses deriving from transactions with non resident subjects.

The main aim of these general rules is to fight the phenomenon of profit shifting to low taxation States, which may be accomplished through the fictitious realization of transactions with residents of such countries, in order to create negative elements potentially capable of reducing the resident's taxable income.

More in detail, article 110, para. 10, 11 and 12-bis, ITA excludes the deductibility of expenses and other negative elements deriving from transactions with enterprises and professionals resident or localized[151] in States not included in the white list[152], unless the taxpayer proves either:

- that the foreign enterprise mainly carries out an actual business activity, or;
- that the relevant transactions answer to his own effective economic interest[153] and that they had concrete execution.

With specific reference to interest expenses, the burden of proof levied on the taxpayer is often strengthened by the interpretation given to these conditions by the Italian Judicial and Tax Authority. With the decision n. 3194 of 2013, for instance, the Supreme Court considered as not sufficient to admit the interest expenses' deductibility, the actual payment of such amounts and the economic convenience of the loan from which they originated. More in detail, the Supreme Court stated that, despite the presence of these two conditions, it will be necessary, in order to allow the expenses' deductibility, to examine if "*the loan*

[151] According to the circular 51/E of 2010 of the Italian tax authority, it's sufficient that they are subject to tax in that State.

[152] These negative elements shall also be separately stated in the taxpayer's assessment.

[153] This condition may result particularly heavy, as the Italian tax authority interprets it as the necessity for the taxpayer to prove that the transaction with a subject of such States is more convenient than any other similar operation possible in the global market.

(…) may represent a form of profit shifting to the partners, thus avoiding taxation in Italy"[154].

In order to avoid any possible discrimination unacceptable under the EU system, such provision is not anyway applicable to transactions with economic operators subject to taxation in a State which is member of the European Union or of the Agreement on the European Economic Area, even if not included in the white list.

In addition, art. 110, para. 12, ITA excludes the applicability of such regime if the non resident is already included in the CFC regime or in that of the affiliated companies resident in low taxation States[155], as in this case the profits shifted to the foreign subject will anyway be, thanks to such regimes, subjected to taxation in Italy.

The profit shifting to other countries may be accomplished also through infra-group transactions with non residents, realized at conditions different from the market ones. In order to fight this phenomenon, the Italian tax system comprehends a transfer pricing regime, which allows the Italian tax authority to redetermine, for tax purposes, the conditions of the transaction, replacing the ones agreed by the parties with the ones that would have been negotiated if the subject involved had dealt at arm's length.

The relevant provision is art. 110, para. 7, ITA, which establishes that *"the income elements deriving from transactions with non resident companies which directly or indirectly control the enterprise, or are controlled by it, or share its same controller, are taken into consideration at the fair value of the goods sold, the services provided and of the goods and services received, if it originates a raise of the taxable income; the same provision is applied even if it originates a reduction of the taxable income, but only in execution of […] the international conventions against double taxation"*.

While in the past the provision made reference to the company law's notion of control[156], the actual formulation of art. 110, para. 7, ITA does not provide any

[154] Even if this additional requirement may be due to the fact that the company paying the interests was controlled by the one receiving them.

[155] Art. 167 and 168 ITA.

[156] According to art. 2359 ICLC a company is considered as controlled if:

-another company has available the majority of the votes in the general shareholders meeting;

indication on this matter. The Minister of Finance circular n. 32 of 1980 clarified that the provision, in line with its goals, uses a wider notion capable of comprehending any form of control (internal, external, direct and indirect) that could give birth to issues of the kind that the provision aims to fight[157].

For what concerns the individuation of the fair value that will replace the negotiated conditions, art. 110 ITA makes reference to art. 9 ITA which defines it as *"the price that would have been agreed for similar transactions by independent enterprises"*[158]. In particular, for what concerns the fair value of interest expenses, the criterion mostly used to determine it is the comparable uncontrolled pricing method, which considers as fair the interest rate that independent parties would have negotiated under similar circumstances.

Being applicable only to cross-border transactions, the transfer pricing discipline is inevitably capable of causing a breach in the freedom of establishment's principle. The European Court of Justice, anyway, stated that such possible discriminations have to be considered as justified by the legitimate goal of granting a proper division of the tax claims among the different states[159].

4. Permanent establishments.

4.1. Notion and taxable income.

Since 2004, the Italian tax system provides an explicit definition, almost fully reproducing the OECD's model one[160], of permanent establishment, given by

-another company has available enough votes to exercise a dominant ascendancy upon the general shareholders meeting;

-another company exercises a dominant ascendancy upon it because of specific contractual bonds.

[157] For instance, the use of the company law's notion of control would have made it impossible to apply the transfer pricing regime to transactions realized between a company and its permanent establishment.

[158] The National rule may anyway be waived by an eventual International convention against double taxation signed with the state of the non resident controlled company, as the oecd model provides, in its article 9, his own transfer pricing regime.

[159] Decision C-311/08 of 2010, Société de Gestion Industrielle.

[160] Minor differences may be encountered, such has the different minimum duration required by the OECD model, more than twelve months, in respect of that required by art. 162 ITA, at least three months, to consider a construction site as a PE.

article 162 ITA, according to which *"the expression permanent establishment defines a fixed place of business, through which the non resident enterprise fully or partially carries out its activity"* in Italy. The rule also provides some examples of what shall be considered as a PE[161] and of what shall not be considered as such[162]. Until 2010 Italy had placed an observation to the OECD commentary, according to which the examples listed in the *positive list* should have been considered, for what of its concern, as always representing a PE, without any need to verify the existence, in the concrete circumstances, of the requirements listed by the general definition. Such waive is no longer present in the 2010 revision of the commentary, meaning that Italy has abandoned such perspective.

Next to this provision, which illustrates the concept of material PE, art. 162, para. 6, ITA introduces the institution, similarly resembling the one ruled by art. 7 of the OECD model, of the personal PE, represented by the person who, whether or not resident, habitually concludes contracts in the name of the foreign enterprise, provided that the relevant contracts are different from the ones of mere purchase of goods[163]. In addition, art. 162 clarifies in its para. 7, that an enterprise shall not be deemed to have a PE in Italy merely because it carries on business in Italy through a broker, general commission agent or any other independent agent if such persons act in the ordinary course of their business.

From an accounting perspective, the PE is treated as an autonomous enterprise, and it is then subjected to the same accounting obligations concerning any other national enterprise.

While the definition of PE almost completely resembles to the one provided by the OECD model, some literature[164] highlighted that a waive from such model may be spotted with reference to the individuation of the incomes taxable upon

[161] Branches; places of management; offices; laboratories and workshops; mines or other structures used for the extraction of natural resources; construction sites having a minimum last of three months.

[162] Places only used for the storage, exhibition or delivery of goods, or, in general, for preparatory or auxiliary activities.

[163] While, according to some literature, the Italian system considers existing a personal PE if the agent only concludes contracts with a preparatory nature, thus waiving from the OECD model. A. Lovisolo, *L'evoluzione della definizione di stabile organizzazione,* in *Corr. Trib.,* 2004, XXXIV, p. 2655.

[164] V. Uckmar, G. Corasaniti, P. De Capitani Di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale,* Milan, 2012, p. 251.

the PE, as article 7 of the OECD model only allows the taxation upon the PE of revenues attributable to its activity, while the Italian system may introduce a stronger force of attraction principle, which may allow to tax upon the PE even business revenues not connected to its activities.

In particular, article 151, para. 2, and 153, para. 2, ITA establishes, respectively for commercial and non commercial entities, that capital gains or losses linked to goods used for the business activities carried out in Italy, even if not received through the PE, are considered as produced in Italy[165].

Moreover, art. 152, para. 1, ITA states that companies and other commercial entities having a PE in Italy shall be taxed on the base of the results of the profit and loss account related to the PE and of *"the other activities producing revenues taxable in Italy"*, thus establishing for the relevant subjects a full force of attraction of the PE.

The Italian tax authority, though, with the Minister of Finance Circular 165/E of 1998, excluded any force of attraction with reference to dividend payments and capital gains not effectively linked to the PE.

In addition, the full force of attraction approach seems to be contradicted by the existence of some other provisions which levy a withholding tax on incomes produced in Italy by a non resident subject but not connected to its PE. For instance, the aforementioned rule of art. 27, para. 3-ter, ILTA levies the 1,375% rate withholding tax on dividends paid to EU states companies and not connected to a PE in Italy, thus excluding the capability of the PE to attract in its taxable income revenues not connected to its activity[166].

Such issue has anyway no relevance in the many cases in which a convention against the double taxation based on the OECD model has been signed between Italy and the other State involved, as in these circumstances the conventional

[165] The same treatment shall be applied to capital gains deriving from the sell of the participations in resident non listed companies and to profits received from companies and other entities carrying out a business as their exclusive or principal activity.

[166] The same reflections may be done with reference to the rule of art. 25, para. 4, ILTA, which levies a 30% rate withholding tax on royalties paid to a non resident, unless such payments are made to its PE.

notion will prevail, unless the taxpayer decides to apply the national one, as it is more favourable to him[167].

According to the OECD Authorized Approach, expressed in the 2010 OECD Report on the attribution of profits to the permanent establishments, the PE shall be treated as a *separate entity,* hence *"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"*.

Despite the lack, at a national level, of specific provisions enacting such principle, the Italian tax system tends to conform to this approach as the Italian tax authority considers the transfer pricing regime previously illustrated is considered to be applicable also to transactions between the PE and the other parts of the enterprise[168].

The PE taxable income will anyway benefit of the allowance for corporate equity, for this purposes, any reference made in the ACE discipline to the partners shall be interpreted as a reference to the other parts of the company.

4.2. PE financing.

For what concerns the financing of PE, it has to be pointed out that the Italian legislator does not take any explicit position on the matter, leaving its resolution to the application of the general provisions ruling the taxation of business income and to the interpretative action of the Italian tax and judicial authorities, which have frequently made reference to the solutions adopted by the commentary to the OECD model, as the greatest part of the circumstances under judgment concerned PE of subjects resident in States with whom Italy had signed a convention against double taxation.

More in detail, it was at first[169] admitted the qualification of the amounts attributed by the head office to the PE as loans productive of deductible interests,

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[167] Art. 169 ITA.

[168] Italian tax authority Resolution n. 18/E of 2005.

[169] Italian tax authority circular n. 32 of 1980

even if with the clarification that the interest rate should have been considered as the one that the two operators would have applied dealing at arm's length.

With the resolution n. 44/E of 2006 the Italian tax authority changed his approach to the matter, stating that, even if there is no rule compelling to allow free capital to a PE located in Italy, in order to establish if the resources assigned to the PE by the head office[170] may be considered as loans producing passive interests deductible from the PE's taxable income, it is necessary to analyse the ratio between the free capital and the debt capital attributed to the PE. It is, as a matter of fact, interest of the state where the PE is located, to avoid tax arbitrages aiming at shifting the profits from the PE to the head office, which may be achieved though an insufficient attribution of free capital and an excessive debt financing.

More in detail the Italian tax authority clarified that, in order to avoid such phenomena, it is necessary for the PE to be provided with, as clarified by the OECD commentary, *"a patrimonial structure which is adequate to the enterprise and to the activities it carries out"*, which means that it has to be equipped with an amount of free capital that, even if not resulting from its accounting books, shall be figuratively determined for tax purposes, in order to establish if the passive interests are correctly deducted, as it would be for any other independent enterprise.

In particular, it will be allowed the deduction only of those interests connected to debt financing that the PE would have needed if it could have had the availability of an adequate free capital fund.

Such figurative adequate amount shall be determined with reference to the global patrimonial structure of the company, to the activities ordinarily carried out by the PE, to the material assets available for the PE and to the economic risks it bears.

Given the open-endedness of these criteria, and the need of legal certainty that characterizes any fiscal issue, the Italian tax authority grants to the taxpayer the possibility to use the procedure of international ruling[171] which represent a previous agreement concluded with the tax authority on the fair value attributable to some expenses, included interest ones, which binds the two parties for the tax

[170] Through attributions of the enterprises own resources, or through loans granted by third parties to the head office or to the PE itself.

[171] Legislative Decree 269/2003, Art. 8.

period in which it is concluded and for the two subsequent ones, unless significant variations in the relevant circumstances intervene.

The legislative foundation of such approach has been founded not only in the conventions against double taxation, but also in the transfer pricing regime, even if that represents, according to some literature[172], a clear stretching of the provision, whose scope of application does not comprehend the requalification of debt as equity.

For what specifically concerns banks, such approach has brought to particularly relevant consequences, as the Italian tax authority has sometimes fixed the amount of the figurative free capital allocated to the PE for tax purposes, as the same amount of free capital required to an independent bank by the circular n. 229 of 1999 of the Bank of Italy. The foundation of this approach has been found in the 2008 OECD report, which allows to use, in order to determine the arm's length amount of capital that shall be considered as attributed to a bank's PE, next to the other three authorized OECD approaches[173], the so-called *safe-harbour approach-quasi thin capitalisation/regulatory minimum capital approach*, according to which the banks' PE are required to have at least the same amount of free capital as would an independent banking enterprise operating in the host country. Such approach, even if "*is not an authorized OECD approach, as it ignores important internal conditions of the authorized OECD approach, e.g. that the PE generally has the same creditworthiness as the enterprise as a whole*" may be acceptable "*as long as it does not result in the attribution of more profits to the PE than would be attributed by an authorized OECD approach*"[174].

Next to the criticism already mentioned, concerning the lack of any legislative position on the point, and the inadequacy of the transfer pricing discipline to found these conclusions, it has also been noticed that, even from an International perspective the tax authority's approach may be criticized, as, first of all, no proof has been given, in the circumstances where it was applied, that the use of the safe-harbour approach would not have caused an attribution to the PE of more profits

[172] G. Mameli, *The Debt-Equity Conundrum, Branch Report Italy*, in *Cahiers de droit fiscal international*, 97b, 2012, p. 373.
[173] The capital allocation approach; the economic capital allocation approach and the thin capitalisation approach.
[174] OECD 2010 Report on the attribution of profits to permanent establishments.

than those that an authorized OECD approach would have attributed. In addition, it has been noticed that the Circular of the Bank of Italy enacts the Directive 92/121 of the European Union[175] which specifically refer the free capital requirement to the bank as a whole, so that the Italian tax authority's approach may result in a breaching of the European Union harmonized rules and also in an illegitimate violation of the freedom of establishment principle, as it will make particularly burdensome for an EU resident bank to exercise such freedom in Italy.

While in some decisions the judicial authority accepted those arguments and therefore denied the requalification of debt as equity[176], in some others the position of the tax authority has been accepted[177], sometimes[178] also applying sanctions to the PE in relation to the excessive amounts of interest expenses deducted, which seems unjustified, given the objective condition of uncertainty that at the moment characterizes such circumstances and that should prevent, at least, such kind of measures. The matter will anyway most certainly have to be solved by the Supreme Court.

5. Conclusions.

From the description provided of the tax regime of foreign financial investments in Italy, it appears that the Italian system tries to attract such investments through the levying of a reduced tax burden on the revenues that they provide.

Such policies seem anyway not neutral for what concerns the choice between equity and debt investments made by natural persons.

As previously described, while the national rules often further reduce the amount of the withholding levied on cross-border interest payments, frequently establishing a no-withholding regime, there are, despite the economic double taxation phenomenon that occurs in these situations, no national rules waiving

[175] Subsequently amended by Directives 2000/12 and 2006/48.
[176] Provincial tax court of Milan, decisions n. 141 of 2011 and 186 of 2010.
[177] Provincial tax court of Milan, decision n. 475 of 2010.
[178] Regional tax court of Lombardy, decision n. 62 of 2012.

from the general 20% withholding regime applied to cross-border dividend payments to individuals[179].

It may then be concluded that, with reference to debt financing the main aim of the Italian tax system is to attract foreign investments, often reducing the tax burden levied on the revenues that they provide in respect of that levied on similar investments made by residents. On the other hand, for what concerns equity financing, the system only ensures the so-called capital import neutrality, as the tax burden levied on non residents' equity investments is not heavier than the one born by residents' similar investments, but not a particularly favourable regime adequate to attract such kind of investments.

The aim to attract foreign financial investments is anyway often accompanied, as demonstrated by the different tax treatment that is applicable to foreign investments coming from low taxation states, to the guarantee that a proper tax rate is globally levied on such revenues, so that the Italian choice to limit the tax claims on foreign investments seems related not only to the will to reach an adequate standard of competitiveness on the financial market, but also to a full application of the principle of taxation in the state of residence, which also inspires the OECD model, to which the great part of the Italian international conventions against double taxation makes reference. In addition it shall be noticed that as a member of the European Union, Italy has to adequate its tax system to the policies against harmful tax competition pursued in such context, whose intent is to limit the possibility for the states to use tax policies to attract foreign investments.

With regard to the fight of cross-border tax planning phenomena, it has to be noticed that the Italian tax system suffers from a structural slowness of the legislative procedures which makes it hard for the legislator to promptly and specifically intervene on these matters, thus contributing to the inadequacy of the instruments provided to deal with issues of this kind[180].

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[179] As previously explained it has also been eliminated the provision which established a reduced rate for preferred shares which, giving no right to vote, but more favourable patrimonial rights, are normally subscribed by natural persons.

[180] Up to now neither the OECD Report on Hybrid Mismatch Arrangements nor the European Commission report on double non taxation have had any impact in Italy.

Such lack is anyway partially compensated by the presence of some general provisions, such as the rule of article 109, para. 9, lett. a), ITA, which forbids the deduction of that part of the securities' remuneration representing a participation to the profits of the issuer. This provision limits the possibility of tax arbitrages based on the different qualification of hybrid financial instruments, such as preferred shares or profit participating loans, and aiming at the unjustified possibility to benefit from both the deductibility of the security's remuneration on the head of the issuer, which is generally granted for debt financing, and the measures against economic double taxation, which reduce the tax burden levied on revenues originating from equity financing.

In addition, the general anti-abuse principle applied by the Italian jurisprudence, and the progressive development of the international policies of contrast to tax arbitrage, which represent a relevant interpretative substratum for both the Italian tax and judicial authority, often contribute to strengthen the Italian system's protections against such phenomena, even if with the lacks in terms of legal certainty that they determine[181].

[181] It has been noticed, for instance, that the previously described decision of the Italian tax authority, to oblige the banks' PE to hold the same amount of free capital required to an independent bank by the circular n. 229 of 1999 of the Bank of Italy, has been taken directly in a concrete case, without even a previous general act, such as a circular, expressing this new position.

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Taxation of cross-border employees

Sabrina Tronci

095303

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INTRODUCTION[1]

The recognition of employment income must begin with the definition of the employment relationship and its differentiation from self-employment and other job categories. Article 2094 of the Civil Code affirms that the employee is someone who agrees to work in the company, with his intellectual or practical activity, employed by and under the direction of the employer, then he receives a compensation for the activity performed.

Italian tax law is concerned primarily on the objective aspects of the employment relationship, rather than the subjective profiles: the qualification of the relationship aims to identify the taxable income that derives from this relation. According to Art 49 of the Presidential Decree n. 917 of 1986 (Income Consolidated Tax Act), any income that arises from the employment relationship, related to a work activity performed under the direction of others, is part of the employment income category.

Italian civil law aims to identify the figure of the employee to select a range of subjects and needs, and consequently in order to grant or deny economic and regulatory conditions.

Tax law, instead, feels the need to identify the economic facts, which are indexes of the "ability-to-pay", and the amount of wealth produced, on which the tax charge will be applied.

The element of subordination distinguishes the employees from the professional, and the employment income from professional and business income. From the point of view of civil law, the subordination is a personal duty which obliges the employees, limiting their freedom to follow the directives of the employer. In tax law, the subordination is the subjection of the employee to the economic initiative of the employer. The activities related to the employment are free from any economic initiative and therefore they are carried out without any pre-ordered means.

[1] The main points of the Introduction are inspired by F. CROVATO, *Il lavoro dipendente nel sistema delle imposte sui redditi,* Padova, 2001

For this reason, the taxation of that class does not take into account all aspects of costs related to equity components which are important in the professional income and in the business income. The legislature rather believes that the costs for the employee will not be significant enough to be recognized with analytical methods, so he provides only a flat-rate deduction, which in recent changes, however, has lost partly its function.

Tax law uses the same expression used in the Civil Code, “employed by and under the direction of others”, to describe the situation of those who make available their personal activity, with a duty of subordination to the employer.

Article 49 of ICTA does not refers directly to Article 2094 of the Civil Code. As we said above, the positions of tax law and civil law about the function of subordination are pretty different. In civil law, the subjects are relevant, the subordination is the element that leads to a protection of the worker, which aims to rebalance the position, basically weaker, of the employee compared to the one of the employer. In tax law the subordination is an element that justifies the adoption of certain rules for the determination of employment income, methods of assessment and formal obligations of the taxpayer.

Employment income is linked to a concept of “passivity”, in the sense that it is not self-directed, the employee does not act independently but he receives orders, because he is involved in a hierarchical structure. The employee is in a state of awe about the content and the manner of the work performance. The direction is the technical mean by which the employer relies on the availability of employee's working power. These directives apply to the content, manner, time and place of the performance. The effective degree of subordination, however, is variable and it depends on the type of the work relationship.

The principle of inclusiveness (onnicomprensività) is one of the three main principles that inspire the employment income taxation system, with the cash principle and the principle of taxation on the gross amount.

The principle of inclusiveness is developed by the Courts, according to which everything that the employer gives to the employee during the employment relationship is covered by the concept of “compensation”, excluding only the reimbursement of some kind of expenses, as we will see later.

The term “compensation” has not a unique definition. The inclusiveness principle derives from the old version of Article 2121 of the Civil Code (now Art 2120), which defines the annual salary as the set of all sums, including benefits in kind, paid in dependence of the employment relationship, when this relation is not occasional; everything that is paid by way of reimbursement for expenses is excluded. However, the compensation no longer includes only those sums paid in consideration of the actual work activities, but more broadly, it includes any amount that is connected to the performance of the employment relationship.

The concept of inclusiveness is not intended to include any kind of payments, a link with the working relationship is always necessary. Article 49 of ICTA, which in its original formulation refers to the term “addiction” of the sums to the employment relationship, must always be taken into account to understand the principle of inclusiveness. The term "addiction", and the current term "in relation", do not have a purely temporal connotation, in the sense of contingency between supply and employment, these criteria express a relationship of inherence to the work context.

Article 49 of ICTA gives the criteria to identify those payments that constitute income, for purposes of taxation. First of all, income is an increase in wealth in the economic situation of a subject. This initial element allows to determine what do not constitute income, even if it is paid in the context of an employment relationship.

The expression "in relation" requires that the compensation must relate to the working environment, in order to be taxed; the taxation of payments resulting from the personal relationship between the employee and the employer, or payments that are related to the organization of the company, are not relevant.

The inclusiveness is largely mitigated by a long list of exclusions from the taxable base, that we will analyze below, which are excluded because of their nature, because some of them do not constitute an increase of wealth, or which are

excluded for purposes of tax relief. Those exclusions, also, are not a homogeneous group, but they comprise payments excluded for various reasons.
This lack of uniqueness in the exclusion entails a restriction on the applicability of the concept of inclusiveness in this income category.

The employment relationship is the justification for the assignment of compensation. The legal title varies, the article says, "for whatever reason", so the assignment can have many causes, but the employment must remain the real reason that justifies the award. Some payments that represent a benefit for the employee, are not inherent to the work context and they are not employment income.
Sums of money are paid without any kind of exchange between the employee and the employer, such as donations linked to particular events in the life of the employee, or discounts on the purchase of goods produced by the enterprise, or other benefits that lead to agreements between the employer and the employee.
Benefits provided for the employees that are useful to improve the performance of their work are generally excluded, because they are provided also in the interest of the enterprise.

Article 6 of the ICTA affirms that those income received in lieu of the ordinary salary and those benefits achieved by way of damages for the loss of income, constitute income of the same class as those being replaced or lost.
The amount received in lieu of income includes all the elements that have a substitutive function in the taxable base.
The financial damage is excluded from taxation when the company has an interest in the activity that caused the damage; all charges related to the production of income of the employee, or that are related to a personal matter of an employee, are excluded, because they are independent from the work relationship.
All the benefits achieved as damages are intended to restore the damage, so they give rise to taxable income only if damages consist in loss of income. The reason of the compensation must be considered to detect the presence of new wealth. An amount received as compensation does not constitute income when it concerns a

capital loss suffered, this compensation is taxable when it is provided for the loss of revenue which, if achieved, would be taxable.

The compensation for financial losses suffered as a result of the work activity are not taxable, such as the reimbursement of medical expenses related to an accident at work. Allowances that replenish pecuniary loss shall not constitute income, because they are not new wealth. Compensation that is not attributable to a specific loss of property is taxable. This limitation is necessary in order not to violate the “ability to pay” principle.

Article 6 of ICTA provides for the exclusion from taxation for payments made by the employer in the event of death or permanent disability of the employee. Article 6 provides in general the inclusion in the taxable income of damages for loss of income, so it provides the general taxability of profits, as replacement of income that would be taxed, but with these exceptions.

The distinction between lost profits and reintegration exists, but it is not absolute.

Compensation for loss of earnings may relate to revenue that, if came into existence, would have been exempted. Compensation may, instead, refer to a loss already recognized in the tax return, in this case, it is taxed to prevent the recognition of a double tax benefit.

The reimbursement of an expense sustained in advance by the employee has a different regime. Fees of various kinds are included in the category of reimbursement of expenses, related to the employment relationship, which represent the return of an expense incurred by the employee in various ways and for various reasons. Reimbursement is not an enrichment and it is not taxable when it constitutes a return of an amount that the person has spent on behalf of others, and that, in any case, does not relate to his personal or family needs.

The Italian Supreme Court in Case No. 3843 of 1974 identifies two categories of reimbursement: 1) reimbursement for expenses sustained by the employee on behalf of the employer and; 2) those sustained by the employee for his personal interest. Only the first category falls within the concept of redemption, in the second case we must speak of income.

The costs sustained for the execution of the work activities are excluded from the definition of wages. Such refund is to avoid an unfair reduction of salary of the employee, because they do not increase his income[2]. The interest in the expense is the subjective discriminating criterion, developed by case law and doctrine. The company has an interest in the expense when it aims to achieve a better performance of the employee, the promotion of the company, or, in general, the improvement of the daily work efficiency.

Gratuitous payments are not included in the taxable base, because of their nature: they are not part of the salary, there are not strictly related to the work relationship, they are more related to the private sphere of relations between the employer and the employee.

The notion of income includes a notion of exchange: income is obtained in exchange for the obligation to give something or do something. Free entries are not attributable to work, their source is the employer's will to increase the wealth of the recipient.

Article 49 of ICTA refers to donations and it includes them in the taxable income. It refers, however, only to those donations that are in relation to the employment relationship, in this case, the very sense of the word "liberality" loses its meaning. Donations of a personal nature will remain excluded.

Favorable treatments are widely available in this category of income, they have a welfare support purpose, the employee must provide for some services to meet the employees elementary needs. Sums given in the occasion of holidays and anniversaries, loyalty rewards, have the aim of retaining the employee, in order to create solidarity between the employee and the company. Overall, the legislation has care profiles, when there are elements of generality, as in the case of canteen and public transport. The interest of the worker is the interest of the company: it is a collective interest.

[2] Cass. Pen. 9 febbraio 1973, n 302; Cass. Sez. Lav. 26 ottobre n 197, Cass. Sez. Lav. 14 ottobre 1988 n 5587

The taxation of employment income is a taxation on the gross amount: this is one of the main features of this category of income. The legislator dismissed the relevance of the costs for the calculation of taxable income for reasons of simplicity and control. Article 13 of ICTA provides for the flat-rate deduction of costs for the production of income from the taxable base, but this method now serves only to mitigate the progression of Income Tax.
The employee sustains a series of charges for its work: transport costs, housing costs, expenses for telephony, electrical, expenses for meals and lodging away from home. These costs, however, are not readily identifiable and their identification may still lead to phenomena of tax avoidance.

In 1973 the legislator had introduced a system of deduction to recognize the cost for the production of income to the employee. In 1973 the tax system was not based on self-taxation and the tax return, the idea of controlling all the statements was still prevalent. The present times need new practices.
The lump-sum deduction of expenses has 17 different graduations, and it gets to disappear for higher incomes. This system is intended to protect the "minimum subsistence", which is that part of the income that is used to meet basic and essential needs of the taxpayer: the protection of minimum subsistence loses its function as the income grows: this phenomenon would not be present if the deduction serve to cover the costs of production. Article 13 of ICTA, therefore, has the function of ensuring the minimum vital and to mitigate the progressive tax on personal income. The insufficient importance of costs in employment is currently a sacrifice imposed on taxpayers. The lump-sum method responds to practical needs of the administrative system: these reasons are, however, too weak to support such an infringement of the rights of accuracy, fairness and the respect of "ability to pay" principle.

The taxation system of employment income is based on the cash principle, this choice is for a reason of simplification, because the receipt or payment can be verified by inspection in the accounts of the person who pays, or the person who receives the sums, or in handling banking, so it is easy to place the receipt in a specific tax period, or at another time.

The application of the principle of cash may result in mismatches between the moment of the production of income and the time of taxation, with changes related to the events of payments. However, if the income is small, and the source of income is quite elementary, the delay is tolerable compared to the simplifications that the principle of cash allows.

The accrual basis is more sophisticated: in this case, the income taxed is not the income actually received during the tax period in question, this principle takes into account the aging of the components of income. This produces more precision, but also more complexity. So the cash basis, and then the taxation in the moment of perception, is appropriate for elementary phenomena that produce income.

In the employment income category the deduction of costs for the production of income is not allowed, as we said above, the phenomenon of credit has not a significant size, cases of deferred income are rare. Thanks to all these features, simplification can be privileged over the need of precision.

The compensation of employees is identified on an "enlarged cash base" . The wages accrued during the reference period, but materially paid in the new year until January 12th are included in the income of the previous year. The taxation is also based on the system of substitution: the substitute had, prior to the introduction of this provision, the decision to include or not these operations in the financial statements at the end of the year. This system makes possible to anticipate the levying of taxes, with respect to the allocation of the income under the cash basis and it meets the financial needs of companies.

The enlarged cash base principle is also extended to the remuneration of directors of the company.

In this way, the tax year in which the fees are subject to tax in the hands of the director, is the same year in which they are deducted from income of the employer, maintaining the symmetry between the taxation year for the director and the year of deductibility for the company.

PART 1

TAXATION OF EMPLOYMENT INCOME,GENERAL CHARACTERISTICS

1.1 General Definition

In Italian legislative system we find the definition and regulation about the taxation of Employment income in the Presidential Decree n. 917 of 1986, that is the Income Consolidated Tax Act (ICTA).

As we said above, Art. 49 gives the definition of employment income: it consists of "all compensation derived from agreements which have their object in any kind of work performance, both private and public, when the employee is employed by and under the direction of others". We find the same definition in Art. 2094 of the Civil Code.

The feature of subordination marks the difference between employment income and professional or business income.

The qualification process must surely move by the name given by the parties to the relationship, the *nomen juris*. Then we must consider the nature of the conduct of the parties and the detailed rules for the performance of the work, included in the agreements of hiring. In the qualification process we have to evaluate the first element of the control of the employer on the employees, and then proceed to the overall assessment of all the indexes that reveal the subordination[3].

Professional income is defined as income derived from the professional and habitual exercise of a non-commercial activity[4]. The activity must be continuous and autonomous, so not under the direction of an employer.

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[3] A. URICCHIO, *La qualificazione del reddito di lavoro dipendente tra definizioni normative e itinerari della giurisprudenza*, in *Riv. Dir. Prat. Trib.*, p. 50-83

[4] Art 53 ICTA: "Sono redditi di lavoro autonomo quelli che derivano dall'esercizio di arti e professioni. Per esercizio di arti e professioni si intende l'esercizio per professione abituale, ancorché non esclusiva di attività di lavoro autonomo diverse da quelle considerate nel capo VI" (different activities from those who produce business income).

Business income is related to the exercise of a commercial activity[5]. A commercial activity according to Art. 2195 c.c. is about: 1) production and intermediation of goods and services; 2) transportation services; 3) banking and insurance; 4) any supplementary activities of the previous. Some different activities are included if they exceed a certain dimension. Those activity are commercial even if they do not have a business organization. All businesses carried on through a business organization must be considered commercial[6].

Pensions, interests on credits derived from employment are part of this category[7]. Special supplementary allowances of public employees, the contingency allowance of private workers, sickness benefits, currency revaluation, loyalty bonuses, money paid for transfers and change of venue are included too.

Employment income also includes heterogeneous cases, forms of income that are assimilated to the general one even if they are characterized by some significant differences (art. 50 ICTA).

The list of Art 50 ICTA is absolutely exhaustive and it does not allow an extensive interpretation. According to the Administration, in Circ. n. 326/E of 1997, the items listed in the Article can be divided into three distinct groups:

- The first group covers cases in which the connection with the work performance does not exist (life annuities, periodic checks that do not derive from capital nor from labor, such as checks resulting from legal separation or dissolution of marriage, etc);

- The second group includes the cases set in relation with the work performance, but with a lack of a real employment agreement (allowances paid by the State, Regions, Provinces and Municipalities for the exercise of public functions, as well as allowances received by members of the National Parliament and the European Parliament and allowances, however named, perceived by public officers);

[5] Art 55 ICTA: “Sono redditi d’impresa quelli che derivano dall’esercizio di imprese commerciali. Per esercizio di imprese commerciali si intendel’esercizio per professione abituale, ancorché non esclusiva, delle attività indicate nell’art. 2195 c.c.…”

[6] F. TESAURO, *Istituzioni di diritto tributario. Parte speciale*, Milano, 2012, p. 70-72

[7] Art 49 ICTA

- The third group, finally, includes cases in which the compensation does not derive directly from the work performance (all other paragraphs of Article 50)
The main “assimilated” items of income, are the followers:

- Payments of cooperative members
- Compensations received by priests
- Compensation received from a third party for a work performance
- Compensation for public functions: every compensation paid to members of tax Courts, agents of the Court surveillance, judges, judges mediators, witnesses , etc. ..
- Indemnities paid for elective office: allowances and life-annuities received as members of the National Parliament; as provincial and municipal councilors; as judges of the Constitutional Court; as Italian representatives in the European Parliament; etc. ..
- Compensation for socially useful work
- Scholarship, awards, grants for purposes of study or professional trading
- Free life annuities and fixed terms annuities
- Pensions of any kind: every payments received by the employee after the termination of the employment relationship
- Periodic checks which do not derive from capital or services
- Compensation for coordinated and continuous collaborations (co.co.co), since 2001

All compensation received as director, officer, auditor or inspector in corporations, associations, partnerships or other entities, and income derived from contributing to newspapers, magazines, encyclopedias are included in this category. It includes all sums received also as donations. The applicable provisions are the same as for all other assimilated items of income, including Article 51 ICTA about the determination of employment income. Income earned by directors or auditors is professional income, if the position is assigned to a professional, someone who habitually carries out these activities. This income is employment income, if the activity is carried out on behalf of the employer, or in connection with the employment relationship with him.

Anyway, every income received by the employee is considered "assimilated income" by the provision, when these conditions are fulfilled:

- There is a work performance without any subordination and
- Within the framework of a single, continuous relationship and
- Without the use of organized means and
- With an agreed regular salary.

The condition of the "absence of the subordination" means that these relations are not characterized by autonomy and professionalism in the full sense, but that a certain degree of autonomy is present in the way of carrying out the work performance. The employee is, however, included in the system of interests of the employer and he is connected to the company organization.

The relation should be "continuous", so the activities are not occasional, but they are identified as a single unit. Continuity exists when only one subject coordinates the activity, during the time of the relationship.

The work performances are repeated during the relation, and all together constitute a single activity of collaboration.

The absence of "organized means" allows to assimilate this income to employment income rather than those of professional and business. The employee works with the means provided for him by the employer.

Wages should be fixed, the employer and the other party have to agree, so that the employer will pay periodically a predetermined amount of money to the employee.

Collaborations that are part of the professional activity of the taxpayer do not produce income "assimilated" to the employment income, these collaborations provide professional income to the performer.

We have a large definition of employment income, it includes not only salaries but any compensation, whether in cash or in kind, received during the tax period, related to an employment relationship, reimbursement of expenses relating to the production of income and gratuitous payments, profit sharing payments and tips

(Art 51 ICTA). As we said before in the Introduction, the principle that inspires our system is called “onnicomprensività”, inclusiveness[8],

Italian tax law considers employment income every sum received by the employee, regardless of the nature of the compensation, the nature of the subject paying the compensation or the existence of a specific connection between the work performance and the compensation.

Goods and services available for the employee and his relatives, called fringe benefits, are included only if their value is higher than 258 Euro. These are special compensation given to encourage the productive activity, or as an integration of the regular salary. These benefits are valued at their fair value, after 1998. Before 1998 they were valued at their cost.

The fair value[9] is the market value established between two independent parties in a free transaction. If the market value is unknown the value is considered with the lump sum method.

The following items of income are not included in the employment income category (Art 52 ICTA):

- Social security contributions, paid by the employer or the employee, in accordance with provisions of law or agreements
- Health care contributions up to the limit of 3615,20 Euro
- Donations and grants for holydays and special occasions until 258,23 Euro (Art 52, Para. 3 ICTA). The term “special occasions” includes every kind of event: civil and religious, those related to the private life of the employees or to the life of the company
- Supply of provisions in canteens or equivalent services, until the daily amount of 5,29 Euro, and the provision of transportation services. The provision includes agreements with restaurants, baskets and ticket-restaurant

[8] G. FALSITTA: *Manuale di Diritto Tributario. Parte Speciale*, Padova, 2009, p. 175

[9] Art. 9 ICTA, comma 3: “ Per valore normale(…)si intende il prezzo o il 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 i servizi sono stati acquisiti o prestati, e, in mancanza, nel tempo e nel luogo più prossimi”

- Services provided by the employer for education, recreation, religious purposes for employees and their families. The provision is applicable when the services are available for the majority of the employees or categories of employees, otherwise they are individual fringe benefits, therefore taxable income.
- The value of the shares offered to all employees, minor than 2065, 83 Euro only if they are not transferred within a period of three years.
- For shares assigned to the employees before June 2008, the difference between the value and the price, provided that the amount paid is equal to the fair market value, and subject to the condition that the option cannot be exercised before 3 years from the grant, and that the employee maintains for at least 5 years shares representing at least the difference between the fair market value of them, at the time of the exercise, and the price paid by the employee. The last condition is that at the time of the enterprise the shares are listed on a regulated market; the exemption does not apply if the held shares represent more than 10% of the voting rights; the exemption also applies to shares issued by resident or non-resident companies controlling, or controlled by the same company.
- Tips for croupiers, up to the threshold of the 25 %
- Sums related to the deductions provided to the employees according to Art.10 ICTA, which are documented by the employer
- Reimbursement for expenses, health care, deductible according to Art. 13-bis ICTA

Regarding use of the car, housing, railway transportation, the exemption is calculated at a flat rate, taking into account the personal use of them by the employee.

In case of transfer of the place of work the employee incurs in expenses for travelling to the new place of work, that normally it does not sustain. The reimbursement of these expenses, especially if documented in an analytical form, is excluded from income.

This partial exclusion is justified because these costs are extraordinary and somehow induced by the employer.

The compensation (and increases in salary) received by employees working abroad, in changing locations, are included in the income for 50%[10] of their amount. In this case the employment agreement put this continuous shift as a clause, the payment is consistent with the quality of work beaten, it takes in consideration the greater effort required to these workers than to those who perform their work under normal conditions. So the payment is higher and it is part of the taxable income.

The payments received for the transfer and others of the same nature, and the accommodation of the employees are taxed at the 50% with the limit of 1.549 Euro per year, and 4.648 Euro if abroad and only for the first year[11].

The compensations received for the transfer of the place of work outside the municipal zone are part of the income for the part that exceeds 46,48 Euro for each day or 77 Euro if the place is abroad, except for transportation and trip expenses, that are completely deductible[12].

Employment income is allocated on a cash basis, so compensation is taxed when effectively received, through withholding taxes on account levied by the employer.

The taxation period coincides with the calendar year but all the sum received until the 12th of January of the following year are included, this is due to the "enlarged cash base" principle (Art 51 ICTA), as better explained in the Introduction.

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[10] Art 51, comma 6 ICTA: "Le indennità e le maggiorazioni di retribuzione spettanti ai lavoratori tenuti per contratto all'espletamento delle attività lavorative in luoghi sempre diversi(…), concorrono a formare il reddito nella misura del 50 per cento del loro ammontare."

[11] Art 51, comma 7 ICTA

[12] Art 51, comma 5 ICTA

1.2 Deductibility of expenses

Any sum of money which is a reintegration of a previous loss cannot be taxed because it does not represent an income. Otherwise this would constitute a violation of the general principle of "the ability to pay" and "reasonableness", because the effect would be the taxation of remunerations that do not qualify as income.

The reimbursement of expenses related to the production of the income is generally taxed. The deduction of expenses from employment income was achieved with a flat-rate method instead of the analytical method, there was a general provision about "deduction of expenses for the production of the income" and it was recognized to the generality of the employees, regardless of the effective sustainment of these expenses or of their effective amount. At the beginning this deduction was possible at a certain, fixed amount. After 1998 it depended on the amount of the income effectively received, with a corresponding graduation. The basic function of these deductions became the alleviation of the progression of the Income Tax on this category.

From 2005 this deduction was totally suppressed, this was considered unfair in comparison with the possibility to deduct the expenses from business and professional income.

From 2007 these deductions from the gross amount of the income were restored; they are used basically to make the taxation of this category less heavy.

Anyway, reimbursements received by the employer for the expenses are generally included in the taxable income, and the expenses effectively sustained are not completely deductible; this is consistent with the principle of taxation on "the gross amount", as above in the Introduction.

The rationale for this choice is, first of all, the simplification of the system.

There are antifraud purposes: to prevent the deduction of expenses not related to the production of the income.

There is a large discussion in the legal literature[13] about the consideration of damages recognized to the employees, the general rule is to focus on the nature of the damages, they usually are a compensation for a loss suffered, they do not represent an increase of the income, so they must not be taxed as income. According to the administrative practice, in the explanatory report of ICTA, only the reimbursement for the loss of future profits is taxed as income, because it is the replacement of income that would have been taxed, if it existed. Article 1223 of the Civil Code states that "compensation for the damages also includes the consideration of the loss of future probable earnings". The Supreme Court in its judgment no. 11629 of 15 October 1999 supports the necessary consideration of the loss of earnings, as well as the damage, for the purpose of compensation. As explained in the Introduction, the nature of those sums as a replacement of ordinary income marks the difference between taxable amounts and amounts that are not taxable.

In case of extraordinary expenses, sustained in the interest of the employer we have a reimbursement of sums advanced by the employee for the employer, so they cannot be taxed[14]. The Italian Supreme Court has expressed different positions about the classification of this sums: in the judgment n. 5081 of 26 May 1999, the Court solves the problem of the inconsistency between the principle of inclusiveness and the general principle according to which every income must constitute an increase of wealth, it affirmed that a reintegration of a loss suffered does not constitute income for this reason. The Supreme Court has later changed its position, affirming the inclusion of the reimbursement of expenses in the employment income[15].

Expenses for meals and lodging can be considered in three ways:

- Analytical reimbursement of expenses incurred: this is the analytical refunds of the coast of meals, lodging, travel expenses, and other expenses (laundry, telephone, parking, tips, etc..) documented by the employee;

[13] See CROVATO F.. *Il lavoro dipendente nel sistema delle imposte sui redditi,* Padova, 2001,p. 125; and FALSITTA G., *Corso istituzionale di diritto tributario,* Padova, 2009;
[14] G. FALSITTA, *Manuale di diritto tributario. Parte speciale*, cit., pag 186
[15] Cass. N. 2212/2000, n. 2604/2000, n. 3330/2000, n. 15182/2000

- Lump-sum reimbursement: in this case the expenses are not analytically documented by the employee, the refund is up to the threshold of 46,48 Euro for each day or 77 Euro if the place is abroad, the travel expenses are excluded
- Mixed method: the free amount is reduced by one third in the case of reimbursement of accommodation, or reimbursement of meals, as well as in the case of the refund of free accommodation or free meals, and it is reduced to two-thirds in the case of reimbursement of the expenses both for accommodation and meals.

The expenses for trip and transportation of the employee and his family are completely free from taxation, and all the expenses relating to the termination of the lease agreement for the employee's accommodation.

Anyway, a good solution would be to distinguish between expenses relating to the production of income, in connection with the employment relationship, and those not related.

The deductibility of expenses in the professional income category is different[16].

Every expense that is related to the production of the income is deductible with some exceptions. For example costs for the purchase of property are not deductible. The deferred salaries are deductible each year. The costs of the car used by the professional are 20 per cent deductible, those for telephony are deductible within the limits of 80 per cent, those for hotels and restaurants within the limits of 75 per cent, costs for courses for the 50 per cent[17].

The system works differently also in the business income category. The costs for employees are fully deductible[18] unless the work is performed by the entrepreneur or his family[19]. The expenses for the lease of property for mixed use takes place within the limits of 50 per cent. The costs related to the business are fully

[16] For the deduction in the other categories see also F.TESAURO, *Istituzioni di diritto tributario*, Milano, 2012

[17] Art 54 ICTA

[18] Art 95, comma 1, ICTA

[19] Art 60 ICTA

deductible. The cost of goods and services in case of mixed use are partly deductible.

We talked about the reason of those different provisions from one category to the other: simplification first of all, and anti-avoidance purposes.

1.3 Taxation at source

The taxation of employment income takes place according to the scheme of the withholding tax. The employer is the withholding agent, the worker is the one replaced[20].

The employer makes the payment but he holds part of the compensation of the employee. The withholding made by the employer will be withdrawn from the amount of tax due by the employee, as a result of the tax return. Deductions at source shall be made from any employer, whether it is a partnership or corporation, institution, association, grouping, individual, government administration. The withholding tax applies to the portion of income and assimilated income included in the category of employment income (as we said above in Paragraph 1.1) , paid in each pay period, at the rates established in the Consolidated Income Tax Act, less any deduction from income provided for in Article 10-bis ICTA and any deduction from the gross tax provided for in Article 12 and 13 ICTA[21].

Amounts subjected to separate taxation are excluded.

The time of withholding practically coincides with that of “charge” from employer on employee. Even if the rule is designed to prevent agreements between the employer and the taxpayer. It wants to ensure fiscal neutrality of those who produce income.

Any adjustments of the sums due must be made by February of the following year or at the end of the employment relationship, the adjustments will be calculated

[20] Art. 23 DPR 600/1973

[21] Art. 23 DPR 600/1973, II comma

between the withheld amounts and the total amount of taxes due resulting from the tax return.

If the salary is not sufficient, the employee must make a deposit or the amount will be subtracted from next wages[22].

The withholding agent must, in accordance with Article 4 of Presidential Decree 322/1998, files a tax return, summarizing the facts that have affected him during the previous year. He must transmit data relating to withholding tax and the adjustments made.

The withholding agent shall provide a specific certification. The certificates are delivered to the interested parties by the end of February of the following year.

In case of failure to submit the declaration or if the return submitted does not include all the individual income owned, a penalty from the 120% to the 240% of the sum due shall be applied.

If the declaration is submitted with a delay not exceeding one month, the penalties applied are reduced.

A penalty is due also in case of failure to submit the copy of the declaration for the Municipality of residence for tax purposes, or when the copy is not the original[23].

If the withholding agent does not make the deduction, the penalty is equal to the 20% of the sum due; if he fails to pay, or if he makes a late or insufficient payment, the penalty is the 30% of the sum due.

The Tax Administration with the Resolution No. 165 / E of 11 July 2007, stated that the penalties on the withholding agent shall be applicable even if the failures are due to unintentional or technical error.

The omitted or insufficient payment of taxes due based on the tax return, as well as the failure or the insufficient payment of withholding taxes made by the withholding agent may be regularized by performing spontaneously payment of:

- The tax due

[22] A. CASOTTI, *Reddito da lavoro dipendente,* Milano, 2003, p146-151

[23] A. CASOTTI, *Reddito di lavoro dipendente,* cit., p 197 e ss.

- The interests calculated at the legal rate from the date on which the payment should have been made
- The reduced fine.

PART 2
SPECIAL COMPONENTS OF EMPLOYMENT INCOME

2.1 Fringe benefits

Compensations that consist in goods or services from the employer to the employee and his family (cars, accommodation, gifts, bonus of any kind, self-phones, life insurances, cultural and fitness club memberships, scolarships), so called *fringe benefits,* are taxed as part of the employment income over the limit of 258,23 Euro[24].

Some of them were created for anti-avoidance purposes, but it is generally a series of allowances granted to supplement the wages or in order to encourage the production.

Until 1997 they were evaluated at their cost, the one effectively sustained by the employer. After 1997 we had the use of the fair value, or market value[25], as we said above.

This kind of compensation is widely used in Italy to remunerate directors, officers, presidents of companies and corporations, so the top of the corporate governance.

It is common to verify the presence of payments made to encourage the managers to take up their job, that are benefits influencing in a large way the global amount of their remuneration.

[24] F. TESAURO, *Istituzioni di diritto tributario*, cit., p 60
[25] G. FALSITTA, *Manuale di diritto tributario. Parte speciale*, cit., p 176

We are talking about pension plans, life or injuries insurance, training plans, stock-options, shares; those benefits are often provided both to the employee and his family.
As we said at the beginning of this work, all these sums and values are assimilated to employment income. This kind of income is taxed at the source from the employer. If the amount of the monetary salary is not capable to absorb the withholding tax, the employees must give to the employer how much is necessary to fill the gap.
Those fringe benefits also may include some goods made available to the employee by the employer for the conduct of its business, such goods are not part of the salary, so they do not contribute to the calculation of income.
The employment relationship requires the employer to provide the employee with all the tools that are necessary for the work performance, all those which have the goal of the worker safety. These assets are used to meet the needs of the company, or they are provided for in order to respond to legal requirements for the protection of the worker safety.
The taxation of fringe benefits is based on the principle of the “attraction” to the sphere of employment income, so these goods and services fall in the amounts received by the employee, paid by the employer or a third person, "in relation" to the employment relationship.
The taxation of fringe benefits is excluded when they are tools made available to the employees for the performance of their job, then in those cases they are part of the enterprise organization.
The free entry of employee for his training and specialization, goods which have the aim to ensure a comfortable, secure working environment are means to improve the performance of the employee in the company, so they are not part of the taxable income of the employee.
The solidarity for the employee is a reason common to all the exclusions from taxation provided for by law. Employees are subjects who need protection, assistance, greater involvement in the activities and in the equity of the company.

Seniority bonuses, Christmas packages, scholarships and centers for children, canteens, collective transport, are fringe benefits that give reliance to the loyalty of the worker.
The canteen service is available for the employee who has to sustain higher costs to eat outside the home. The service is used to meet basic needs of all employees.
The public transport service enables the employee to go to work in a comfortable manner, avoiding excessive stress, which can affect the efficiency of the work performance.
Allowances paid in special occasions and celebrations in favor of the generality of employees or classes of employees, subsidies related to personal needs, amounts paid for specific purposes or for scholarships, child care and colonies are excluded from taxable income, so they constitute an exception to Article 49 ICTA.
All these fringe benefits listed above are inherent to the employment relationship, but they dependent only on the will of the employer, which produce enrichment of the employee, without any legal obligation to do so.
Such provision cannot, however, be so recurrent to become regular, in fact, in this way the character of liberality fails.
These elements should be present to ensure the exclusion from the taxable base:
- The benefit must fall within one of the set purposes: recreation, worship, education, health etc.
- The provision must be voluntary
- It should cover the majority of employees or classes of employees.

Art. 51 ICTA, Para 4 gives a specific regulation for the use of the car provided by the employer. The taxation is based on the utilization of the car, and it is limited to the 30 percent of the cost of travelling established by the ACI (Italian Cars Club).
The rule assumes that the 30 percent consists in “personal use” by the employee. It is a lump-sum valuation, it is not based on an analytical basis.
The employee could pay a sum of money for the promiscuous use of the car, in this case this sum must be subtracted from the value of the benefit.

If the car is used exclusively for the use of the employee and his family, his market value will be taxed. The cost for the car used by the employee is totally deductible by the employer[26].

In case of benefits consisting in loans, the taxable income is the 50 percent of the difference between interest at the official rate and the interest calculated at the rate applied on them. Loans granted to employees prior to 1997, in case of redundancy payments or payments to victims of fraud, are excluded. The rate is that nearest to the moment of the benefit receipt, so when the payment is effective. This rules applies to any kind of financing[27].

In many cases the managers have the availability of an house, especially during transfers or periods of work abroad. For this benefits, the difference between the registered value (catasto) plus any expenses related to the building, paid by the employer and the amount paid for use of the property, shall be considered. In case of requirement of housing is considerable the 30 percent of this difference. If we do not have an official value established in price list, shall be considered the difference between the market price for the use of the property and the price effectively paid by the employee.

If the building is shared between more employees, the previous difference must be shifted in relation to the share of the building used by every employee[28].

Every cost sustained by the employer for the employment is deductible from the global business income, even if it consists in a gratuitous payment.

All the expenses related to the lease and the upkeep of accommodation, except for the canteens and the buildings leased for the transfer of the employee, are not deductible for the employer. Expenses related to the houses available for the employee are deductible within the limit of the corresponding income for the employee (so the difference between the official annual value and the payments

[26] P. DUI, *Tassazione e contribuzione nel lavoro dipendente,* Milano, 2005, p. 171-174

[27] P. DUI, *Tassazione e contribuzione nel lavoro dipendente*, cit., p 175

[28] P.DUI, , *Tassazione e contribuzione nel lavoro dipendente,* cit., p. 178-181

sustained). In the case of the necessary transfer of the employee, these expenses are totally deductible for the year of the transfer and the successive three years.

Every expenses for meals and accommodation during the employee's transfer are deductible within the limit of 180 euro, and 258 euro if the transfer is abroad.

Officers and directors remunerations are deductible in the same year of the receipt. The profits shared by the employees are totally deductible[29].

2.2 Tips

The employment income includes any amounts received by way of donation. This has an anti-avoidance purpose. The rule is consistent with that which establishes the deductibility of all the expenses related to the employees by the employer, including donations. However tips are paid directly by the client and not by the employer.

There is no any direct reference about the taxation of the tips in our regulations.

An exception is represented by the tips of the croupiers. These are directly included by the text of the law between the taxable employment income cases.

According to Article 51 let. i) of the Tax Code, that is the rule about the determination of income from employment, tips of croupiers are taxed within the limit of 75 percent. The inclusion in Article 51 makes the tips part of the employment income in the strict sense.

The principle of "inclusiveness" would lead to include any kind of tip in taxable income. However a threshold is specifically provided for the tips of the croupiers. The consideration of the taxability of tips however, represents serious problems of compatibility with the constitutional provisions, in particular Article 3 about Substantial Equality, and in relation to Article 53, following which all tips should be taxed the same way. In fact, the provision of a different treatment between the tips of the croupiers and the tips received by any other employee can be justified only on the grounds of actual diversity of conditions. Article 3 of the Constitution

[29] Art. 95 Tuir

requires to treat in an equal way, equal situations and in a different way, different situations. This difference does not exist between the general of the employees and the employees of casinos.

According to the principle of "ability to pay" (Art 53 Const.), all tips shall be taxed in the same way, the diversity of the activity does not change the attitude of contribution manifested by the taxpayer.

Moreover, there is no employment relationship between the client and the employee. The treatment of tips of croupiers is specifically included in a contract of employment, in this way it becomes related to the employment relationship.

If the tip is not directly provided in the employment contract, it cannot be taxed as earned income, and it cannot be included in the employment income category. Donations paid by the employer are included, such donations are taxed and they match costs deductible for the employer.

In this sense, the prediction of the taxability of donations can hardly be extended to include tips[30].

2.3 Reward and productivity bonuses

The rewards are integrative elements of the base salary and consist essentially in real additional compensation which, in general, has the nature of remuneration. They were born around the sixties as compensation, with different forms, related to business productivity. This happened with the specific purpose to let the employees participate in the benefits of the company, and with the aim of encouraging them to work harder for the productivity of the company.

In fact, in a short time, these incentives were transformed in real fixed compensation: they therefore effectively become an addition to the base salary with plural intervals (usually annually). The amount of them and the criteria for

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30 A. VIOTTO, *Considerazioni in merito al trattamento tributario delle "mance" percepite dai lavoratori dipendenti*, in *Riv. Dir. Trib.*, 2012, 11, 1139

calculating them vary from company to company. As a rule, they are agreed in each individual business reality thanks to the intervention of the bargaining.

The tax law considers these payments as part of the ordinary remuneration if they are paid continuously to the generality of employees.

This recognition has its basis in the fact that these rewards, thanks to the consolidation of practice, become part of the salary .

Article 53, paragraph 1, of Law Decree n. 78, 2010, converted, with amendments, by Law n. 122 of 30th July 2010, provides that: "In the period from the 1st January 2011 to the 31st December 2011, the sums paid to employees in the private sector and related to increases in productivity, quality, profitability, innovation, organizational efficiency, linked to the reported results of the economic trends or the profits of the enterprise or any other relevant factor for the purpose of improving business competitiveness ", are taxed at a rate of 10%, for those employees who have received an income minor than 40000 Euro (30000 after 2012), until the threshold of 6000 Euro, (2500 after 2012).

The business practices knows two basic types of remuneration rewards: 1) rewards tied to specific and objective parameters; and 2) purely discretionary bonuses, that are not tied to any predetermined parameter and that are not objectively identified. While the former suffers the fluctuations of the parameters which it is connected to, the awards belonging to the second category are paid regardless of the existence of any specific parameters and they are not objectively determined.

Those compensation have the nature of payments, when they constitute mandatory payments for contractual services and their payment is characterized by a certain continuity, consistency or frequency within a given period of time .

The recurrence time of these awards, the payment of the same to a large group of employees and the ability to determine the amount, cause them to become an integral part of the remuneration due.

The evolution of the phenomenon has recently led to the development of new bonuses explicitly linked to the achievement of objectives, these bonuses aims to reward the professionalism of employees.

Productivity bonuses are forms of incentive, linked to indicators parameterized to increases in individual production and / or business due to the activity of the worker: consequently, they depend on the workers themselves, being generally related to criteria such as, for example, quality and quantity of product or saving of costs for the production. The consistency, continuity, and compulsory determinability of compensation make possible to classify these bonuses as part of the remuneration.
After much back and forth, the last Financial Stability Act of 2013 has introduced the tax relief for productivity bonuses, which extended such benefits, but only through an agreement between the social partners.

2.4 Stock options

Originally, the attribution of shares and stock options to employees had mainly social purposes and was part of a project of co-management of enterprises. The basic idea was that the employees should benefit from the profits that they help to produce, so they should participate in the decision-making process and in the organization of the company.
Today these ethical considerations of social and business organization have weakened. Popular shareholding, for the majority of the employees, has the purpose of promoting their social situation and involving them in the property of the enterprise.
The tax law reform of 1997 was the first set to regulate explicitly the stock options. The value of the shares issued according to articles 2349 and 2441 of the Civil Code, were exempted from taxation. This exclusion was used to reduce the tax burden, turning some or even all the money of the salary, in bonuses and shares.
Stock options were considered a tool for the positive relation between enterprises and employees, and for the general development of the economy.
The promotion of the capitalization of the companies was an important goal too, alongside the promotion of the social status of the of employees and the goal of

the loyalty of the managers; in this last case the stock options have the aim to encourage them to produce up to increase the value of the shares in which they have an option.

These objectives, however, were not realized in practice.

In the regulation of 1999 were not limits to the transfer of shares by employees, the shares were in practice cash paper. There were no limits to the discount on the shares with respect to the market value, so it was not a benefit linked to the future increase in value, but only a benefit about the immediate exemption on shares received.

The current regulation wants to rationalize the taxation of stock option plans, and it has anti-avoidance purposes.

The new regime takes into account the purpose of a stock option plan: the need to encourage share ownership, capitalization, and the requirements of employers to find an effective system of stimulating the efficiency of employees.

The limit related to a minimum period of possession, the limit on the transferability and ceiling of value were needed. The period of possession serves to exclude that the operation of stock options is made to free from taxation a part that is ordinary salary, and to strengthen the bond between the employee and the company.

Article 51 Para 2 letter g) ICTA falls into a willingness to involve employees in the affairs of the company.

In the case of stock options granted to managers, the benefit is provided in recognition of the merits of the manager.

The attribution of stock options and shares to the employees can integrate the compensation. It represents, on the other hand, a way to participate to the risks of the enterprise, to finance the company with venture capital.

This happens through a public offer made in priority to employees, or through bids to subscribe in the event of a capital increase.

If the stock option is provided to special executives, it can have a different purpose. In this case, it is aimed at encouraging the manager to remain loyal to the company, but above all they want stimulate the manager to good performances which increase the value of the offered shares. It is introduced a generic link between the remuneration and the quality of the work performed for the company[31].

We have options to be exercised in the medium term and they include clauses related to the achievement of management objectives.

The stock option plans for employees regarding options to be exercised in medium or long term, are means of long-term incentive.

The incentive is the fact that the employee may purchase options at the price established at the time of the offer. The employee will be encouraged to contribute to the growth of the their value[32].

Article 2349 Civil Code provides that the company may decide to distribute profits to employees through the issuance of special classes of shares with simultaneous increase of capital. The Assembly may decide the allocation of financial instruments, with property or administrative rights, without the voting right in the general Assembly.

We talk about an effective participation of the employee in the company management, there is a complete assimilation with the position of the shareholder. Our tax law is very much in favor of these alternative forms of remuneration. The provision refers to shares, of old and new issue, issued by the company or other companies of the group.

We shall also consider Article 46 of the Constitution that establishes the right of workers to collaborate in the management of enterprises. This payment system has become more common over the past 20 years, with the inclusion of clauses in collective agreements designed to transform the wage in others forms of remuneration, linked to the efficiency of the employee.

Today, the management has plans related to their goals, while other categories have incentives linked to the performance of the company in general.

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[31] Relating to the stock options plan ESOP (Employee Stock Ownership Plans) and ISO (Incentive Stock Option Plan), refer to P. STIZZA, *I redditi da lavoro dipendente nella giurisprudenza della Corte di Cassazione*, in *Dir. Prat. Trib.*, 2006, p. 1443-1447

[32] F. CROVATO, cap. X, *I piani di stock option nell'impresa multinazionale*, in *La mobilità transnazionale del lavoratore dipendente: profili tributari*, Padova, 2006, p.264-265

The first rule that regards the stock options plan, Art. 51, Para 2 ICTA, has the aim to involve the employee and promote his social position, it wants to create a strong link between the employee and the company.
If the purpose is the social promotion, the plan must be provided to all employees. The provision does not refer to all the employees but to the majority of them, it must be a large number of them to avoid privileges and discriminations. Every exclusion will be justified and must be reasonable. For example the plan cannot consider occasional employees who do not work continuously for the company.
The option shall be offered to all employees, it does not mean that everyone must exercise the option[33].
The tax is levied beyond the limit of 2065,83 Euro. This means that the part that exceeds the limit will be taxed as employment income. The limit works every time there is a gratuitous assignment of shares or a sale at a lower price. The rule wants to exempt a stock of value. The value must be established according to Art. 9 ICTA, that refers to the market value (see later).
This facilitation does not work when the shares are sold before three years or they are sold to the employer or the company. In this case, the total amount will be considered employment income as any other fringe benefits. The taxation, in this case, will be on the market value of the benefit less the cost sustained by the employee. The value considered is that of the shares at their grant. The employee is related to the company for quite a long time. If the share was transferred to the employer or the company, it would distort the intent of the incentives. In unlisted companies, however, it is reasonable to consider the possibility of agreements leading to the acquisition of shares that otherwise would not have a market. The loyalty intent is achieved in the mandatory three-year possession.
The employee could decide to sell the option, he could have multiple options, so we need to establish which of those he intend to sell. The method used to verify

[33] Regarding the requirement of "generality", F. CROVATO, cap. X, *I piani di stock option nell'impresa multinazionale,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* cit., p.269-271

the three years limit is the FIFO, the share considered the first out, the first sold is the first in, so the first brought or received by the employee[34].

In the second case considered by the provision, the availability of stock options to the executive managers have different purposes. It is not in fact a stock of value, but it offers a perspective opportunity, linked to the performance of the market.

This option regards shares that have a certain price, but there is uncertainty about what will be their value at the time of the exercise. The employee is subject to a risk, but it could get a high gain. The rule takes into account the business risk in the discipline of employees. This aspect is more interesting for those who work primarily in the management of the company. The link between the work of the manager and the best performance of the company will be of varying degrees and intensities, but surely present.

The capital gain, after the sale, will still be taxed at 20 percent. The logic is that the manager produces wealth and he deserves a treatment similar to that of the shareholders. Otherwise income of a manager should totally be taxed at 46 percent. The stock options is a facilitation.

After the exercise of the option, the share can be sold at any time.

In this way the stock option becomes a multiple of the remuneration of the manager.

Anyway we find a limit in the second part of the provision. If the share represents more than the 10 % of the voting rights, the employee does not have the threshold of 2065 Euro. This provision wants to avoid a chance in the control of the company through a stock option plan.

There is not a specific provision about the possible buyer, so the company could buy the share by the employee, with the limit established in the civil code.

According to the preexisting Art. 51, Para 2, lett. g-bis), the difference between the market value at the time of the allocation of the share and the value paid by the employee (at least equal to the market value at the time of the offer, so there

[34] F. CROVATO, cap. X, *I piani di stock option nell'impresa multinazionale,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* cit., p.277-279

mustn't be any gain at this time), is not employment income. The exemption works only if the purchase price of the option is at least the same of the market value at the time of the offer. The presence of a purchase price makes possible the application of this provision (g-bis). If the cost sustained by the employee is lower than the market price at that time, the difference shall be totally considered employment income. This benefit will be taxed at its market value, less the cost paid by the employee.

Para 2, let g-bis) of Art 51 ICTA was repealed by Art 82, Para 23 of the Law Decree n. 112 of 2008. The exemption does not work anymore, the difference is fully taxed.

Art 51, Para 2bis ICTA affirms that those share must be issued by the company that the employee works for or companies in the same group of that one.

The moment of the offer is called *granting*. This happens when the right to buy the share at a certain price becomes effective, we have an offer. The date of the granting is usually clear in the approval decision of the plan.

In the case of extraordinary transactions, the employees who have exercised the option may be damaged. For this reason some protection rules are negotiated and included in the plan. For example, you could include the assignment in advance of the shares. The exemption continues to operate, this kind of transactions are characterized by the "fiscal neutrality principle". The option remains the same after the merger or spin-off of the company.

The value of the share is the "normal value" mentioned in Article 9 of ICTA, for shares listed on a regulated market, it consists in the average price of the previous month. For the others, the value is a portion of the assets of the company, if it is a newly formed entity, will be considered proportionally to the transfers.

The favorable regime of employee finds completion in the discipline of capital gains. After the period of three years the shares are transferable. If the selling price is higher than the cost incurred, the difference will be taxed as capital gain.

The employee can buy the option at a lower price or receive it for free from the company, so he has a better position than a third common investor[35].

This incentive method has suffered a blow to the dramatic events that have characterized the stock markets around the world, mainly due to the "mess" accounting of Enron, WorldCom and Tyco, and the events of 11 September. The executives of large companies, in fact, had a lot of purchase options underwater, so the stock options had the grant price higher than the market price of the security.

This situation drove many companies to find other incentive methods, and also the legislature has started to have a more cautious approach when considering the taxation of these instruments.

There are specific rules to discourage the use of stock option as a wide form of compensation, those rules are useful to distinguish the employment income from another kind of income less heavily taxed. One of them is pretty recent, Art 33 of the DL 78/2010 about stock options. Depending on the decisions taken at the G20 and in consideration of the economic effects potentially distorting, derived from all forms of remuneration made in the form of bonuses and stock options, the compensation for this purpose, which exceeds the triple of the fixed part of the remuneration awarded to employees, who is a manager in the financial sector, as well as holders of coordinated and continuous collaborations in the same sector, is subject to an additional rate of the personal income tax of 10 percent. The provision applies also to a specific category of employees mentioned in Art 2095 of the Civil Code, who have a high degree of professionalism, autonomy and decision-making power.

According to the Cir.4/E 2001 by the "Tax Agency", the purpose of the legislation is to impose the additional levy to a particular field of activity deemed responsible for the recent economic financial crisis; this leads to the conclusion that the

[35] F. CROVATO, cap. X, *I piani di stock option nell'impresa multinazionale,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* cit., p. 288 e ss.

“financial sector” must include banks and other financial institutions, as well as holding companies.
Article 56, paragraph 1 of Law Decree n. 78, provides that the Decree enters into force on the day of its publication in the Official Journal which took place on
May 31, 2010. Therefore, the increased taxation will be applied on the variable compensation paid from that date, even “if accrued in previous years”. In particular the provision of Art 33, effective from July 17, 2011 affirms that the additional 10% rate applies to variable components of remuneration payable with effect from 17 July 2011 (date of entry into force of the Law no. 111/2011), also “if accrued before".
According to the provisions of Law n. 106 of 2011, the withholding tax of 10% on stock options will be applied on a basis greater than the previous: the withholding tax will apply on a taxable base equal to the excess of the fixed base salary (no more than three times, then).

2.5 Remuneration for unused annual leave [36]

Article 2109 Civil Code provides that a worker is entitled to a period of paid annual leave, preferably continuously. This period cannot be less than four weeks. It must be enjoyed for at least two consecutive weeks in the year of maturity, and for the remaining two weeks in the next 18 months. Those holidays should be spent, there must not exist any allowances for unused leave, unless the case of the resolution of the employment relationship.
Beyond the limit of four weeks, if additional vacation time is specified in the contract, you can pay a compensation for unused leave.
If the company pays the employee such sums for this purpose, you must generally believe that these are employment income. This income includes any amount received in compensation and dependency of employment, without taking in consideration the actual performance.
The compensation finds its cause in the employment relationship[37].

[36] P. DUI, *Tassazione e contribuzione nel lavoro dipendente*, cit., p 297 e ss.

It is not a reintegration of capital with a compensatory nature, there is not any damage due to the employer's behavior, it is a voluntary renunciation. It requires a willingness of worker not to take holiday.

Only if the compensation is intended to compensate the employee for the physical wear and tear caused by the loss of the holiday period, that money should not be taxed.

In case of the end of the employment, if the payment is made in the same year of maturity, it will be taxed in the ordinary way. But if the allowance is paid in the next year will fall in separate taxation for arrears.

2.6 Separate taxation and deferred compensation

According to Article 17 of ICTA, the following income are subjected to separate taxation:

- Severance payments; this is, according to the Art. 2120 c.c., equal to the amount of remuneration payable in the last year, divided by 13.5, multiplied by the numbers of the years of work carried out. This amount is increased each year of 1,5 percent and of 75 percent of the increase in the index of consumers prices. It, therefore, takes into account the so-called fiscal drag (Art 17 a)
- other benefits commensurate with the duration of the employment relationship, other allowances received one-off (*una tantum)* at the end of the employment , the amounts received less the legal fees, as damages determined by the Court at the end of the employment relationship and in case of firing (Art 17 a);
- arrears for work performances related to prior years (Art 17 b)
- damages for loss of income accrued over several years (Art 17 i);

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[37] P. STIZZA, *I redditi da lavoro dipendente nella giurisprudenza della Corte di Cassazione*, cit., p. 1458, relating to some recent judgements of the Italian Supreme Court about the nature of this indemnity, that is condidered, by the Court, part of the taxable income, because it depends on the employment relationship.

- any amounts of the same type received for the termination of a coordinated and continuous collaboration (Art 17 c);
- the sums of retirement incentives, with a tax rate reduced to the 50 percent for male workers more than 55 y.o. and female workers more than 50 y.o. (Art 19, Para 4-bis);
- income included in the amounts paid to the heirs in case of death of the employee (Art 17, Para l).

Article 2120 of the Civil Code gives the definition of severance payment: "In the event of termination of the employment relationship, the employee is entitled to severance payment."

In general terms, the severance payments can be defined as that part of the remuneration accrued by the employee during the years of his work, which shall be paid in the occasion of the termination of his activity.

The indemnity is recognized as a deferred compensation because the employees may require payment of this sum of money belonging to them only when they stop working, prior to that time the sum gained over the years is available to the employer, except in cases of the anticipate payment of the sum, required by the employee.

The main purpose of the severance payment is to ensure the worker, through the availability of liquid money, the ability to afford the economic difficulties caused by the termination of employment. According to the doctrine and the jurisprudence, the indemnity has a social security function (see Constitutional Court n. 243, 19 May 1993). Severance payment plays a central role for the development of supplementary pensions because it is the main tool for the financing of pension funds.

This happens when the worker has decided to allocate the severance indemnities to supplementary pension schemes.

The employee chooses a pension fund in which transfer his settlement, hoping to obtain higher returns than if it had been left in the company.

The Legislative Decree n. 124 of 21st May 1993 has introduced the discipline of the private pension funds, in order to complement the obligatory public system, whose purpose is to ensure the highest levels of insurance coverage.

Law n. 243 of 2004 developed the supplementary pension system through the devolution of the severance payments to pension funds.

The reform, due to Law n. 296 of 2006, Art. 1, Para. 749, entered into force on 1 January 2007.

Within 6 months the employee had to make a choice: whether to allocate the severance payment to pension funds or leave them to the company.

The employer must provide the employee with adequate information on the various options, therefore, the employee may:

- decide to join the supplementary pension, indicating the pension fund chosen and declaring its intention to confer the severance payment;
- decide not to participate, expressly stating its refusal (explicit rejection) and opting for the maintenance of the accruing severance payment in the company .

The employer is obliged to transfer the severance indemnities to the employee's pension fund.

Even if the employee does not choose the supplementary pension schemes, in companies with at least 50 employees, the employer actually loses the availability of such sums: he is obliged to give them to a special fund (known as Treasury Fund), established by Law n. 296 of 2006, and managed by INPS, that is the National Institute for Social Security.

The Treasury Fund will pay the benefit in accordance with the provisions of Art. 2120 of the Civil Code.

There is a complex way to calculate the severance payments.

The tax is levied at the rate determined in the year of the receipt, corresponding to the amount that is obtained dividing its total by the number of years, and multiplying the result by twelve. The rate of taxation is the average of the rates of the previous five years.

The other allowances and deferred compensations, listed in the Article 17 may be taxed for their total amount, less the contributions required by law, with the rate determined as above.
The benefits accrued during the employment relationship may be taxed in their amount less than 309, 87 Euro for each year. The rate is determined in the same way.
For the amounts paid to encourage the resignation, the rate applied is equal to half of that applied in the cases mentioned above.
The taxation of such income is derived from the fact that they are received one-off and they have accrued over several years, so they cannot be included in the progressive system of taxation. The law then applies a special treatment, with the purpose of alleviating the tax burden.
The system of separate taxation applies to contributions made in connection with the termination of the employment relationship.
It applies to both benefits paid at once at the time of termination, both payments accrued for the whole duration of the relationship.
The revaluations of severance pay are taxed at 11 percent rate through a withholding tax. This tax must be deducted from the severance payment fund (to avoid double taxation). The tax must be paid by the employee in the perception of severance pay and declared in the tax return.
The allowances received in case of the termination of the employment are part of the system of separate taxation whether or not they are paid by the employer or a third person, regardless the fact that the amount depends on the duration of the relationship.
The system of separate taxation also applies to payments relating to previous years, when they have not been paid as a result of laws, contracts, judgments, administrative decisions or other similar means. The postponement of perception must be beyond the control of the parties (Article 17 b) ICTA).
One of these situations may in fact be a serious period of financial difficulties.

These principles are observed for each type of income included in the employment income, in the event of a non-physiological delay in payments[38].

PART 3
DOMESTIC AND INTERNATIONAL REGULATIONS RELATING TO THE TAXATION OF INCOME OF CROSS-BORDER EMPLOYEES

3.1 International versus Domestic regulations

Before the enactment of Constitutional Law n. 3 of 18th October 2001, the interaction between public international law and domestic legislation was solely dealt with by Art. 10 and Art. 11 of the Italian Constitution. Specifically, Art 10 provides for the automatic adaptation of the Italian legal system to customary international law and the general accepted principles of international law. This adaptation applies for both ordinary laws and constitutional laws, but it cannot override the fundamental principles of the Constitution[39]. Art 10 applies only for treaties regarding the legal treatment of foreigners.

Under Art 11 Const., Italy permits limitation on its sovereignty, when it is necessary for a word order among Nations. International agreements of those kind are directly applied in our country. Art 11 is related to the direct and overriding application of EU law in the Italian legal system.

The Constitutional Court has clarified that these articles do not imply that international treaties assume a special rank in the Italian legal system. This means

[38] Regarding the deferred compensation see P. DUI, *Tassazione e contribuzione nel lavoro dipendente,* cit., p 137-141

[39] P. ARGINELLI and C. INNAMORATO, *The interaction between Tax Treaties and Domestic Law: An Issue of Constitutional Legitimacy*, in *European Taxation*,2008, p. 299-303

that international treaties can be overridden by subsequent ordinary laws and previous more specific ones.
On the contrary, some authors have proposed the principle of “specialty” to solve the contrast between the conventional rule and the successive national rule. According to them, the conventional rule prevails over the internal rule, because it is a special provision compared to a general provision. The specialty criterion could be related to the recipients, (a narrower class of people is involved) or to the substantive scope (conventional provisions focus on a more specific matter).
The Constitutional Law n. 3 of 2001 modified art 117 Const., introducing the principle that Italian legislation must respect the constraints deriving from EU-legislation and international obligations. It guarantees the prevalence of international law over domestic law within the respect of the fundamental constitutional principles.
Art 5 of the Presidential Decree n. 600 of 1973 provides that the application of domestic income tax law is subject to the applicable tax treaties. Art 169 of the Presidential Decree n. 917 of 1986 states that the provisions of the Income Consolidated Tax Act (ICTA) override those included in the international treaties whenever more favorable to taxpayers. This is the codification of the non-aggravation principle, according to which a taxable event dealt with in the provisions of the treaties cannot be subject to less favorable taxation than a comparable event to which the treaty does not apply.
Indeed, the primacy of international law over domestic law in tax matters, arising from the principle of specialty, was confirmed by the legislature of the tax reform in two different rules. First, with Art. 75 of the Presidential Decree n. 600 of 1973, according to which "the application of the provisions concerning the taxation of income are subject to international agreements ratified by Italy", and second, by Art. 41 of the Presidential Decree n. 601 of 1973, in accordance with which: "exemptions provided for by international agreements ratified by Italy and the rules relating to international bodies and organizations shall apply".
These rules have always been considered a general statement of the principle of "specialty". The Italian legislature, therefore, with Art. 169 ICTA, states that "the

provisions of ICTA shall apply, if more favorable to the taxpayer, notwithstanding international agreements to avoid double taxation". Art. 75 of the Presidential Decree n. 600 of 1973 must be interpreted in the sense that conventional provisions must apply without prejudice to the application of internal rules more favorable to the taxpayer. The existence of the non- aggravation principle must be consistent with the existence of a specific obligation agreed by the State at an international level, Italy must comply with this obligation under the penalty of international responsibility. This implies that Article 169 does not affect the taxation power of the other Contracting State as well as conventionally determined, so Article 169 can only lead to a decrease in revenue for Italy and never for the other Contracting State.

The non-aggravation principle applies only to the rules of the conventions to avoid double taxation. This means, therefore, that a legislative recognition of the principle of the "more favorable" rule may be found only in relation to those Conventions.

The Constitutional Court often affirmed that under Art 117 Const. any conflict between conventions and domestic law doesn't imply a matter of succession of law but an issue of constitutional legitimacy.

The conventional rules do not have a constitutional value and they are not immune from the constitutional scrutiny. They have a sub constitutional value, so they must comply with the Constitution. An ordinary judge should interpret domestic law in conformity with the international provisions, as long as the wording permits this.

The prevalence of the conventional rules over the domestic regulation is affirmed with the limit of their inferiority in respect of the Constitution.

In judgments n. 348 and 349 of 2007, the Constitutional Court deals with the relationship between internal rules and the European Convention for Human Rights (ECHR), focusing on some significant points:

1) the Court denies the direct effect of the ECHR in the internal legal system and the possibility for the national judge to set aside national law, which is in contrast

with the provisions of the ECHR: each antinomy must be solved in the centralized control of constitutionality by the Constitutional Court;

2) the Court affirms that the domestic courts should, primarily, solve the contrast by interpretation, adopting an internal meaning of the rule oriented by and conform to the text and spirit of the ECHR;

3) the Court points out that the provision of Article 117 gives a constitutional coverage to international treaties;

4) finally, the Court establishes that, if the judge is unable to solve the contrast between internal rules and the ECHR by means of interpretation, a question of constitutionality arises and the ECHR provision shall be used as parameter, as interposed provision of Article 117, in a case of constitutional legitimacy. However, the judge must check before if the wording of the ECHR itself conforms the Constitution.

In judgment n. 80 of 2011, the Constitutional Court treats again the relationship between the ECHR and the domestic law, revised in the light of the entry into force of the Lisbon Treaty.

The Treaty, under Article 6, has incorporated the ECHR: in this way, the Convention might enjoy the automatic application in the internal system, like the EU law, making obsolete the system of the interposed provision in favor of a new mechanism, which allows a greater appreciation of the external conventional sources.

However, in judgment n. 80 of 2011, the Court affirms that the EU law system and the conventional system are not comparable and it shows, at the same time, the ways in which the assimilation of the ECHR in the EU law system will operate. In this regard, the Court points out that the ECHR has not coverage in Article 11 of the Constitution and that "the principles in question apply only in relation to the cases where EU law applies, and not to the situations covered by the sole national legislation." In other words, the ECHR could be applied directly (according to Art. 11 of the Constitution) only where the principles relate to matters which are not strictly national, but fall within the competences of the EU and only if the substantial coincidence between the ECHR and the Charter of Nice and Strasbourg or other rules of the European Union exists.

Scholars are divided on the evaluation of the judgment of the Constitutional Court under review, according to the positions already established in the judgments of 2007, as we said above.

A quite common opinion is that Art. 11 of the Constitution shall cover the EU law as well as other provisions provided for by other "legal and institutional reality".

Some authoritative scholars highlight the "formal-abstract perspective" of the argument of the Court, which paid attention to the relationship between the sources of law rather than the substance of the rules and their usefulness for the protection of the rights and the dignity of the human person. This led the Court to focus on the aspects of "separation" between the Italian legal system and conventional system rather than on "integration" profiles[40].

The tax treaty must be interpreted according to Art. 31 and Art. 33 of the Vienna Convention with the purpose of assessing its possible conflict with domestic law in the light of Art 117. In case of conflict between domestic regulations and the tax treaty, the domestic regulations should be interpreted in conformity to the tax treaty provisions as far as it is possible. If the domestic law cannot be interpreted in conformity with the tax treaty provision, a question of constitutional legitimacy arises. As a national judge is not empowered not to apply the domestic law, he must refer the issue to the Constitutional Court, which would then decide on the issue.

[40] A. RUGGIERI, *La Corte fa il punto sul rilievo interno della CEDU e della Carta di Nizza-Strasburgo*, in *Consultaonline* *http://www.giurcost.org/decisioni/2011/0080s-11.html*,

3.2 General arrangement of the topic

In the following paragraphs of this work, we are going to discuss about the taxation system of employment income when the employment relationship is characterized by international profiles. We will analyze two cases in particular:

1) The case of the Italian citizen working abroad
2) The case of a non-resident working in Italy

In case n 1), regarding the Italian citizen working abroad, we have to consider two further assumptions:

1) The case of the citizen who maintains his residence in Italy
2) The case of the citizen who changes his residence, and places it abroad. We will return on the concept of “residence” in Paragraph 3.3.

If (case n. 2) the Italian citizen changes his residence abroad, where he carries out his work, problems of double taxation do not arise.

If, on the contrary, (case n. 1) the Italian citizen maintains his residence in Italy, problems of double taxation may be present.

First of all, it is necessary to check if a double taxation Convention exists between Italy and the Source State.

The tax treaties concluded by Italy provide for a regime of employment income largely based on Art. 15 of OECD Model. According to Art. 15, employment income is taxed only in the State of Residence of the employee, unless the employment is exercised abroad. In this case, employment income may be taxed both in the Source State and in the Residence State. Even in case of employment exercised abroad, Art. 15 of the OECD Model attributes exclusive taxing power to the Residence State where: 1) the employee is present in the Source State for a period not exceeding the aggregate 183 days in a 12-month period; and 2) the remuneration is paid by an employer who is not a residence in the Source State; and 3) the remuneration is not borne by a PE of the employer’s company located in the Source State.

So in the case of an Italian resident working abroad, the employee is taxed only in Italy if all the three requirements set out in Art. 15(2) of the OECD Model are fulfilled.

On the other hand, if all the requirements of Art 15 are not met, the income of the employee is taxed both in the Source State and in Italy.

The Italian resident working abroad is taxed in Italy according to:

1) Art 51, Para 8-bis of ICTA: the foreign income is determined on the basis of a salary schedule adopted annually though a Decree of the Ministry of Labour and Social Security. This regime applies if: a) the employment is exercised abroad in a continuous way; and b) it constitutes the sole object of the employment agreement; and c) the employee spends more than 183 days in a 12-month period in the foreign country; or
2) Art 23 of the ICTA, if the conditions for the application of Art 51, Para 8-bis are not fulfilled. In this case the foreign income will be taxed according to the ordinary regime, to give effect to the *worldwide income* principle. A tax credit will be granted to the employee for taxes levied abroad by the Source State, according to Art 165 of the ICTA.

In the case of a non-resident working in Italy we must check the conditions of Art 15, Para 2 of the OECD Model. We could have two cases:

1) All the three conditions of Art 15, Para 2 of the Model are fulfilled: in this case, the non-resident will be taxed only in his Residence State; or
2) The three conditions of Art 15, Para 2 of the Model are not fulfilled (even if one of them is not met): in this case the employee will be taxed both in the Residence State and in Italy, in Italy he will be taxed according to the ordinary regime on the sole part of income produced in Italy.

The last case that we are going to treat is about the taxation of cross-border employees, who travel almost every day across the border to reach their place of work. The situations already considered for the case of the Italian citizen apply also to this case.

3.3 Definition of residence in tax law

As we said above, the residence is important to determine the income to be included in the tax base. The *worldwide income* criterion is used for residents of the State, all income gained is taxed no matter where its origins and place of production are located: all income produced is considered, because of the relationship that exists between subject and territory.

On the contrary, the tax is based on the principle of territoriality for non-residents: taxation is limited to the income received in our State by the non-resident, in relation to events that occurred in this area.

The conducting of a legal or even economic activities in the territory of the State or the location of assets that produce income on the territory is a preliminary condition for the application of the tax.

A person is considered resident in the territory of the Italy in these alternative hypotheses:

- The subject is enrolled in the Resident Population Register for the major part of the tax period
- The person has in the territory his “domicile”, known as the principal place of his business and affairs
- The subject has in the territory his “residence”, this is the place of the habitual abode, according to the Civil Code.

The identification of the residence is important to solve certain cases: for example those people who have transferred their residence abroad but continue to have the center of their primary interests in Italy, or the seat of their economic, material, moral, social, familiar relations, are considered resident in Italy[41] .

The diversity of the concept of “residence” in tax law systems of the countries may rise “conflicts of residence”, or could create problems of double taxation.

In order to settle such conflicts of residence and double taxation, the Italian Government has signed a number of bilateral conventions with the most important

[41] F. TESAURO, *Istituzioni di diritto tributario. Parte speciale.,* cit., p 19-20

countries in the world, called precisely Conventions to avoid double taxation (DTC).

The EU law does not contain a concept of "tax residence", it respects the definition given by the domestic law of the Members States. If "the clauses of the treaty are incompatible with the provisions of EU law, both States shall settle by mutual agreement the terms and conditions shall cease to apply" (Italy-France treaty)[42].

Most of the bilateral treaties signed from Italy follows the OECD Model. This also applies to Art. 4 of the Model, where we find the definition of resident as "*any person who, under the law of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature*".

The definition contained in a treaty does not overrule the definition of residence given by domestic laws of either contracting States. A person may be a resident under Italian tax law but be excluded for treaty purposes. The treaty usually complies with the minimum personal attachment required by Art 4 of the OECD Model. These are: center of vital interest, permanent home and length of stay. Under Art 3 of the OECD Model, however, "*any term not defined therein shall… have the meaning that it has at that time under the law of the State*". When the result of the application of the Model or the domestic rules is still a conflict of residence, the conflict is resolved using the provisions given by the treaty, they usually follow the one of the OECD Model at Art.4 (Para 2) . The Model provides also an example of mutual agreement procedure at Art 25.

3.4 Taxation of employment income of a resident performing services abroad

The taxation of employment income does not differ between residents and non-residents, both regarding the determination of the tax base and the levy of the

[42] G. MAISTO, *Residence of Individuals and the Italy-France Tax Treaty,* in *European Taxation,* 1999, 42-48

withholding tax method provided in Article 24 of the Presidential Decree n. 600 of 1973. There is a distinction between residents and non-residents from the point of view of deductible expenses and deductions, limited for non-residents.

Those kind of income "assimilated" to the employment income, as above, earned by a non-resident are taxed, instead, with a withholding tax of 30%[43], he cannot benefits from the deductions provided for in Art 11, Para 1 of the ICTA, nor from the progressive system, whose lowest rate is at 23 %[44].

The employment income gained abroad for a period exceeding 183 days for each tax period relating to a continuous employment relationship, is taxed on the basis of conventional wage established by a decree of Ministry of Labour and Social Securities (Article 51, Para 8 -bis ICTA). The income so determined, instead of that actually received, is then included in the taxable basis of the employee and this method is generally more favorable than the ordinary one[45].

Double Taxation Conventions usually include the criterion of "concurrent taxation" of both States, in case the employee works for more than 183 days in the State of the source. The remedy provided for the recovery of tax paid abroad is the exemption method or the tax credit method, according to the OECD Model, and the tax credit method according to Art 165 of ICTA.

Outside the cases provided for in Article 51, Para 8-bis ICTA, the tax credit for foreign income is limited to the ratio between foreign income and total income, this involves the application of the highest rate between the State of residence rate and the rate of the source State.

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[43] Art 24, Para 1-ter: " sulla parte di imponibile dei redditi di cui all'art 47, comma 1, lettera c-bis), del testo unico delle imposte sui redditi, approvato con decreto del Presidente della Repubblica 22 dicembre 1986, n. 917, in materia di redditi assimilati a quelli di lavoro dipendente, corrisposti a soggetti non residenti, è operata una ritenuta a titolo d'imposta nella misura del 30 per cento".

[44] S. SOTTOCASA, *Il distacco di personale,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari*, Cap. II, Padova, 2006, p. 26-27

[45] The favorable treatment is related to the objective conditions of a larger difficulty that the foreign worker is facing. The fiscal regime must consider problems related to the forced abandonment of the family and the place of origin, new conditions of work and life, different from the usual ones. A further objective is to make competitive the Italian workers abroad. For additional details: G. TINELLI: *la nuova disciplina fiscale del reddito di lavoro dipendente prodotto all'estero,* in *Riv. Dir. Trib.*, 2000, 03, p 269 e ss.

The Income Consolidated Tax Act (ICTA), excluded before 1997, in art 3, Para 3, let c), the foreign income from the taxable basis for the purpose of personal income tax if:

- The employment was exercised abroad in a continuous way and
- It consisted in the sole object of the employment agreement[46].

A problem raised because, according to Art 15 of the OECD Model, the income received for a period minor than 183 days should be taxed in the state of residence of the employee, and, according to Art 3 of the ICTA such income was exempt from tax in Italy: the result was a double non taxation[47].

In 1997[48], the legislator modified the regime. Foreign income received by resident employees was taxed as part of the worldwide income.

The problems regarding double taxation could have been resolved through methods provided for by the tax treaties[49].

Initially a tax credit corresponding to the withholding tax levied on the foreign income was granted to the companies employing workers abroad. This rule was introduced to prevent the distortion produced by the abrogation of the exemption system. Anyway the employer suffered taxation, even if only indirectly.

This rule was contrary to EU law, which prohibits State aid to enterprises, so this method was repealed with the current one provided for by the Art 51, Para 8-bis of ICTA[50].

The foreign employment income is determined on the basis of the salary schedule adopted by a decree of the Ministry of Labour if:

- The employment is exercised abroad in a continuous way; and
- It constitutes the sole object of the employment agreement; and

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[46] An *ad hoc* contract providing for the carrying out of the employment abroad was requested in order to integrate the requirement of “exclusivity”, or at least a supplementary contract. It was intended to differentiate in this way a permanent and stable transfer , from an occasional one, that did not benefit from the treatment of exclusion. Refer to: G. TINELLI: *la nuova disciplina fiscale del reddito di lavoro dipendente prodotto all’estero,* in *Riv. Dir. Trib.*, cit., p 273-274

[47] M AULENTA, *La tassazione dei redditi da lavoro dipendente prodotti all’estero,* in *Rass. Trib.*, 2008, p 157

[48] D. Lgs 314/1997

[49] A. PERSIANI, *Foreign Employment Income in the Italian Tax Setting,* in 64 *Bull. Intl. Taxn*, 8/9, 2010, Journals IBFD

[50] P. L. CARDELLA, *Il punto sulla disciplina dei redditi di lavoro dipendente prestato all’estero,* in *Rass. Trib.*, n. 3 maggio giugno 2003, p 904

- The employee spends more than 183 days in a year in the foreign country

This last provision derives from the application of the tax treaties, it is about the period of the physical presence in the foreign country.

The employment must be exercised without significant breaks, at a certain degree of permanency and stability. The work performance must be entirely exercised abroad.

The Italian residence of the employee should be regarded as an implicit requirement for the application of the regime. The employee should maintain the center of his personal and family's interests in Italy, otherwise the application of the rule is excluded.

If the conditions for the application of Art 51, Para 8-bis do not exist, the employee will be taxed on the income actually received. The rationale is to extend the worldwide income principle and to standardize the tax base with the base established for the social security[51].

The Circ. n. 207 / E of 2000 clarified the terms of the new regime. It imports an exception to the analytical determination of income in favor of a flat-rate. It shall apply to persons resident in Italy under Article 2 of the Tax Code, it applies when there is not a DTC providing for the exclusive taxation abroad; it considers in "183 days clause" even holidays, public holidays and rest.

The provision has a technical aim to close the system, in the absence of conventional provisions or when the Convention does not apply. This is the case when one of the requirements of Article 15 OECD Model is not fulfilled, which allows for taxation in the foreign source state. This is a rule used to cover all cases of non-taxation of income abroad[52].

Art 51, Para 8-bis applies to the salary received by the employee. It covers also indemnities for travelling abroad and fringe benefits. Regarding severance

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[51] S. SOTTOCASA, *Il distacco di personale,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* Cap. II, p. 56-57; refer also to P. STIZZA, *I redditi da lavoro dipendente nella giurisprudenza della Corte di Cassazione*, cit., p. 1478; refer also to G. TINELLI: *la nuova disciplina fiscale del reddito di lavoro dipendente prodotto all'estero,* in *Riv. Dir. Trib.,* cit., p. 277

[52] M. AULENTA, *La tassazione dei redditi da lavoro dipendente prodotti all'estero,* in *Rass. Trib.*, cit., p 165 e ss.

payments, the Italian Supreme Court affirmed that the deferred payments is related to the whole duration of the employment relationship and it must be included in the foreign income regime. The Tax Authorities, however, are at the opposite position[53].

Some problems are still present for the case of an effective income lower than the one determined by the decree. In this case the application of the provision may infringe Art 53 Const. regarding the "*ability-to-pay*" principle.

3.5 Taxation of employment income of a non-resident performing services in Italy

We have already said that non-residents are taxed to the extent of income earned on the basis of a territorial connection with the State (source principle), that we find in Article 23 of the Tax Code.

A minimum of stability of the transfer is required, together with the Italian residence of the employer.

The non-resident employee, performing work activities in Italy, receives a salary from his employer or from the foreign employer in Italy. All those compensations are included in the wording of Article 49 of ICTA.

It is important to refer again to the Convention against double taxation applicable to the case. Article 15 Para 2, letter b) of the OECD Model establishes that income from employment exercised in Italy, shall be taxed in Italy only if the recipient is present there for more than 183 days, and if the employer who pays the remuneration is resident in Italy or if it is a permanent establishment in Italy of a non-resident enterprise[54].

[53] A. PERSIANI, *Foreign Employment Income in the Italian Tax Setting,* in 64 *Bull. Intl. Taxn*, 8/9, 2010, Journals IBFD

[54] S. SOTTOCASA, *Il distacco di personale,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* Cap. II, p. 39-41

3.6 Cross-border employees

In this section we deal with the taxation of cross-border employees resident in Italy, who travel every day to work abroad and who come back every day or, at least, once a week to their home State. If the employee works in a non-EU State, a special Convention between the two States must be adopted, as the special agreement concluded between Swiss and the European Community in June 2002.
The Agreement is about the free movement of persons. The Contracting Parties have agreed to carry out the coordination of their social security systems by applying the existing EU legislation on social security.
The agreement coordinates the rules of the various national social security systems, in order to protect the social security rights of migrant workers and the exercise of the right of free movement of EU citizens.
The legislation ensures to the workers moving within the EU territory:

• equal treatment, according to which each State is required to assure to nationals of other Member States the same treatment and the same benefits reserved for its citizens;

• the maintenance of the rights and the advantages acquired and the possibility, therefore, to obtain payment of benefits in their State of residence even if at the expense of another State;

• aggregation of periods of insurance and contribution, through which the insurance periods completed in the various Member State are cumulated.

An additional requirement is present in most of the conventions signed by Italy with neighboring States: the residence and the place of work must be located within the territory precisely established by that Convention.
The Italian Tax Authorities consider a “cross-border employee” someone who daily crosses the border to reach the workplace.
This definition is not accepted in the EU law, nor in the conventions signed by Italy, this interpretation is considered too restrictive.

Initially, the Italian legislator planned to exclude such kind of income from the taxable income base under Article 38, Para 3 of Law n. 146 of 1998.

After 2002 the exemption method was repealed.

In 2003 a new rule was introduced: the foreign income was taxed in Italy only over the limit of 8000 euro, with a series of extensions, that threshold has remained unchanged until 2011.

In the subsequent tax periods Article 51, Para 8-bis ICTA was generally applied, with the conditions and the regime described above.

If the timing period lasts less than 183 days, the income effectively received will be taxed in Italy, according to ordinarily applicable rules.

In those case the problem of the resulting double taxation of income shall be settled by internal rules and conventional measures.

At a domestic level, we find Article 165 ICTA, which provides for a credit method for taxes paid abroad in a definitive way.

The conventional rules prevail over the internal ones when providing a more favorable regime to the taxpayer.

Most of the Italian Conventions are based on the OECD Model; in Art 15 it provides for rule of the taxation in the State of residence and also in the State where the activity is performed.

Double taxation is avoided by the exemption method (Article 23 A) or by the credit method (Article 23 B).

In the Italy-Austria Convention and Italy-France Convention, the power to tax the income of cross-border employees is recognized only to the State of residence.

In the agreement between Switzerland and EU, the income of the cross-border employee is taxed only in the country in which it is performed. Swiss makes a periodic payment to neighboring Italian municipalities.

Coming back on the threshold applied in this regime, since 2012, it has fallen to 6,700 Euro, this amount was later confirmed for 2013 in Article 3, paragraph 40-bis of the Stability Law for 2013.

This system pursues three goals: 1) the technical aim of the balancing of the taxation system; in fact, Article 3 of ICTA affirms that employees, resident in

Italy, who receive employment income abroad, are taxed on a worldwide base. The employee will be probably taxed also abroad and the result would be a case of double taxation. It would be only partially mitigated by the tax credit system provided for in Article 165 of the ICTA.

2) financial and economic objectives of attracting the taxable income to Italy, in order to avoid that the income produced across the border would be legitimately "abandoned" in favor of the foreign State by the employees, for example by moving their tax residence in the other State. In this case, the Italian State would lose its taxation power on that share of wealth.

3) cultural objective of ensuring the Italian State that set of knowledge and learning experiences that frontier workers could convey to foreign citizens[55].

3.7 International aspects

While talking about the taxation of cross-border employees, we must consider the more general contest of international relationship, and in particular the conventions concluded between the States to prevent double taxation.

The tax treaties concluded by Italy are widely based on Art 15 of the OECD Model. According to it, the employment income shall be taxed only in the residence State, unless it is exercised partly abroad. In this case the income may be taxed both in the source state and in the residence state. The article gives the right to tax the income only to the Residence State if:

- The employee works presently in the source state for less than 183 days; and
- The employee is not paid by a resident employer in the source State; and
- The employee is not paid by a permanent establishment of a foreign company in the source State.

[55] B. BIVONA, *Frontalieri: ok a proroga fino al 2014 della franchigia tributaria*, in *Fiscooggi.it*, 21 Febbraio 2013

If all these three conditions are fulfilled, the income of the non-resident working in Italy will be taxed only in his residence State.

If one of these conditions is not fulfilled, and the employee works both in Italy and in his residence State, the result is that the same income will be taxed in both contracting States. In this last case, the ways to avoid double taxation are in Art 23 A and 23 B of the OECD Model. They provides for two methods: the exemption method and the credit method. According to the exemption method, the Residence State will not tax the income, that will be taxed in the Source State; according to the credit method, the Residence State will give a credit to the taxpayer of the same amount of taxes paid abroad in the Source State. Italy has adopted this last method in most of our bilateral treaties.

Some of them provides for the exemption method only if that income is effectively taxed in the other contracting State. This is the case of the treaty between Italy and France.

We have already seen the case of the Italian employee working abroad: he will be taxed in his Residence State, so in Italy, only if all the conditions of Art 15 of the OECD Model are fulfilled.

Otherwise, if one of these conditions of Art 15 of the OECD model is not fulfilled, he will be taxed in both Contracting States. In Italy, the tax will be levied according to Art 51, Para 8-bis if the employee stays in Italy for less than 183 days in a 12-month period; on the contrary, if the employee stays in Italy for more than 183 days, the ordinary regime will be applied. The resulting double taxation will be solved through the credit method.

The Italian Tax Authorities have interpreted the “183 days clause” including holidays, weekly rest, and other non-working days, regardless the place in which those are spent. The criterion of the physical presence is so abandoned.

Some of the treaties do not include the modification of Art 15 after 1992, we find the consideration of “*the fiscal year*” instead of “*any twelve month period commencing or ending in the fiscal year*”.

There is not a clear definition of the term “employer” in the Model. This could create problems of double taxation. Let us consider the case in which the formal employer, who pays the remuneration, is resident in the State of employee’s residence, and the real employer is considered the one resident in the Source State. The result is that the employee could be taxed only in the Residence State, where one of the conditions of Art 15 of the OECD Model is not really met, so it is necessary to give a proper definition to the terms used in the Model.

The principle of the “substance over form” shall be used to solve those cases. It must be considered also in the qualification of employment income, in order to distinguish this from professional income.

The employer shall be that one who has the effective control over the employee’s performance. Where a solution cannot be found, the mutual agreement procedure is the only possible option.

According to treaty provisions and Art 165 of the ICTA, the double taxation of the income is thereby eliminated through the tax credit granted by Italy for taxes paid abroad. The amount of taxes paid abroad, relevant for the tax credit, must be reduced proportionally to the part of the income actually taxed in Italy on the basis of the current special tax regime[56].

The taxation of a non-resident in Italy will be possible even if only one of the requirements above is not fulfilled. The tax regime applied in Italy will be the ordinary one.

In some recent cases (as No. 29455, 29456, 29457, 29458, 29459, 29460 and 20461 of December 2008) the Italian Supreme Court stated that Italy could levy taxes even on the sole basis of the treaty provisions, irrespective of the exemption method provided for in the domestic law[57]. All these judgments are related to reimbursement claims filed by non-resident Italian citizens employed in the Italian

[56] P. STIZZA, *Il quadro normativo relativo ai redditi di lavoro dipendente “transnazionale”*, in *La mobilità transnazionale del lavoratore dipendente: profili tributari*, Cap. XIV, p. 495

[57] A. PERSIANI, *Foreign Employment Income in the Italian Tax Setting*, in 64 *Bull. Intl. Taxn*, 8/9, 2010, Journals IBFD

railway company and exercising their employment in Switzerland. Under Art 19 of the Italy-Switzerland treaty, the exclusive taxing power in this case is attributed to the State that makes the payments.

At a domestic level, Italy can levy taxes only on income derived from activities exercised in Italy, so the Supreme Court has decided on the sole base of the Treaty.

In this case, "*even in the presence of the internal rules* (still valid in relation to other States, in the absence of any bilateral agreements*) which limited the power of taxation of the Italian State through the mechanism of exclusion of income from employment from the taxable base* (or through the tax credit system) *, the Italian State, in the Convention, has reclaimed its power of taxation and the other Contracting State has declined to exercise it, otherwise recognized by the internal Italian regime*"[58].

In this case Art. 19 of the Convention between Italy and Switzerland applied and it is not entirely comparable to the internal standard. According to Article 19, paragraph 1, "*the remuneration, including pensions, paid by a Contracting State or a political subdivision or a legal independent institution governed by public law of that State, either directly or by drawing from a special fund, to a person possessing the nationality of that State in respect of services rendered, present or past, shall be taxable only in the Contracting State where such remuneration comes from*".

The Supreme Court affirmed that:

1) the requirement to tax an income is the "possession of income in cash or in any other kind from any source, or of any kind included in one of the categories specified in the Tax Code"[59]

2) the legislator has identified three criteria of territorial connection to regulate the exercise of "fiscal sovereignty":

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[58] Cass. Sez. trib., 23 Settembre 200,. n. 19154
[59] Art 3, comma 1 ICTA

- The criterion of residence, under which the global income of the resident is to be taxed in Italy;
- The criterion of territoriality of income produced, under which the income is taxed in the state of the production;
- The origin of the income criterion under which the tax is based on the nationality of the paying institution;

3) it affirmed that *"if every requirements is fulfilled, income from employment is taxed under Art. 19 of Italy - Swiss Convention, ratified and enforced by Law 23.12.1978 n. 943, so it should therefore be taxed in the State of origin*. "

The provision of the Convention gives relevance to the nationality of the employee and the employer who pays. No relevance is given to the residence, that is a central requirement in the domestic law.

Furthermore, Switzerland is considered a tax haven so there is a presumption of the keeping of residence in Italy[60]. However this rule was not present in our system at that time[61]. The Supreme Court interpreted this rule as an authentic interpretation provision[62], but some doubts still remain[63].

The Supreme Court affirmed that the Convention gives to Italy the power to tax, but the international scholars generally consider that the Treaties do not create this power, they only attribute the rights to tax between the Contracting States.

The absolute prevalence of the treaties over the domestic rule of the exemption valid at that time, is viewed as inappropriate by many authors. One of the main reason is the existence of art 169 ICTA, that affirms that the Income Tax Code is

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[60] Art 2, comma 2bis TUIR: "Si considerano altresì residenti, salvo prova contraria, i cittadini italiani cancellati dalle anagrafi della popolazione residente e trasferiti in Stati o territori diversi da quelli individuati con decreto del Ministero dell'economia e delle finanze, da pubblicare nella *Gazzetta Ufficiale*"

[61] The provision was introduced in Italy by the art 10 of the law n°448 in December 1998, the case considered is before that date

[62] A. PERSIANI, *La tassazione del reddito da lavoro dipendente prestato all'estero tra taxing rules di fonte convenzionale e norme interne di esenzione,* in *Dir. Prat. Trib. Intel.,* p. 1687

[63] According to the Author the provision has some clear differeces that distinguish itself from a tipical authentic interpretation provision. Regarding this subject, see G. MELIS, *L'interpretazione nel diritto tributario,* Padova, 2003, p 474 e ss.

applicable, if it is more favorable to the taxpayer, even if the internal provisions are in contrast with an international convention[64].

Coming back just briefly on the foreign tax credit method, we said above that it gives the possibility to the Italian employee who works abroad and has paid taxes abroad, to deduct from the tax due in Italy according to the world wide income principle, a portion of the taxes paid abroad.

It is necessary that foreign-source income is considered part of the income taxable in Italy. The income shall be deemed “foreign” on the reciprocal basis of those contained in Article 23 of the Tax Code: the place of employment criterion. Conventions to prevent double taxation signed by Italy, can ignore these definitions[65]. It is also necessary that the tax paid abroad contains similarities to the Italian tax levied on that income. The payment of the foreign tax must have been concluded definitively.

Article 165, Para 4 Tax Code provides that the deduction should be calculated in the same tax year in which the income is produced abroad.

If the foreign income is produced in multiple States, the deduction will apply separately for each State. This rule is called “*per country limitation*”[66].

According to Art 165 ICTA, the deduction shall be made within the limits of the ratio between foreign earnings and total income. Italian rules will be used to quantify the foreign income and the total income, in order to operate with homogeneous quantities. The foreign income will be calculated under Article 51, Para 8-bis TUIR, if all conditions are fulfilled.

Article 23 of the Tax Code allows to deduct the foreign tax directly from the tax due in Italy relating to the income from employment performed abroad.

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[64] A. PERSIANI, *La tassazione del reddito da lavoro dipendente prestato all’estero tra taxing rules di fonte convenzionale e norme interne di esenzione*, in *Dir. Prat. Trib. Intel.*, p. 1694

[65] P. L. CARDELLA, *Il foreing tax credit* , in *La mobilità transnazionale del lavoratore dipendente: profili tributari*, Cap. XIII, Padova, 2006, p. 422-423

[66] P. L. CARDELLA, *Il foreing tax credit* , in *La mobilità transnazionale del lavoratore dipendente: profili tributari*, cit., p. 430 e ss.

The credit is limited to the lower between the tax paid abroad and the Italian tax that is levied on income earned abroad. Article 165 has a wider application than Article 23.

PART 4
EU TAX LAW RELATING TO THE INCOME OF CROSS-BORDER EMPLOYEES

4.1 Introduction and the main findings of the ECJ regarding taxation of cross-border employees

As illustrated above, the internal taxation rules have to deal with a second regulatory level, that it is contained in the international conventions to avoid double taxation, in particular when the case involves States with which a DTC is in force.

There is a third level of regulation, the EU level.

In the EC Treaty we found Article 3, let. h) which established the principle of the "approximation" of the national legislations to the extent required for the functioning of the common market, and Article 94 of the EC Treaty, which provided for the authority of the Council to issue, with unanimous deliberation, all the directives for the approximation of the national systems and rules, which have a direct impact on the establishment and functioning of the common market.

The harmonization of rules about the taxation of employment income was withdrawn in 1992, due to the opposition of some States[67].

[67] G. MELIS, *I redditi da lavoro dipendente e il diritto comunitario,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* Padova, 2006, Cap. I, p. 1 e ss.

The principle of non-discrimination has been developed with great precision by the ECJ and it should inspire the domestic legislation. The non-discrimination principle has affinities with the purpose of the legislative harmonization.

The non-discrimination principle in the field of employment is achieved by Article 39 of the TFEU, which refers to the freedom of establishment of people within the EU territory.

Article 43 and 48 of the Treaty are important in this sense, they guarantee the freedom of establishment, that is an implementation of the principle of non-discrimination.

The principle of free movement regards also employees: they have the right to carry out an activity for and under the direction of others, in return of a remuneration: any discrimination based on nationality shall be abolished, with regard to employment, remuneration and any other job conditions.

The ECJ talks about direct, indirect or reverse discrimination.

We have direct discrimination when an internal rule of a Member state establishes a discriminatory treatment based directly on nationality, that is the object of the EU law protection. This form of discrimination is more intense for legal persons, the discrimination is based on the location of place of effective management.

Indirect discrimination occurs when the internal provision discriminate some situations on the base of a different element, that refers indirectly to nationality.

This item could be the tax residence.

In *Zurstrassen* case[68], the law of Luxembourg subordinated the joint taxation of married couples to the condition that both of them were resident in Luxembourg. The ECJ found the rule inconsistent with Article 39, because this condition can be met more easily by someone who is a national of Luxembourg.

There are actually different situations between residents and non-residents. Residents are generally taxed on a world-wide basis, with the possibility to deduct

[68] CGUE, 16 Maggio 2000, C-87/99, *Zurstrassen,* in *Raccolta,* 2000, p. 1412 ss.

certain expenses in the State of residence. The problem is to determine when the position of a non-resident becomes comparable to that of an entity resident in the State.

In the famous *Schumacker* [69]case, a Belgian citizens produced in Germany most of his employment income; in Germany he was treated as a non-resident, while in Belgium had no taxable income, and he was not qualified for personal allowances.

In the case *Wielockx*, a Belgian citizen, resident in Belgium, produced almost all of the income from his employment carried out in the Netherlands, he could not constitute pension reserve in the Netherlands under the same conditions provided for the residents of the Netherlands.

In the *Zurtrassen* case, as mentioned above, a Belgian citizen residing in Luxembourg, which receives almost the entire income in Luxembourg, could not benefit from the splitting provision, because his spouse was resident in Belgium.

In such cases the ECJ has treated the conditions of non-residents in the same way of those of residents and it considered the internal rules deduced discriminatory and inconsistent with the EU legislation.

In *Wallentin*[70] case, a German citizen had received as taxable income only a salary as trainee in a Swedish church, this compensation is taxed with a withholding tax at 25% rate, without the benefit of any deduction, that is granted to Swedish citizens.

The non-resident entity that produces income mainly in the state of Source, cannot benefit from deductions related to his personal situation nor in the state of Source (because he is not a resident there), nor in the State of their residence because there is not any taxable income. According to the ECJ this condition is unacceptable and discriminatory.

[69] CGUE, 14 febbraio 1995, C-279/93, *Schumacker,* in *Raccolta,* 1995, p 225 e ss.
[70] CGUE, 1 luglio 2004, C-169/03, *Wallentin,* in *Raccolta*

In *Gerritse*[71] case, a non-resident produces only a partial income in the State of source. The court believes that the non-resident taxed at source for income earned in the state of source, must be able to deduct the expenses connected with their activities. Furthermore, the tax applied to a non-resident must be less than, or equal to that which would be applied to an individual who is resident, if they are in a similar situation, applying the progressive system of rates which is in force in Germany.

In *Asscher*[72] case, a Dutch citizen resident in Belgium, worked in the Netherlands. He is taxed in the Netherlands, as a non-resident, at a rate higher than the rate applied to residents. The court considers that in this case there is a discrimination between the citizen resident in the Netherlands and the Dutch citizen non-resident.

In *Gschwind*[73] case, the Court allows the internal provision provides for the splitting for non-resident couples, under the condition that they produce in the Source State the 90% of their taxable income, or that the income in the state of residence is under a certain limit.

In *De Groot*[74] case, there is a case of restrictive discrimination. The State of residence excludes one of its residents from certain benefits, for the fact that he has produced income in another Member State.

In *Danner*[75] case, the ECJ considers the discriminatory provision of a Member State which prevents non-residents to deduct from taxable income social securities contributions. This limitation is only possible if the State provides for the non-taxation of pensions paid by the non-residents.

In the judgment *Meindl*[76], an Austrian citizen, resident in Germany, married to an Austrian woman who lives in Austria, cannot benefit from the joint tax even if he

[71] CGUE, 12 giugno 2003, C234-01, *Gerritse,* in *Riv. Dir. Trib.,* 2004,III, p 187 e ss. Con nota di B. E. PIZZONI, *Ancora in tema di trattamento impositivo differenziato tra soggetti residenti e non residenti: Gerritse (e Wallentin)*
[72] CGUE, 27 giugno 1996, C-107/94, *Asscher*, in *Raccolta,* 1996, p 3091 e ss.
[73] CGUE, 14 settembre 1999,C-391/97, *Gschwind*
[74] CGUE, 12 dicembre 2002, C-385/00, *De Groot*
[75] CGUE, 3 ottobre 2002, C-136/00, *Danner*
[76] CGUE, 25 luglio 2007, C-329/05, *Meindl*

produces joint taxable income in Germany, and his wife received more than 10% of the income of the couple in Austria. The Court considers this provision discriminatory if the income received by his wife is non-taxable income, which makes the position of someone who lives in Germany with his spouse resident, comparable to the situation of a resident who has his spouse who is not a resident.

4.2 Domestic rules and the ECJ principles

Italian law does not seem to be in contrast with the Schumacker doctrine, especially regarding the notion of tax residence. Article 2, Para 2 of the Tax Code provides a large definition of residence, a non-resident that produce most of his income in Italy will be included.

Art. 23 of the Tax Code regards the income from activities carried out in Italy, as compensation of employees, that is received and taxed in Italy. Article 23, Para 2, letter b) considers taxable, the income paid by the State, by people resident in the State, or by permanent establishments in the territory even if it is the PE of a non-resident entity.

The taxation of employment income does not make differences between residents and non-residents, both regarding the determination of the tax base, and the application of withholding payment provided for in Article 24, Para 1, of the Presidential Decree n. 600 of 1973.

There is discrimination between residents and non-residents regarding the deduction of expenses related to the production of income. Some deductions are not recognized to non-residents.

Those kind of incomes which are similar to those of employment income (Article 50, Para 1, letter c-bis), are subject to a withholding tax of 30%, if the income is received by a non-resident.

A non-resident cannot benefit from the deductions provided for in Article 11 of the Tax Code, nor from the progressive rate. This discrimination is in clear contradiction with the principles enunciated by the Court in Gerritse sentence[77].

Anyway, according to Art 1, Para. 1324 of Law n. 296 of 2006, deductions for dependents referred to in Article 12 of the ICTA were provided to non-resident employees for the years 2007, 2008 and 2009 only if they did not receive a net income higher than the threshold set out in Art 12, Para. 2, and only if they did not enjoy, in their residence State, any tax benefit related to family.

We have already said that residents who engage in a foreign work for more than 183 days in any 12 months are taxed according to the decree of the Ministry of Labour.

If the employee receives less than the standard salary stated in the decree, there would be a breach of Article 39 of the CEE Treaty.

In fact, the scheme would be a disincentive to the carrying out of work abroad.

If it is not applicable the regime established by Article 51, Para 8-bis), for example because the temporal condition is not fulfilled, the ordinary regime will apply.

The tax credit is granted in Italy to the extent of the ratio between foreign earnings and comprehensive income, the result is that the highest of the rates of the two States will be applied.

This rule is still justified by the ECJ in Gilly[78] case, the Court in that case determined that the higher rate resulting from the application of the tax credit, is not contrary to Article 39 and 43 of the Treaty.

However, the method of calculation must be able to consider all personal allowances recognized by the state to its residents.

The role of the Court of Justice in the process of harmonization of direct taxation, is considered extremely significant by the legislature, by the Italian Courts and by the Italian government.

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[77] G. MELIS, *I redditi da lavoro dipendente e il diritto comunitario,* in *La mobilità transnazionale del lavoratore dipendente: profili tributari,* cit., Cap. I, p. 26 e ss.

[78] CGUE, 19 novembre 2009, C-540/07

The principle of non-discrimination established by the Court affects every internal rule that makes less favorable the exercise of an activity by a foreigner in the Italian State with respect to the condition of an Italian citizen, and the exercise by its own resident of a work in another Member State under conditions less favorable than those provided in the event that this activity was carried out in Italy (restriction).

The sovereign power of the States must be respectful of the principles developed by the ECJ. Also international treaties must be compatible with the Community rule.

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Taxation of cross-border investment income of individuals

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INTRODUCTION

The taxation of investment income is a strongly debated issue in Italy. Hence the Italian taxation system seems to be unfair with respect to earned and unearned income. Therefore, income from financial assets are usually subject to flat withholding or schedular taxes and are not included in the taxable base of personal income tax; income from immovable property are either taxed by schedular taxes (and not included in the taxable base) or taxed on a fictional taxable base, which is in most cases lower than the market value of the immovable itself. The progressivity of the Italian tax system is limited to income from employment and business, included with respect to the effective earned income in the taxable base of individual income tax. This unequal situation is made even worst by the high level of tax evasion.

In structuring a similar taxation system[1] with respect to income from capital assets the principles of certainty, neutrality and simplicity of taxation prevailed on the ability to pay code. The mobility of capital was approached in the sense to privilege income from capital in order to avoid capital flight and to attract investment. Consequently, taxation on capital income is lower than on earned income; it seems to be easier for the State and the taxpayer as no assessment is required; it is neutral with regard to the choice of investment of the individual, who is taxed with the same tax rate for almost every type of investment he decides to do, not depending on the amount of income he has perceived.

This discrimination between income from capital and income from employment and business is one of the most important topics of the election campaign that involves Italy during these days. Some politicians proposed a stronger taxation on financial asset, others talks about the introduction of a general wealth tax.

[1] Which was defined a “dual system” by F. Tesauro, *Istituzioni di diritto tributario, Parte Speciale*, Padova, 2012, p. 7

Chapter 1

GENERAL PRINCIPLES AND STANDARDS IN TAXATION OF INVESTMENT INCOME OF INDIVIDUAL: DOMESTIC SYSTEM

1.1 The notion of income; income from immovable property and from financial asset

The Uniform body of law on income tax (hereinafter UBIT[2]) does not establish a definition of income. According to art. 1 UBIT, income is relevant to the tax law if it derives from one of the typical source defined in Art. 6[3], so the notion of income depends on the source that gives rise to that income. The UBIT has a case by case approach, determining all the taxable income in a precise and detailed way. But looking at the rules of the law it is possible to evaluate the notion of income used by the Italian legislator.

Firs of all, it must be noticed that the notion of income is included into the notion of wealth increase, but the opposite is not true, as not all the wealth increases can be considered income. To be considered income a wealth increase has to be linked with the taxpayer, in the sense that it has to derive (as a consequence) from a source related to the taxpayer himself[4].

Historically Italian law taxed incomes that are directly produced by an effort or an investment of a person[5]. It was required a direct connection between the income and the taxpayer, so that income deriving from occasional sources should not be taxable. But a recent reform changed the approach: Legislative Decree no. 461/1997 modified the residual category "other income", introducing a general

[2] Approved by President of Republic Decree no. 917/1986

[3] Which are: estate income, capital income, emplyment income, self-employment income, business income and other income.

[4] See G. Falsitta, *Manuale di diritto tributario, Parte speciale*, Padova, 2010, p. 15

[5] See G. Corasaniti, *Diritto tributario delle attività finanziarie*, Milano, 2012, p. 10, G.Falsitta, *Manuale di diritto tributario. Parte speciale*, quoted, p. 2

clause about the taxation of capital gains. According to this new rule, also occasional capital gains shall be taxed (not only speculative ones). This evolution brings the best literature to say that now, to have an income, it is not necessary that it derives from a specific productive source, or as a result of a source which had a preeminent influence in determine the existence of the income. It is simply needed that the activity of the taxpayer was a *condicio sine qua non* of the wealth increase[6]. Now we can say that, even if the principle is that a flow of wealth can be considered income only if the law defined it as an income, quite all the taxpayer's wealth increases can be subsumed into one of the hypothesis of income stated by the law[7].

So, the concept of income seems to be similar to the notion of income given by Haig and Simmons: value of taxpayer's wealth at the end of the taxable period + consumption during the taxable period – value of the taxpayer's wealth at the beginning of the taxable period. But there is an important difference between the two notions: the Haig-Simmons definition considers income also the higher value of the assets even if it is not realized, instead the Italian notion does not consider a capital gain an income until it is realized, by sale or by another event. The not realized capital gains shall be taxed only if there is a specific rule establishing taxation. With respect to individual taxation, Italian tax system is based on the cash method, not on the accrual method, with the exception of business income.

Defining the concept of estate income is simple: it is income that derives from real estate. An exemption is established with regard to dwellings used by the

[6] See G Corasaniti, *Diritto tributario delle attività finanziarie*, quoted, p. 25, G. Falsitta, *Manuale di diritto tributario. Parte speciale*, quoted, p. 17-18

[7] Indeed the general clause of Art. 67, par. 1, *f)* UBIT, according to which occasional self-employment income and income deriving from obligations to do something, not to do something, to tolerate something, could include any kind of income.

owner as abitual abode[8]. In some exceptional cases capital gains derived from sales of immovable properties shall be taxed, as other income. More deeply, Art. 67 UBIT considers other income: *i)* capital gains realized through division into lots of lands or executions of actions to make them builing areas; *ii)* capital gains realized through transfer on estates purchased or built 5 or less years ago, not included inherited those and dwellings having been used as main habitation by the seller or his family for the most part of the period between purchase and transfer, and in any case capital gains realized through transfers of lands considered building areas at the moment of the transfer. The previous law stated that all speculative sales of immovable properties shall be taxed, but the concept of "speculation" was considered too uncertain[9]. Now, ruling precisely the matter, the legislator has established a sort of presumption of speculation, with no possibility of counterproof.

The definition of capital income is more complex. Financial asset income are divided in the categories of capital income and other income. More deeply, capital income includes all the income deriving from the using of capital, inasmuch art. 44 TUIR does not require a valuable consideration in order to qualify an income as a capital income[10], whereas capital gains are numbered among other income. The problem is to find the limit between capital gain and capital income with respect to "positive differentials", which can be allocated in both of them. To distinguish any criterion between the two categories it is necessary to look at the event giving arise to the income: if the differential is due to an uncertain event, it

[8] The form of this exemption is to concede a deduction in the same amount than the cadastral rent of the immovable itself.
[9] See G. Falsitta, *Manuale di diritto tributario...*, quoted, p. 228
[10] See F. Gallo, *La nozione dei redditi di capitale alla luce del D.lgs. 21 novembre 1997, n. 467*, in *Dir. Prat. Trib.*, 1998, p. 1225

shall be taxed as a capital gain; otherwise, if the income is the consequence of a certain event, it means that it is a capital income[11].

1.2 Taxation of estate income

The taxable base for estate income is determined on the basis of the cadatastral valuation of the real estate, if the real property is not leased. The cadatastral rent is usually very low with respect to the market value of the lot or of the building: this fact consents a very low taxation of immovable property with respect to the income tax. If the real property is leased, the taxable base is determined on the basis of the leasing rent, reduced of 15%. It is also possible for the lessor to choose a different type of taxation, not on assessment but by schedular tax[12]. This opportunity was provided in order to reduce the cases of tax evasion in the estate renting sector. The law establishes an increase of taxation for dwellings which are not use as abitual abode but are kept available to the owner[13], in order to incentive owners to rent their immovable properties. It is not allowed the deduction of any expenses, as the cadastral rent is considered to include all the costs related to the real estate; with regard to rented dwellings, the reduction of the taxable base of 15% has to be considered as a virtual flat deduction of costs.

1.3 Taxation of capital income

To determine the taxable base of capital income it is required to look at the gross income, as it is not permitted any deduction of costs and expenses[14]. The law

[11] G. Corasaniti said that to separate capital income from capital gain it is necessary to look at the process generating the earning: if it is composed only by one operation, we have a capital income; if there are two different operation of purchase and sale, it means that we have a capital gain. See G. Corasaniti, *Diritto tributario...*, quoted., p. 49
[12] See Legislative Decree 23/2011, art. 3.
[13] See Art. 41 UBIT.
[14] See Art. 45, co. 1, first sencence, UBIT.

provides different rules for earnings from participations in companies and for interests.

With respect to earnings from participations in legal entities subjected to corporate income tax[15], there was a radical change after a reform enacted in 2003. Before 2003, in order to avoid double taxation of dividends, the shareholder was allowed to deduct from his income tax an amount correspondent to the tax paid by the company for the part that can be referred to the shareholder's participation. The income tax paid by the company was a sort of advance of the income tax the shareholder would have paid after the distribution of dividends. After 2003, the exemption method was adopted: dividend perceived from companies are exempted for 95% if the recipient is another company; with respect to individuals different rules shall apply as the individual is considered to have a relevant stake in the company or is not.

It is considered to have a relevant stake in a company the shareholder who has a participation representing 5% of company's paid-up capital or 2% of voting rights in the general meeting when the company's shares are listed in regulated markets, or a participation representing 25% of company's paid-up capital or 20% of voting rights in the general meeting for others companies. Dividends from company in which the shareholder has a relevant stake are partially exempted: they are included in the taxable base only for 49,78% of their amount[16]. With this method it is given only a partial relief to economic double taxation, as the same income is taxed in the hands of the company and, partially, in the hands of the shareholder. This partial double taxation is justified by the fact that in this way it

[15] In Italy some legal entities are subjected to company income tax even if they are not companies. This is a consequence of the 2003 reform which was partial. Art. 73 TUIR numbers legal entities subjected to company income tax: they are resident companies with limited liability, resident entities, included trusts, which carry on a business, esclusively or prevalently, resident entities, included trust, which do not carry on a business esclusively or prevalently, non resident entities, with or without legal personality

[16] A creditable withholding tax at 20% is levied.

is possible to recover progressivity that the corporate income tax does not establish, as it is proportional[17].

Dividend perceived by shareholders who have not a relevant stake in the company are taxed by withholding at a 20% rate[18]. In this case economic double taxation is not avoided at all: we can justify it considering the low tax rate and the fact that in that case we can distinguish clearly the company's income, derived from business activity, and the shareholder's income, whose little stake in the company may be considered as a pure investment, not depending only on the business income of the company, but also on others factor, i.e. speculative reasons.

The same rules that apply to dividends are established for income from financial instruments similar to shares[19] and income from profit sharing agreements which payment due is capital. A financial instrument is considered similar to share if its remuneration is utterly made up of participation in profit of the company itself, of a company belonging to the same group or an affair in relation to which the financial instrument was issued.

With regard to interest, rules are simpler, because there is no problem of double taxation. Interests are quite always taxed by withholding or schedular taxes at 20% rate[20], either from current or postal accounts or from bonds. Exceptions are established with respect to government securities issued by Italy and other States

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[17] Even if, according to G. Falsitta, *Manuale di diritto tributario...*, quoted, p. 169-170 this double taxation seems to be unfair.

[18] Law Decree 138/2001 has recently reorganized the tax rates of financial income, equalizing them at 20%. See G. Corassaniti, *Diritto tributario...*, quoted, p. 100.

[19] The company law reform of 2003 introducted in Italian law a new category of securities, the financial instrument, for which the company bylaws can provide different features with respect to shares and bonds. They could be defined as similar to shares or similar to bond considering the risk espressed by the security itself.

[20] Before 2011 there were different rules for different kind of interests: in some cases the tax rate was 12,5%, in other cases 27%. In order to simplify the system and to avoid tax arbitrages, a recent law equalized tax rates on interest at 20%. See nt. 16.

included in the so-called *white list*[21]and less important bonds, which are taxed at 12,5% rate. This different treatment is due to the will to preserve an advantage for buyers of treasury bills as an incentive to invest in such bonds. It is established that late payment interests and deferred payment interests are not capital income, but they are income of the same category of the income from which they derive.

Other capital income are: perpetual rents and annual perpetual services, payments due for guarantees, earnings deriving from mutual funds, earning deriving from repurchasing agreements and securities lending, incomes included in capital paid out as a fulfilment of life insurances.

1.4 Taxation of capital gains

With respect to capital gains, as they are represented by differential values, it is allowed the deduction of related costs and expenses, except for interests. This different regulation could bring to arbitrages aiming at allowing the deduction of expenses requalifying a capital income as a capital gain, but this seems really difficult as there is a clear criterion (event causing the differential) to distinguish.

For the purpose of analyzing rules about capital gains generated with respect to participation in entities, we must note that participation in resident partnerships are included in those which can give arise to a capital gain, whereas earnings deriving from resident partnerships are not considered capital income. This difference is due to the different approach used to avoid economic double taxation

[21] Which is a list, approved by Minister of Economy and Finance Decree containing all the States which allows an adequate exchange of information. Now this list has not been already issued: the black list, which numbers all the States not allowing an adequate exchange of information, substitutes it.

for resident partnerships, the look through approach[22], instead of the exemption method provided for companies.

Capital gains derived from transfer of participation, if the seller is a company, are exempted for 95%, in parallel to what is established for dividends[23], if particular conditions occur at the moment of the realization[24] (this regime is called participation exemption).

Capital gains from realization of participation transferred by an individual are subjected to the same rules explained for dividends. Firstly it is required to distinguish between relevant and non relevant participation; if the participation is relevant, capital gain is partially exempted; if the participation is not relevant, capital gain is taxed by schedular tax at 20%. Similar rules are established for financial instruments similar to participation and profit sharing agreements.

This symmetric treatment for dividend and participation capital gain is due to the similar nature of the earning itself: as the capital gain is supposed to reflect earnings the company has not distributed yet, in order to realize the accrued value of the participation the shareholder has the choice to sell the participation itself or to receive dividends.

With respect to sales of bonds or others securities which can give arise to interests, capital gain are taxed by schedular tax at 20% (or 12,5%), symmetrically to interests.

[22] The look through approach consists in the transparency (for tax matters) of the partnership, so that its incomes are directly imputed to the partners. See Art. 5 UBIT.
[23] Even if there is a significant difference: it is not possible to deduct costs related to participation exempted from taxation if it generates capital gain (and it is not possible to deduct capital losses), whereas it is possible to deduct those related to partipation giving arise to exempted dividend (see art. 109, c. 5, UBIT).
[24] It is necessary (see art. 87 UBIT): a minimum holding period of the participation (1 year); the classification as fixed asset in the first year the participation entered into balance sheet; the participated company shall not be resident in a black listed State; the participated company shall carry on effectivly a business (these two latter conditions shall have existed for three years before the realization).

Rules for capital losses are strictly connected to those for capital gain: with regard to capital losses derived from realization of relevant participation, they can be used to offset capital gain of the same type and they can be carried forward for the following four years in the same proportion the capital gain should have been taxed (49,72%). Thus, capital losses derived from realization of non relevant participation can be used to offset capital gains of the same type and they can be carried forward for the following four years for the total amount. In this case it is necessary to indicate the loss in the tax return of the year the loss was realized. The same rule applies to capital losses derived from realization of bonds and others securities taxed by schedular taxes.

According to the ordinary regime applicable to capital gains, they shall be reported in the tax return (even if they are not included in the taxable base) and the taxpayer himself shall pay the schedular tax.

In order to make simpler for the taxpayer all the tax obligations related to income generated by financial assets, Legislative Decree no. 461/1997 has introduced two different way of taxation of these incomes. These particular tax regimes apply only if there is a choice of the taxpayer.

The individual asset administration regime applies if the taxpayer deposits the securities upon an authorized intermediary. This option could be realized only for non relevant participation, bonds and others securities and derivatives and it allows the offset between capital gains and capital losses of different types. The intermediary becomes withholding agent of the taxpayer who does not have any tax obligation.

The individual asset management regime applies if the taxpayer entrusts the management of his savings to an authorized intermediary. Under this regime capital gains are taxed even if they are not realized but only accrued. The schedular tax shall be paid at the end of the taxable period by the intermediary-withholding agent. It is possible to offset not only capital gains and capital losses, but also capital losses and capital income.

With regards to collective asset management by mutual funds, the rules have been recently modified[25] in order to tax capital gains only at the moment of the realization in the hands of the taxpayer and not when they have accrued in the hands of the mutual fund itself. This correction is due to a reverse-discrimination between resident mutual fund and non resident-harmonized mutual fund: the firsts were taxed on the accrued income, instead the latter on the realized income. But this modification created another discrimination between the individual and the collective asset management regime. In fact, whereas in case of collective asset management taxes are levied on the realized income, the individual asset management regime provides taxation with respect to accrued income. Some authors hope a restatement of the matter[26].

1.5 Estate income and financial income earned by individual entrepreneurs

Entrepreneurs-natural persons are subjected to different rules with regard to assets that could generate estate income and capital income or capital gains, if these assets are related to the business. Indeed, the business carried on has a force of attraction on all the other income categories, so that all the income is considered business income.

If an immovable property is an asset to which production or exchange of the business is directed or instrumental to the business itself, it is necessary to apply

[25] See Law Decree 138/2011, Art. 2, par. 28-34
[26] See G. Corasaniti, *Diritto tributario...*, quoted, p. 110

rules to calculate business income also to these assets. If the real estate is owned for others reasons, not related to the business, it is taxed with the ordinary rules.

With respect to financial asset, the partial exemption regime provided for relevant participations[27] shall apply to all the dividends and to capital gains (and losses) respecting the conditions provided by Art. 87 UBIT for the participation exemption regime[28]

1.6 Tax treatment of trusts

As art. 2 of the Hague convention on the law applicable to trusts and to their recognition explains, “the term "trust" refers to the legal relationships created - *inter vivos* or on death - by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose”.

Italy is a civil law system: for this reason, Italian law had some problems with regards to recognition of trust, as it is difficult to correctly qualify the trust deed and to admit that the trustee’s assets and the trust fund are separated with respect to liability towards creditor. However, according to case-law, we can say that trusts are generally recognized in Italy as a method to earmark a wealth to a particular aim or to particular persons.

Some problems about trust arose also with respect to tax matters. In fact, Art. 73 UBIT considers resident trusts as legal entities subjected to corporate income tax, but it is pointed out that if the beneficiaries are vested, income earned by trusts is attributed to beneficiaries themselves. Nevertheless, as the existence of the trust assumes a discretionary power of the trustee to attribute trust earnings to

[27] In this case the withholding taxes levied are creditable
[28] See paragraph 3.2.

beneficiaries, if the beneficiaries have an unconditional right to receive trust incomes we must notice that this is not a trust, but an agency. In this case trust does not exist, but tax law assumes its existence.

In case of attribution of trust income to the vested beneficiary, the income is qualified as a capital income according to Art. 44 UBIT.

1.7 Other taxes on capital assets

Italian law levies also other taxes on capital assets.

An inheritance tax[29] was re-introduced in 2006 after abolition in 2001. It is levied on the part of the inheritance acquired by any heir and legatee, with exemption up to a fixed amount[30] of inheritance value (we can say that this tax is substantially levied only on big wealth). An exemption is granted for participation granting the control of the vote majority in the general meeting of a resident company.

A local estate tax (IMU) was recently introduced in order to enforce the fiscal federalism (art. 119 Cost.), even if the debt crisis of 2011-12 brings the legislator to dispatch a big part of the revenues to the State. IMU is an *ad valorem* tax levied on dwellings, building areas and agrarian lands. The tax base is the cadastratal rent of the estate, multiplied for 160 and multiplied again for different coefficients depending on the kind of real estate. The tax rate is 0,4% for dwellings used by the owner as abitual abode, 0,76% for others real properties and they can be increased or decreased by Municipalities. This tax is strongly criticized as in our legal system there is a traditional aversion to immovable properties taxes. Some politicians now are promising to abolish IMU for dwellings used by the owner as

[29] See F. Tesauro, *Istituzioni*, quoted, p. 289
[30] 1 million € for spouses, ascendants and descendants and 100000 € for brothers and sisters

abitual abode[31], others political parties want to make this tax more progressive in order to limit the tax pressure on the lower class[32].

A wealth tax on financial asset is the stamp tax levied on the periodical communication to customers related to financial products, included bank and postal deposit. It must be considered a wealth tax on financial asset as it is levied for the fact that someone owns a financial product[33]. The tax is flat, and the tax rate is 0,1% for 2012 and 0,15% for 2013.

In Italy there is not a general wealth tax, even if some political parties and trade unions support its introduction with respect to the richest persons[34].

1.8 Duties of communication to tax authorities

The Italian tax system imposes several duties of communication to tax authorities, both on the intermediaries and the taxpayers.

We can say that in Italy the professional bank secret "died" in 1991, when Art. 18 of Law 413/1991 allowed tax inspectors to ask financial institution for all the data related to their affairs with costumers. So, in compliance with Art. 26 of the OECD Model Convention, the exchange of information is not limited by the fact that the information in point is held by a bank or another financial institution.

The last example of a very pervasive system of taxpayers control is the Art. 11 of Law Decree 201/2012, that established the duty of financial institutions to periodically communicate to the Tax registry all the data related to contracts and

[31] See the Freedom of Liberty Party Programme for 2013 Election, p. 13
[32] See E. Patta, *Liste pulite, dal Pd no a tre candidati*, in *Il Sole 24 Ore*, Jan. 19, 2012. The EU agreed with this view. See EU Commission Delegation in Italy, *Report about employment and social development*, Jan. 8, 2012, available at: http://ec.europa.eu/italia/attualita/primo_piano/aff_sociali/rapporto_occupazione_sviluppi_sociali_2012_it.htm
[33] See F. Tesauro, *Istituzioni..*, quoted, 304.
[34] See M. Monti, *Un'agenda per un impegno comune*, p.5; A. Trocino, *Il Piano Camusso cementa l'asse a sinistra*, in *Corriere della Sera*, Jan. 26, 2012

operations concluded with customers, including the amount of all the operations and the current accounts balances[35].

This new law gave arise to many problems: aside from the huge amount of data that concerns and the possible difficulties for tax authorities to manage all of them, it is debated if these data could be used to issue an assessment, as Italian law considers banking operations data presumptions adequate for an assessment. Even if the President of the Court of Auditors expressed his favourable opinion[36], the Italian literature and the Revenue Agency director[37] pointed that this data cannot be used to (automatically) issue an assessment, but only to find the taxpayers to control and, eventually, assess.

This new rule has to be seen as a new way to fight tax evasion, modifying the pre-existing approach, according to which financial inquiries could have been used only to issue an assessment, into a new method, based on the use of this information to arrange a list of deemed tax evaders[38].

Other communication duties are imposed to taxpayers who own capital assets abroad. We are going to talk about it in par. 2.8.

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[35] See M. V. Serranò, *L'articolo 11 del decreto "Salva Italia" e l'emersione degli imponibili attraverso le indagini finanziarie*, in *Boll. Trib* ,2012, 5, p. 327

[36] See Sezioni Riunite Corte dei Conti, *Allegato 1* to the *Audizione sul D.L. 201/2011*, p. 26

[37] See M. V. Serranò, *L'articolo 11*..., quoted, p. 331.

[38] See V. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *Diritto Tributario Internazionale*, Padova, 2012, p.372

Chapter 2

CROSS BORDER INVESTMENT INCOME

2.1. Immovable properties

We have a cross-border case of immovable income either with regard to income derived from real properties located in the Italy owned by non resident persons or with respect to incomes arisen by estates existing abroad owned by a resident.

As the Italian tax system is based on the principle of worldwide taxation for residents, all the income earned by them all over the world must be considered in the taxable base. Instead, according to Art. 23 UBIT, non resident persons are taxable only for the income having a source in the State.

Thus, residents who own a real estate abroad shall report the related income in the tax return in the category “other income”. The amount of income shall be determined according to the evaluation made by the foreign state. It is allowed the deduction of the foreign income tax from the Italian tax. If the immovable property is exempted in the State of source, in case of lease the taxable base is determined in the amount of 85% of the leasing rent, otherwise the taxpayer has not to report any income in Italy too. The rules on capital gains derived from real properties transfers applies also to foreign properties.

Non residents who own a real property in Italy are taxed in Italy on the base of the *locus rei sitae* attachment. They shall file a tax return and report the immovable property income, determined in compliance with Italian tax rules, in the correspondent category. Capital gains related to immovable properties are taxable at the same conditions of internal capital gains.

2.2. Dividends and interest deriving from a foreign source received by resident

With regard to dividends deriving from a non-relevant participation in a foreign company due to Italian resident, they shall not be included in the individual income taxable base. Art. 27, par. 4, President of Republic Decree 600/73, levies a withholding tax at 20%. The same rule applies also to remunerations of financial instruments similar to shares and profit sharing agreements. The withholding tax is applied by intermediaries involved in dividend collection; if there are no intermediaries involved, the shareholder has to report the dividend in his tax return and to pay a schedular tax of the same amount.

The taxable base of the withholding tax is the after tax income: in this way a partial relief to international double taxation is granted, as the law allows to deduct the foreign tax from the taxable base. In any case, it is possible to apply DTC more favourable.

If the foreign dividend derives from a relevant participation, it is included in the individual taxable base for 49,72%[39]. The law grants a tax credit for foreign taxes paid abroad by the percipient in the amount of 49,72% of the foreign tax.

Before 2006, Art. 44, par. 2, UBIT considered similar to shares the equity participation in non resident companies or entities ruled by Art. 73 UBIT in case the remuneration, if it had been paid by a non resident company, would not have been deductable for the company itself. This strictly “national” condition seemed to be discriminating for a resident percipient of a foreign remuneration (derived from a financial instrument) which would have been not deductible in the State of source but deductable in Italy. For this reason, Legislative Decree no. 247/2005 has modified this rule in the sense that a financial instrument is considered similar to shares if the related remuneration is completely undeductible for the issuer in

[39] However, the withholding tax shall apply but it is creditable

the State of source. The undeductibility shall result from a statement of the issuer itself or from others certain elements. With this correction the legislator finally equalized the treatment of financial instruments issued by a non resident and a resident company.[40] But this definition, linked to the possibility to deduct the amount of the remuneration and to the relevance given to the connection with company's profit[41], was thought not in compliance with the definition of "interest" provided by OECD Model and EU Savings Directive, according to which an interest is an income from debt-claims of every kind, whether or not carrying a right to participate in the debtor profit[42].

Dividends coming from resident in black listed States in which the resident shareholder has a relevant participation, are totally included in the taxable base[43], unless they have already been imputed to the shareholder according to art. 167-168 UBIT (C.F.C. provisions and similar) or the taxpayer has proved that this participation does not cause the localization of the related income in the tax haven. It is said that this rule is provided because there is no juridical double taxation, as these income are not actual taxed in the resident state of the company. However, this provision may result in contrast with the ECJ ruling in the *Cadbury Schweppes* case[44], which considered in compliance with the TFUE the exercise of the freedom of establishment in order to have tax advantages if the company is actually carrying on a business in the host state[45].

[40] See V. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale,* quoted, p 262
[41] According to Art. 45 UBIT, a financial instrument is considered similar to shares if its remuneration is utterly made up of participation in profit of the company itself, of a company belonging to the same group or an affair in relation to which the financial instrument was issued. See paragraph 2.1.
[42] V. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale,* quoted , p. 302
[43] The withholding tax applies, but it is creditable
[44] ECJ, Sept. 12, 2006, c-196-04.
[45] Ibidem, p. 271

With regard to interests perceived by a resident from a foreign bond, they are subjected to a schedular tax at 20%. If bonds are not deposited upon an intermediary, they shall be reported in the tax return and the taxpayer itself shall apply the schedular tax. But in this case no relief of international double taxation is granted, as the taxable base is computed on the before tax income: this provision could be considered as a restriction to the freedom of movement of capital[46].

2.3 C.F.C. provisions

As many States do, Italy provides for rules for the case of controlled companies resident in tax havens in order to avoid the localization of income in these countries to defer taxation for an indefinite period of time[47].

With regard to C.F.C., Italy based its regime on a look through approach. In fact, income of controlled companies resident in a tax haven (that is a black listed State), even if they have not been distributed, are imputed to the resident controlling subject, with a tax credit for taxes paid abroad. The income, as re-determined according to Italian rules, is computed in the resident's taxable base proportionally to the participation held in the foreign company. The same provision applies to participation in non resident entities with respect to income deriving from their permanent establishments in tax havens.

This provision shall not apply if the taxpayer proves that:

- the C.F.C. is effectively carrying on a business in the market of the State or territory where it is placed;

[46] See G. Corasaniti, *Diritto tributario...*, quoted, p. 342
[47] See V. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale*, quoted, p. 345

- The participation in the C.F.C. does not give arise to localization of its income in the tax haven. This condition exists if C.F.C. incomes are produced at 75% in State which are not tax havens. The Revenue Agency has stated[48] that this hypothesis is realized when the C.F.C. had produced foreign incomes through a permanent establishment in a State with an ordinary taxation system. If incomes are dividends from companies resident in a State with an ordinary taxation, as the source of these incomes is the capital owned by the C.F.C. this condition does not seem to occur. But a recent circular letter[49] by Revenue Agency itself reconsidered this position, stating that, even if the income of the C.F.C. shall be considered, in principle, produced in a tax haven, the fact that dividends distributed by the holding to the Italian resident actually derive from an income produced and taxed (in an ordinary way) in a white listed State shall be taken into account.

The possibility to not apply this provision is strictly connected with the European Union principle of freedom of establishment as stated in the *Cadbury Schweppes* case, which allows the tax advantages due to a foreign establishment if and only the controlled foreign companies are not wholly artificial arrangements intended to circumvent national law.

Law Decree no. 78/2009 has recently modified the C.F.C. system, introducing a presumption of C.F.C. which does not carry on a genuine commercial activity, if the 50% of the incomes of the C.F.C. derives from passive income and intercompany services. In this case it is necessary to prove also the lack of tax avoidance[50]. The quoted Law Decree has made a more relevant change in these

[48] See Revenue Agency, *Resolution* 18/E/2003
[49] See Revenue Agency, *Circular letter* 51/E/2010
[50] See Revenue Agency, *Circular letter* 51/E/2010, quoted

provisions, extending the application of C.F.C. rules to controlled companies resident in a State different from tax havens if:

1. the controlled companies are taxed in a lower amount than the 50% of tax that it would have paid if resident in Italy, and

2. income derives for more than an half from passive income and intercompany services.

In compliance with *Cadbury Schweppes*, the C.F.C. regime shall not apply if the taxpayer proves that the foreign establishment is not an artificial arrangement directed to an undeserved tax advantage.

It is debated if the C.F.C. rules are in compliance with Art. 7 of the OECD Model, as it allows to tax foreign incomes even if there is no permanent establishment abroad. This problem could be resolved considering that this rules can fit together, as the C.F.C. regime applies not to the taxation of the controlled company, but to the taxation of the controlling person, with no interference with art. 7[51].

A peculiarity of the Italian tax system is the rule provided for not controlled foreign companies resident in tax havens[52]. Art. 168 UBIT stated that a treatment similar to C.F.C. shall apply to foreign companies resident in tax havens participated for 10% in case of listed companies or for 20% in other cases. If these conditions are realized, the income to be taxed *pro quota* in the hand of the resident taxpayer, even if there was no dividend distribution, shall be calculated as the higher amount between the earnings resulting by the balance sheet of the foreign company or a lump-sum determined with respect to a supposed yield of the assets owned by the company itself.

[51] See V. Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale*, quoted, p. 353
[52] This rule does not apply to foreign companies not resident in tax havens

To conclude, we can note that in these cases there is no application of methods to avoid economic double taxation of foreign dividend, as these dividends are assumed not to be taxed in the State of source. Nevertheless, the freedom of establishment upheld by the Treaty on Functioning of the EU must be protected in any case: the chance provided to the taxpayer to prove the business effectively carried on in the foreign country is the realization of this principle.

2.4. Dividends and interests deriving from an internal source perceived by non resident

Art. 23 TUIR states the principle that capital income paid by:

1. the State;
2. the residents in the State;
3. the permanent establishments of a non resident enterprise

are considered produced in the State (and taxable in the State). With respect to dividends due by a resident company to an individual person resident in a foreign State, Art. 27, p. 3, President of Republic Decree 600/73 levies a withholding tax at 20%. In case of individual asset management, the dividend does not compose the management result but it is subjected to the withholding tax.

The non resident taxpayer has the right to refund up to 25% of the withholding tax if he proves that he had paid abroad a tax on the same dividend. To exercise this right it is necessary a certificate of the foreign tax authority attesting the tax payment. In case of more favourable DTC, it shall apply.

With regard to outbound interests, Art. 25, p. 5, President of Republic Decree no. 600/1970 ascertained a general clause levying a withholding tax at 20%.

Art. 23 UBIT exempted from territoriality (and from taxation) interests and other earnings deriving by bank and postal deposit and current account; other exemptions are provided for bonds issued by the State and others public administration, listed companies, public entities carrying on a business transformed in companies by statutory-law. This second exemption is limited, with respect to individuals, to persons resident in States which allows an adequate exchange of information.

With regard to other sources of income other exemptions are granted, at the condition that that the recipient is resident in a State allowing an adequate exchange of information, for:

1. income deriving from deposits and current accounts other than postal and bank ones;
2. perpetual rent and perpetual annual obligation;
3. payment due for guarantees;
4. incomes deriving from repurchase agreement on securities and currencies;
5. incomes deriving from securities lending.

2.5 Capital gains

With regard to capital gains derived from the sale of bonds, shares or similar securities issued by a non resident legal entity or parts of non resident partnerships or other entities, they are subjected at the same rules of internal capital gain.

Instead, according to Art. 23, p.1, letter f) UBIT, capital gains deriving from the transfer of relevant participation in resident companies shall be taxed in Italy.

This presumption does not apply to capital gains related to sales of non relevant participation in listed company. According to the Revenue Agency[53], this exclusion applies regardless of the place where the participation is.

An exemption is provided for all the capital gains (excluded those related to relevant participation), if the person who realizes the capital gain is resident in a State which allows an adequate exchange of information.

It is possible to apply DTC more favourable for the taxpayer.

2.6 Tax on foreign capital assets.

Art. 19 of Law Decree 201/2011 has introduced in the Italian tax system two new wealth taxes: the tax on foreign estates (IVIE) and the tax on financial asset held abroad[54].

IVIE is shaped on IMU, even if there are some significant differences. First and foremost, whereas IMU is levied on individuals, companies, trusts, non-commercial entities, etc., IVIE shall apply only on resident individuals that own an estate abroad, whichever use it is destined to. The taxable base is calculated on the estate cost resulting from bill of sale (lacking which it is calculated with regard to estate fair value). The tax rate is 0,4% in case of dwelling used as abitual abode by the owners and 0,76% for the other ones and a tax credit correspondent to foreign wealth taxed on the estate is granted in order to avoid international double taxation.

The tax levied on the value of financial assets held abroad is similar to the stamp tax on financial assets held in Italy. Also in this case the tax is levied only on

[53] See Revenue Agency, *Circular letter* no. 52/2004, par. 5.
[54] See M. Piazza, *Le nuove imposte patrimoniali su immobili e attività finanziarie detenuti all'estero,* in *Corr. Trib,* 2012, 1, p. 69.

resident individuals, not on companies or other entities. However, the main difference seems to be that for the purpose of the foreign tax, it shall be considered not only financial products and financial instruments, but all the financial assets, and these shall be taxed even if there is no communication to the customer[55].

2.7 Cross-border trusts

Features of trusts and plurality of persons involved make possible the fact that cross-border trusts are quite common in practicse.

As it was previously said, trusts are subjected to the corporate income tax; different rules are provided with regard to trust having vested or non vested beneficiaries.

In case of a resident trust having non resident vested beneficiaries, the imputed income shall be taxed in Italy as it was produced in the territory of the State according to art. Art. 23 UBIT[56]. With respect to non resident trusts, if there are no vested beneficiaries, they shall be taxed in Italy according to Art. 23 UBIT. However, some problems may be with regard to non resident trust having vested beneficiaries. According to art. 44, p. 1, letter *g-sexies)* UBIT, income imputed to the vested beneficiary of a trust, even if non resident, shall be taxed as capital income. The Revenue Agency affirmed that the phrase “even if non resident” shall be interpreted with regard to the trust and not to the beneficiary. The purpose of the rule is to consider taxable in Italy the resident vested beneficiary of the

[55] M. Piazza, *Le nuove imposte*... quoted , p. 71
[56] See V. Uckmar, G. Corasaniti, P. De’ Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale*, quoted, p. 376

trust.[57] Thus, in case of non resident trust, the income to be considered taxable in Italy shall be only that imputed to a vested beneficiary and that produced in Italy by the trust itself. It must be highlighted that the Revenue Agency[58] considers Art. 44, par. 1, letter *g-sexies)* UBIT applicable also to non resident trust having unvested beneficiaries, as in this manner the danger of international tax avoidance is prevented.

Furthermore, the Revenue Agency does not seem to consider non resident trust as entities subjected to C.F.C. regime[59], except extraordinary cases.

For the purpose of residence in Italy, trusts are considered resident in the State according to rules of the corporate income tax about residence[60]. However, with exclusive regard to trusts, two presumption of residence in Italy are established by Art. 73 UBIT. Hence, trust instituted[61] in tax havens are deemed to be resident in Italy if:

- at least one of the settlor or one of the beneficiary are resident in Italy;
- after the trust institution, a person resident in Italy attributes to the trust a right on an estate.

These presumptions were provided for the purpose to contrast tax avoidance and evasion. Even if the possibility of counterproof is established only for the first presumption, the Revenue Agency, in order to interpret the rule in compliance

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[57]See V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale*, quoted, p. 376; Revenue Agency, *Circular Letter* 61/E/2010.

[58] See Revenue Agency, *Circular letter* 61/E/2010, quoted

[59] See Revenue Agency, *Circular letter* 61/E/2010, quoted

[60] See V. Uckmar, G. Corasaniti, P. De' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale*,quoted, p. 377-379

[61] The word "instituted" was considered by the Revenue Agency (see *Circular letter* 48/E/2007) as referred to a "formal resident for tax matters". In order to have an explanation of the main problems due to this expression, see Ibidem, p. 379-380

with Constitution, considers this possibility to exist also with regard to the second one[62].

2.8 The so-called “fiscal monitoring”

As after Directive 1988/361/EEC all the limitation to currencies transfers were abolished, the controls concerning foreign assets owned by residents became necessary, in order to avoid international fiscal evasion. For this reason, Law Decree 167/90 provided specific duties of communications for individuals and intermediaries (all these duties and controls are called “fiscal monitoring”). More deeply, the latter, if they execute the transfer, shall:

1. keep evidence of all the data related to the person on behalf of or in favour of the transfer was done, the date, the reason of payment, the transferred amount and eventual destination accounts, connected to transfers of money of financial asset from o to foreign countries, if the amount of the transaction is more than 10000 €, if they executed it on behalf of or in favour of natural persons, non-commercial entities, civil and professional partnerships, resident in Italy; keep evident all data related to purchases and sales of securities effectuated by beneficiaries;
2. keep this evidence for 5 years at tax authority’s disposal;
3. communicate this evidence to tax authority.

With regard to individual, non-commercial entities, civil and professional partnerships resident in Italy, they shall complete and file a declaration, called the *RW* form, reporting:

[62] See *Circular letter* 48/E, quoted.

1. transfers of money and financial assets, from and to foreign countries, executed through a non resident, not through a resident intermediary, if the amount of the transfer is higher than 10000 €;

2. all the investments abroad and the financial assets through which may derive foreign incomes taxable in Italy in an amount higher than 10000 €;

3. transfers of foreign assets in an amount higher than 10000 €.

Furthermore, resident and not resident persons shall declare all the money and financial assets they transport from or to foreign countries in the amount of more than 10000 €.

Art. 6 provides for a sort of presumption of realization which I will explain in paragraph 3.1.

The intermediary duties of communication shall not apply in case of transfers related to individual asset administration and individual asset management regimes: in these cases the intermediary-withholding agent applies the tax, therefore there is no problem of tax avoidance.

With regard to communication duties of taxpayers, recently the Revenue Agency has interpreted the duty to report in the tax return all the investment abroad comprehensive of assets that cannot give arise to income taxable in Italy because of the concrete modality of using them[63]. According to this interpretation, i.e. not leased estates kept available to the owner in a State that does not tax them with regard to the income tax shall be reported in the *RW* form, even if these properties do not give arise to an income taxable in Italy in compliance with Art. 70, p. 2,

[63] See Revenue Agency, *Circular letters* 43/E and 45/E 2010; A. Tomassini, C. Benigni, *Le novità sugli obblighi di monitoraggio fiscale*, in *Corr. Trib*, 2009, 41, p. 3327-3328; N. Arquilla, *L'Agenzia delle Entrate illustra la disciplina del monitoraggio fiscale*, in *Corr. Trib*., 2010, 38, p. 3125

UBIT. Financial asset shall always be reported as they can always give arise to incomes taxable in Italy[64].

It is not necessary to report in the *RW* form, if related incomes are collected through an intermediary:

1. securities which management was entrusted to a resident intermediary;
2. contracts concluded through a resident intermediary;
3. deposits and current accounts.

According to the Italian Supreme Court, duties related to asset held abroad are imposed not only to the record owner and the beneficiary owner, but also to who has these assets available abroad and can transfer them, even if he does not own it but he has the fiduciary duty to transfer them to the beneficial owner[65].

Penalties are established in case of violation of law. It seems to be quite contradictory that many decrees[66] in the course of time on one hand provided tax amnesties, on the other hand increased penalties for the breaches of reporting duties established by Law Decree no. 167/1990. Penalties proportional to the amount not reported are provided by the law; it is also made provision for confiscation of assets in the amount of the "correspondent value". There is a debate with respect to which value has to be taken into account: a literal interpretation leads to the asset value, literature is more inclined to weaken this provision considering the word "value" referred to penalties[67].

A recent rule, in order to make the activity of tax inspectors more effective, established a presumption in case of breach of the duty to report. In fact, taxpayer

[64] See Revenue Agency, *Circular letter* 9/E 2002
[65] See Cass. 17051/2010
[66] See Law Decrees no. 350/2001 and no. 78/2009
[67] See V.Uckmar, G. Corasaniti, P. de' Capitani di Vimercate, C. Corrado Oliva, *Diritto tributario internazionale*, quoted, p.369

who does not report a financial asset held in a tax haven is deemed to make up these activities with not taxed incomes, except when differently proved[68].

The rules about fiscal monitoring aim at contrasting tax evasion: with collected data, tax inspectors can verify the foreign income source the taxpayer shall report and control the amount of the asset own by the taxpayer himself, in order, i.e., to use these data to found an assessment based on presumptions.

[68] See A. Tomassini, *Presunzione di imponibilità per attività e investimenti nei paradisi fiscali*, in *Corr. Trib*., 2009, 30, p.2443. This new provision was enacted in compliance with agreements between OECD States with regard to assets held in tax havens, even if the cited author does not agree with this interpretation, as it does not enforce exchange of information and tax authorities cooperation. The above-mentioned author criticised this new rule with respect to its open-endedness.

Chapter 3

LEGAL FICTIONS AND RECHARACTERIZATIONS OF INVESTMENT INCOME[69]

3.1 Legal fictions for capital income

The Italian tax system usually does not use legal fiction with regard to capital income. We can find only two examples of similar provisions.

With respect to cross-border situation, art. 6 D.L. 167/90, entitled “presumptive taxation” states that for all the individuals, non-commercial entities, civil and professional partnerships compelled to report financial assets held abroad, money and securities transferred or constituted abroad reported in the *RW* form, in case the related income are not reported in the tax return, are deemed to be profitable, except when differently proved, in the amount of the average discount tax in force in Italy during the taxable period, unless in the tax return it is specified that this income is going to be perceived in a following taxable period. The counterproof could be given by the taxpayer until 60 days from the delivery of an express request notified by the tax inspector office.

This presumption is established in order to force taxpayers to report in tax return income related to financial assets held abroad, as tax inspectors can find difficult to assess these incomes which are located beyond the territory of the State. The reason of this legal fiction could be precisely found in a facilitation to tax inspector’s activity, i.e., if there are no agreement with respect to exchange of information with the State in which the taxpayer held financial assets. The burden of proof is up to the taxpayer, as it is easier for him to exhibit document than for

[69] The Italian legal system does not levy an exit tax with regard to not realized capital gains of individuals other than entrepeneur.

tax inspector to conduct an inquire abroad: the Revenue Agency[70] has stated that the taxpayer shall obtain by foreign intermediaries documents or certificates attesting that these financial assets do not give arise to incomes o give arise to lesser interests than the average discount rate.

I actually think that this provision is clearly in compliance with Art. 1 of the First Protocol to the European Convention of Human Rights, protecting the right to use and enjoy one's property. As a matter of fact, even if we consider the second paragraph of this article (which established that the first paragraph shall not in any way impair the right of a State to enforce as it deems necessary to secure the payment of taxes) applicable to substantive tax law, the rule can be justified as it is possible to contradict the presumption and it is proportional to the result it wants to reach, not limiting too much the peaceful enjoyment of property.[71] I strongly believe that this provision is not in contrast with the principle of equality and the ability to pay code too, as the chance to counterproof gives to the taxpayer, who is supposed to easily get documents proving the income truly produce by his assets, the possibility to have not to pay for a never realized income.

Another presumption, not relating to cross-border situation, is ascertained by Art. 45, par. 2, UBIT, with respect to loaned capitals: interests are deemed to be paid when and in the amount stipulated in writing. If the timing is not stipulated in writing, interests are deemed to be perceived in the amount accrued during the taxable period. If the amount is not determined in writing, the interests are deemed to be perceived in an amount equal to the legal rate. This presumption is justified to invert the burden of proof with regard to situation in which it could be

[70] See Revenue Agency, *Circular letter 45/E/2010*
[71] See ECHR, Case of Gasus Dosier- und Fördertechnik GmbH v. The Nederlands, 1995, Appl. No. 15375/89; Case of Galeotti Ottieri della Ciaja v. Italy, 1999, Appl. No. 46757/99

difficult for tax inspectors to discover the real amount of interests received by a person, similarly to art 6 D.L. 197/1990. It is up to the taxpayer to preconstitute a written documentation. Also in this case no problems seems to be with regard to art. 1 of First Protocol, the principle of equality and the ability to pay code: the chance for the taxpayer to give the proof that he perceived interests in an amount different than the deemed one grants him that he would not be taxed on a merely fictional income but on the actual income; this rule seems to be proportional to the result it wants to reach, as the possibility of counterproof must be considered a sufficient guarantee for the recipient.

3.2 Anti-dividend washing provision

A sort of recharacterization of capital income is established by Art. 109 UBIT. Nevertheless, this could not be properly defined a recharacterization of income: actually this provision does not concern earnings but expenses. In fact it is devised to eliminate possible tax arbitrages due to different regimes applicable to participation held by entrepreneurs (companies, commercial partnerships, individual entrepreneurs).

As aforesaid capital gains realized from transfer of participation, if some conditions occur (a minimum holding period of twelve months of the participation; the classification as fixed asset in the first year the participation entered into balance sheet; the participated company shall not be resident in a black listed State; the participated company shall carry on effectively a commercial activity; these two latter conditions shall have existed for three years before the realization), are partially exempted from taxation. With respect to individual entrepreneurs, this exemption is fixed on 50,28%. Symmetrically to capital gains exemption, capital losses (with respect to exempted participation) are relevant for the individual entrepreneur income tax in the amount of 49,72% of their value. Otherwise, if no one of these conditions occurs, capital gains and capital losses generated by this participation are totally included in the taxable base. On the other hand, dividends are (partially) exempted if they derives from a company resident in a white listed State.

Therefore, these different rules can be exploited in order to obtain tax advantages. We can suppose the following situation: an entrepreneur sells his participation benefiting from the partial exemption regime, before that dividend is paid out. The purchaser receives the dividend and, evidently, the participation value decreases in the amount of the paid-out dividend, but the value recognized for tax purposes is the same. Thus, the purchaser resells the participation, realizing a capital loss completely deductible.

For the purpose to avoid such tax arbitrages, Art. 109, p. 3-bis UBIT established a limit of deductibility with regard to capital losses related to shares and financial instruments similar to shares[72], not respecting the condition provided by Art. 87 UBIT for the participation exemption regime: these capital losses are not relevant up to the non taxable amount of dividend paid out during the previously 36 months. The par. 3-ter of the same article restricts the application area of the above-mentioned rule to shares and financial assets similar to shares purchases during the 36 months before realization, if the conditions established by art. 87, co. 1, *c)* and *d)* occurs (the participated company shall not be resident in a black listed State; the participated company shall carry on effectively a business; these conditions shall have existed for three years before the realization).

[72] As in our domestic system the business income rules define capital losses only the losses related to fixed asset, it is specifically provided that losses derived from the realization of shares and financial instrument similar to shares other than fixed assets are assimilated to capital losses coming from fixed assets.

This rule gives arise to some interpretative problems, as it does not seem to regard only the above-mentioned tax arbitrage. Indeed, according to this rule, no consideration should be given to the previous participation sale: the fact that the seller benefited from participation exemption regime is not relevant for this rule to apply. However, it was said, according to the *ratio* of this provision, that it is impossible to not consider the position of the seller[73]. This consideration leads to the necessity to evaluate the awareness of the purchaser with regard to the occurrence of these conditions for the seller. Especially with respect to operations in the Stock Exchange, it could be very difficult, or even impossible, for the purchaser to be aware of the identity of the seller and of the existence of necessary elements in order to apply the participation exemption regime[74]. Nevertheless, as we are going to see later, it is possible to ask the tax authority for an exemption from the application of this rule: the taxpayer, in this case, would be able to activate this proceeding.

As par. 3-quater, referring to Art. 37-bis President of Republic Decree no. 600/73[75], gives to the taxpayer the chance to prove that tax avoidance in the particular case does not occur, it is possible to obtain a non-application of this rule. The ruling proceeding to get a dispensation from the anti-avoidance rule[76] could be an obstacle for enterprises doing similar operations in large amounts, as financial markets requires very quick actions which this administrative proceeding could not allow because of its duration[77]. However, with regard to the fundamental freedom of movement of capital protected by the TFEU, a restriction

[73] See Assonime, *Circular letter 13/2006*, p.35-37. The proposed interpretation is supported also by literal reasons, as the 3-ter refers to the so-called "objective" condition for the participation exemption regime (*c)* and *d)*). The fact that the above-mentioned conditions occurs seems to presume the application of the participation exemption regime to the transferrer.
[74] See Assonime, *Circular letter 13/2006*, quoted, p.41
[75] That is the general anti-avoidance provision with regard to income tax.
[76] Art. 37, par. 8 establishes a ruling involving the taxpayer and the regional directory of Revenue Agency, with fixed deadlines and terms.
[77] See Assonime, *Circular letter 13/2006*, p. 40

does not appear to be, as this provision applies both in domestic and cross border cases.

Anyway, the reference to art 37-bis cited preserves the power of tax inspector to consider operation to which it cannot applies art. 109, co. 3-bis cited as done for the only reason to have a tax advantage, circumventing the law: in this case the tax advantage could be denied. The burden of proof is up to the tax authority[78].

[78] See Assonime, Circular letter 13/2006, p. 50

Chapter 4

INVESTMENT INCOME, MOBILITY OF CAPITAL AND ABILITY TO PAY CODE

4.1 Taxation of capital income and ability to pay code.

According to Art. 53 Cost, everybody has the duty to contribute to public expenses in function of his ability to pay. The second comma of this article states that the tax system is shaped on progressive criteria.

Therefore, in compliance with Constitution, all the taxes have not to be progressive: what it has to be progressive is the tax system as a whole. The second comma allows the legislator to provide flat taxes; however this flat taxes must not modify our tax system so that to make it proportional or unbalanced.

Nevertheless, the plenty of flat taxes levied on capital incomes (like schedular taxes on estate leases, withholding and schedular taxes on dividends, interests and capital gains) are not in compliance with the Constitution: in Italy the progressive taxation survives only for employment and business income, as quite all capital incomes are not included in the income taxable base, but subjected to alternative, flat forms of taxation[79]. The strange paradox is that capital incomes are earned by persons who have already accumulate a stock of wealth: thus, there is no doubt that they start from a better starting point than who has no wealth and has to work in order to earn what it is necessary for his life.

This situation brings us to the problem of the different taxation it should be between unearned and earned income: as the latter arises from an effort of the

[79] See G. Falsitta, *Manuale di diritto tributario...*, quoted, p. 53-55; F. Gallo, *L'uguaglianza tributaria*, Napoli, 2012, p. 31-32

person who produces it, it should be taxed less heavily than the first, which does not require any activity to accrue.

The problems is increased because of a huge tax evasion, especially with regard to self employment and business income and (foreign) capital income itself[80]. From this phenomenon it follows that the tax pressure is on the shoulder of employers, retirees and honest self-employers and entrepreneurs who pay properly the due amount of tax. It is clear that a similar situation seems to be unacceptable for persons who actual pay taxes, as the system is build in a way to disadvantage a specific class of citizens, especially the poorest one, in respect to the riches. The economic crisis has made these circumstances worst.

In some cases the legislator provides incentive to evade with tax amnesties, which had brought more damages in term of inequality intensification than revenues for the State itself.[81]

All these facts and these imbalances derives from a large amount of problems, however a contribute to them is given by an attitude widespread among the people and a part of ruling class, who look at the relationship established between the State and the citizens through taxation as a limit to fundamental rights of the citizen himself, especially the right of property[82]. We cannot say that this approach is completely unjustified, as the honest taxpayer in Italy is oppressed by taxation and services offered by the State are not satisfactory[83]. What I am saying is that the roots of the current situation in my country stay in the way of thinking of the average man, who looks at the State as a robber of his possessions.

[80] See M. Mobili, *Le nuove rotte dell'evasione fiscale*, in *Il Sole 24 Ore*, Jan. 25, 2012. This article contains a report of the discovered tax evasion in 2012, according to which 17 billion € hidden to tax authorities was assessed by tax inspector last year.

[81] See F. Gallo, *L'uguaglianza tributaria*, quoted, p. 34

[82] See F. Gallo, *Le ragioni del fisco*, Bologna 2007, p. 38-41

[83] See G. Falsitta, *L'imposta confiscatoria*, in *Riv. Dir. Trib*., 2008, 2, p. 89. *Contra* F. Gallo, *Le ragioni del fisco*, quoted, p.61- 79; Idem, *L'uguaglianza tributaria*, quoted, p. 36-38: taxes are not justified by benefit given in exchange by the State, but by the citizen's membership in the State itself

These two views are mirrored, in juridical terms, in two different conception of the ability to pay principle itself. Who accentuates the solidarity among citizens expresses in the formula "contribute to public expenses"[84] interprets the ability to pay code as a way to divide the public expenses among citizens, according to the rule of reason codified by a well-established case-law of our Constitutional Court; otherwise, who is more focused on the protection of the (supposed) fundamental right of property[85], states that the ability to pay principle express a limit to the legislator, as the law cannot take away from the citizen what he has earned with is efforts and his investment unless the ability to pay is actual and effective.

The two views expressed by the cited authors are both commendable, as the first justifies the taxation because of public expenses, in order to redistribute wealth among the citizens through the Welfare State principle, whereas the latter defends taxpayer from the State, providing protection against taxes which seems to be confiscatory[86].

What I criticize of the second view is that the State is actually seen as an absolute sovereign which contrasts the individual's rights. It is true that the foundations of moderns Constitutions is to protect minority and individual rights[87], but I do not think that the right of property can be considered fundamental in a legal system such as the Italian one, that first of all defends individual liberty and dignity. This line of interpretation seems to be followed by our Constitutional Court, according to which the rules about expropriation (regulated by art. 42 Cost) are not relevant

[84] See F. Gallo, *Le ragioni del fisco*, quoted, p. 81-101, A. Fedele, *Dovere tributario e garanzia dell'iniziativa economica e della proprietà nella Costituzione italiana*, in *Riv. Dir. Trib*.,1999, 1, p. 987.
[85] See G. Falsitta, *L'imposta confiscatoria*, quoted; Idem, *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l'intero reddito del contribuente*, in *Riv. Dir. Trib*, 2010, 2, p. 139
[86] I.e. Irap, a tax that shall be paid also by enterprise at a loss
[87] See G. Falsitta, *L'imposta confiscatoria*, quoted; Idem, *I divergenti*..., quoted.

in case of taxes[88]. The rule of reason can work well also with respect to confiscatory taxes, as they seems to be unreasonable[89]. The strict relationship between taxes and public expenses allowed the Constitutional court saving taxes considering the relevant consequences that their abolition could have cause to the Welfare system.

Coming back to inequality, interpreting the ability to pay code as a way to divide the contribution to public expenses bring us to the conclusion that our system is not in compliance with Art. 53 Cost. However, also the interpretation of Art. 53 in term of legislator's power limitation seems to be sufficient to recognize this contrast, as there is no doubt that the most part of taxes is paid not by who has the most ability to pay.

The resolution of this problem could be found in restoration of progressive taxation in our system[90]. According to Warren Buffett, the third richest man of the whole world, it is the principle of justice that impose progressivity[91]: the tax burden shall increase more than the income increase itself. In this way our welfare system could be restored and work well as a method to redistribute wealth among the people. Especially in a moment like this, when the debt crisis requires a well-done public-spending review[92], it is important that who has more pay more.

I do not mean that the Italian public expenses work well, as is it universally known that corruption and bribery steal, according to a Court of Auditors report[93],

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[88] See Corte Cost., 21/1996 (stating the principle that the legislator has the duty to balance the financial necessity of the State with those of the citizenzs) and 111/1997. G. Falsitta (see *L'imposta confiscatoria*, quoted; *I divergenti...*, quoted) pointed out that this case-law seems to be in contradiction with the ECHR case-law with regard to the right of property and the European bill of fundamental right approved in Nice.

[89] See F. Gallo, *Le ragioni del fisco*, quoted, p. 106-108

[90] See F. Gallo, *L'uguaglianza tributaria*, quoted, p. 29

[91] See W. Buffett, *Stop coddling the super-rich*, *The New York Times*, Aug. 14, 2011

[92] According to the new art. 81 of the Constitution, the State shall ensure the balance between inflow and outflow. This rule was enacted to comply with the Fiscal Compact Treaty. See D. Morgante, *La costituzionalizzazione del pareggio di bilancio*, in *Federalismi.it*, 2012

[93] See Sezioni unite della Corte dei Conti, 2012 Judicial Year Inauguration , writter report of the General Prosecutor Mr. Lodovico Pricipato, 101-102

60 billions € of State revenues and, more generally, that our public system is not efficient. Otherwise, the concept to redistribute wealth among citizen, helping the poorest in order to give them the chance to become richer, is codified in our Constitution. Art. 3, co. 2 says: "The Republic shall remove economic and juridical obstacles that, limiting *de facto* liberty and equality of citizens, do not consent the development of the human person and the effective participation of all the workers to the political, economical and social organization of the Country".

This opinion is now spreading around the world: i.e., France has introduced an extraordinary tax rate at 75% on income bracket beyond 1 million € but the French Constitutional Council on December 30 it has declared this tax not in compliance with Constitution, even if it pointed out that it is due to the fact that the tax is calculated with regards to individuals and not to families (as the French tax system generally determines taxation) not examining challenges alleging the confiscatory nature of this tax[94].

The U.S. case is meaningful, as the U.S. system is well-known as more focused on individual's liberty than on Welfare State and equality. The U.S. congress, in order to avoid the so-called Fiscal cliff[95], approved during the first days of the year an increase of income tax rate from 35 to 39,6% for individual taxpayers earning more than 400000 $ and for families earning more than 450000 $, an increase of inheritance tax rate from 35% to 40% for inheritance valuable more than 5 millions $ and an increase of capital gain tax rate from 15% to 20% for

[94] See Constitutional Council, Decision no. 2012-662 DC, Dec. 29, 2012; H. Carnegy, *Tax rejection creates political problems for Hollande; Council ruling*, in *Financial Times (London Edition)*, Dec. 31, 2012; Attilio Geroni, *Bocciata la supertassa al 75%*, in *Il Sole 24 Ore*, Dec. 30, 2012.

[95] Which was the name given by Mr. Bernanke, President of the U.S. Federal Reserve, to a mix of spendig cuts and tax increases that would have become effective from January 1 if the U.S. Congress had not reached an agreement for a budget law.

who earns more than 450000 $, [96], according to what literature hoped for[97], and similar to Buffett proposal[98].

I do think that similar changes shall be made in Italian law. To restore progressivity, it is important:

- to make the income tax base wider, included capital income which now are taxable by flat taxes;
- to fight tax evasion, which distort the correct allocation of tax burden;
- to contrast international tax evasion and avoidance.

In my opinion, proposals to change our tax systems shifting taxation from direct taxes to indirect taxes and intensifying deduction from the taxable base of the lower class[99] is not correct, as it is well-known that indirect taxes are regressive instead of progressive. What we actually need is to restore progressivity, as our Constitution requires. In order to do that capital income shall be taxed progressively and taxation shall be shifted from labour and business to capital.

Now we are ready to explain how cross-border taxation of capital income could be considered relevant for our purposes

4.2 Cross border taxation of capital income and enforcement of the ability to pay code.

Capital is the more movable input of enterprise. After the end of Bretton Woods system, capital is totally free to go and to be allocated in places where yields are more convenient. This was a great conquest for humanity development, as the

[96] See M.Platero, M.Valsania, *Fiscal cliff, mini-intesa al Senato*, in *Il Sole 24 Ore*, Jan. 2, 2013; Idem, *Usa, intesa sulle tasse, rinvio sui tagli*, in *Il Sole 24 Ore*, Jan 3, 2013.

[97] See S.C. Thompson jr., *Beyond the Buffet Rule: making the income tax more progressive, Tax Notes,* Nov. 7,2011, p.705

[98] See W. Buffett, *Stop coddling the super-rich,* quoted.

[99] That is, i.e., the proposal of the People of Freedom Party (centre-right) reported in the programme for 2013 elections.

enormous flux of capital in developing countries permitted them to achieve progression and wealth. But at the same time the freedom of movement of capital give arise to an harmful tax competition between the States, trying to attract foreign capitals through incentives or tax benefits. The development of tax havens could be seen as an element of this competition: some States allows capital to flow in promising silence and a low level of taxation.

To restore equity and justice in taxation, one of the most important thing is to defeat harmful tax competition. In fact, the fear of capital flight brings the States to tax capital income less than labour income, as labour is sure less movable than capital[100]. All the consequences of this harmful tax competition are those I have written before: inequity and inequality, enormous tax pressure on labour and enterprises, inattention to the ability to pay code, breaches of the Welfare State principle.

The exchange of information could be the key-factor in this battle[101]. I.e., international agreements with respect to exchange of information similar to FATCA could be the best way to fight international tax evasion. Hence, I do no actually believe that agreements inspired to the Rubik model are effective as the FATCA. The Rubik model seems to be a compromise with tax havens and tax evaders. Actually, automatic exchange of information could be seen as one of the most effective weapon against harmful tax competition and international tax evasion.

The EU is moving on this direction. On March 5, 2012 the European Commissioner for taxation asked the Member State to refrain from bilateral agreement with respect to taxation of asset held upon Swiss banks by their

[100] See P. Boria, *Diritto Tributario Europeo*, Milano, 2010, 243-244; F. Gallo, *L'uguaglianza tributaria*, quoted, p. 30-32.

[101] See F. Gallo, *L'uguaglianza tributaria*, quoted, p. 33

residents, in order to give an European solution to this problem[102]. Recently the Commissioner threatened Switzerland to be included in the black list if it would not allow an automatic exchange of information with regards to assets held there by non resident persons[103]. Also Cayman Islands[104] are going to ensure more disclosure, as States and institutional investors are pressing for more information.

Waiting for an automatic exchange of information, it could be desirable an harmonization of capital income taxation by EU[105]. In this manner the harmful tax competition with regard to capital income could be defeated, at least at EU level. The problems of a similar provision is the piecemeal approach of EU with respect to direct taxes harmonization[106]. However, the endorsement of the Code of conduct against the harmful tax competition could be seen as a first step to this direction.

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[102] See M. Bellinazzo, *Bruxelles: stop agli accordi bilaterali con la Svizzera*, in *Il Sole 24 Ore*, Mar. 5, 2012
[103] See Idem, *Bruxelles: se non cambia Berna nella lista nera*, in *Il Sole 24 Ore*, Jan. 19, 2013
[104] See S. Jones, *Caymans poised to shed veil of secrecy*, in *Financial Times (London edition)*, Jan. 18, 2013
[105] See F. Gallo, *L'uguaglianza tributaria*, quoted, p. 33.
[106] See G. Melis, *Coordinamento fiscale nell'Unione Europea*, in *Enciclopedia del Diritto*, Milano, 2007

CONCLUSION

As I try to demonstrate in this short essay, taxation of capital income in Italy seems to be unequal. Incomes from estates, dividends, interest, capital gains are often taxed less than other income. In this situation the mobility of capital is the key-factor that brings the legislator to give these tax benefits to capital income. The best manner to fight this lack of equality is to have an international approach: automatic exchange of information and harmonization of tax on capital could be the best way to restore the ability to pay code and to see that who can pay more actually pays more.

FEDERICO FRANCONI

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PENSIONS

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CHAPTER I: BASIC PUBLIC PENSION

PART 1: NATIONAL ASPECTS

1. Social security, pension and Constitution

Social security is a basic principle of Italian juridical system. It was born in the late eighteenth century as a form of private mutual assistance, but, with the introduction of the Constitution in 1948, it gained a new and revolutionary meaning.

After the introduction of Constitution it acquired a new dignity that led to abandon the theory that had reconstructed it as a form of private insurance.

Constitution in fact established a new set of principles, raising the values of solidarity and social rights. Social security can not be anymore a private interest, but the State is demanded for ensuring the freedom from needs, as a fundamental step to let citizens exercise their civil and political rights and to let them have adequate means for their needs.

The duty of solidarity between citizens [1] authorizes the State to collect contributions[2] from them, in order to finance the system.

In fact art 3[3] second paragraph of our constitution expresses the principle of effective equality that obliges the state to eliminate and prevent all the economic

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[1] Art. 2 Const.:
The Republic recognises and guarantees the inviolable rights of the person, both as an individual and in the social groups where human personality is expressed. The Republic expects that the fundamental duties of political, economic and social solidarity be fulfilled.

[2] Art. 53 Const.:
Every person shall contribute to public expenditure in accordance with their capability. The tax system shall be progressive.

[3] Art. 3 Const.:
All citizens have equal social dignity and are equal before the law, without distinction of sex, race, language, religion, political opinion, personal and social conditions. It is the duty of the Republic to remove those obstacles of an economic or social nature which constrain the freedom and equality of citizens, thereby impeding the full development of the human person and the effective participation of all workers in the political, economic and social organisation of the country.

and social obstacles to equality and freedom of citizens.

Social security has become a public duty of the State that lives with the state's supply of goods and services to the citizens that need it. The new approach includes, in social security, both the social assistance and the national insurance and leads to abandon the concept of private insurance: the benefits are not payments in view of the previous contributions paid, but are social rights of citizens.

Art 38[4] Const. is the fundamental basis for the social security's system.

In the first paragraph the necessity of social assistance can be found as long as it entitles citizens to the social support and assistance to the extent to which they are without means and unemployable.

Pensions are another expression of social security system and because of this a basic public pension system has been created on the base of Article 38 of our constitution.

In fact the second paragraph recognizes the right for workers to have adequate instruments to pursuit their life needs in case of specific events occurring during their lives. This list is not deemed to prevent the introduction of other significant events, but only from some of them the right to pension arises, specifically, from the disability and the old age. From the other events arise other kind of social securities measures.

Despite the article entitles citizens to have adequate means for their needs and necessity, the new approach, before explained, identify both the aim and the limit of public pension system in guaranteeing worker's basic needs and burdening the voluntary contribution of the task of satisfying adequate means. Adequate means, to retain after the event the previous lifestyle, are private interests and therefore have to be pursuit, by choice of each one, with supplementary contribution.

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[4] Art. 38 Const.:
Every citizen unable to work and without the necessary means of subsistence is entitled to welfare support.
Workers have the right to be assured adequate means for their needs and necessities in the case of accidents, illness, disability, old age and involuntary unemployment.
Disabled and handicapped persons are entitled to receive education and vocational training.
Responsibilities under this article are entrusted to entities and institutions established by or supported by the State.
Private-sector assistance may be freely provided.

1.1 Institutions involved

According to art 38 paragraph 4 Const., the State must guarantee the social security system, and this duty can be performed in three ways: directly or throughout operating entities or private operators that act oversighted by the state itself.

The choice made by the law-maker has been of discharging this task through both public and private entities that are called in from the law to apply the public pension system.

It must be said, and always bear in mind, that the management and, in general, all the framework is largely unalike for employees and self-employment people, even if both of them are included in the mandatory pension system[5].

In fact, while the self-employed special system is managed by specific private entities that run the pension mechanism accordingly to the peculiarities of jobs or working sectors, the employees' system is managed by public entities.

The last pension reform tried to unify the operators involved in employment sector, so, from 2012, the public bodies operating in the sector have been reduced thanks to the abolition of certain bodies and the consequent attribution of their tasks to the INPS[6] -National Social Security Agency-.

2 Beneficiaries and risks covered

Current regulation of pension system can be found in law 335/1995 (hereinafter Dini reform), that signed the transition from a earnings-based to a contribution-based system. This law develops a pay as you go system, covering old-age, disability and survivorship risks for all employed people.

This law applies to all people having a job income and, in case of death, to the

[5] R. Pessi, *Lezioni di diritto del lavoro*, Torino, 2012, p. 413 Generally when the worker moves from one system to another, the law recognizes the right to sum the different contribution system in order to let the person obtain the fulfillment of the minimum requirements, even if the collection is admitted upon payment.

[6] Until 2012 INPS was the commissioned body for workers in the private sector, whereas INPDAP was the body managing the public employment, and the ENPAL the sports and art's workers). INPS is even empowered to manage the system of 4 categories of self-employed workers.

family's survivors of the dead worker.
In this system the contribution is seen as made of two different components, the first one identified in a form of savings to be used in the old age, and the second one identified in a form of insurance in cases of disability and death: in fact pension is an income seen as a substitution of the previous income of the worker, that is no more able to product it.
By the way, when the risk occurs, the access to the protection is submitted to requirements of contribution and insurance.

2.1 Disability and survivorship risks

In the disability pension the risk covered is the reduction (when it is more than 1/3) or the permanent loss of working ability caused by a physical or mental problem[7].
To access this kind of pension the worker must have reached at least five years of contributions, three of which have to be in the five years preceding the event.
In case of death, pension is due to worker's family members dependents on him.
Art. 22 law 903/1965 provides the order by which family members acquire the right[8], spouse and sons if any, parents if any, unmarried brothers and sisters.
In cases of divorce and separation there are some limitations.
Sons gain the right if they satisfy three alternative conditions: they are younger than 18 years, alternatively they must be university students between 18 and 26 years old, or they must be disables.
Parents can obtain the pension only in absence of spouse and sons and only in case they were dependent on the worker and they do not receive other kinds of pension.
Brothers and sisters acquire the right only when the previous listed beneficiaries are missing and under the condition of being unmarried (even if because of

[7] The body paying the benefits is empowered of controlling the effectiveness and the measure of the reduction and loss and to exercise the power of revoking/suspending or modifying the payment of pension.
The reduction of capability gives right to a check of disability for 3 years, renewable for the same period, whereas the permanent loss of capability gives right to a pension of inability.
[8] M. Cinelli, *Diritto della previdenza sociale*, Torino, 2010, p. 586 the dependents acquire the right *iure proprio* and not *iure successionis*

divorce or because of spouse’s death).

When the worker dead was already a retiree the pension is called *revertible pension,* otherwise it is an *indirect pension*.

2.2 Old age risk

During the last years the system concerning with the old age pension has often been modified, and the last reform was in 2012.

The first big change was made in 1995 by the Dini reform that introduced two different sets of rules.

According to the first one, regarding workers with more than 18 years of contribution at that time, the system applied would have been the earning-based one even for the pension accrued after 1995. Despite this provision, D.lgs. 214/2011 changed the system applicable to these people: starting from 2012 even to these workers will be applied the contribution-based system, but only for the right to pension accrued since 2012, in fact for the right to pension accrued till 2012 the pension will be calculated using the earning-based system.

The second one, applied to insured who had less than eighteen years of contribution when the law was issued, statutes that those workers have to be subjected to a pro-rata system according to which pension has to be calculated with both of the systems, depending on whether or not it accrued before 1995.

Current regulation, as prescribed by 2011 reform, replaced the two different kinds of pension - the old age and the seniority pensions- with a new one, the old-age pension that is due when a worker satisfied a double requirement: at least 20 years of contribution plus a minimum age that has to be, by the beginning of 2018, 66 years old and, by 2021, 67 regardless of differences between men and women and public and private sectors. This minimum age will be automatically increased according to the life expectancy statistics. Presently the age request is 66 for men and 62 for women.

By the way, the last reform admits workers to claim an advanced pension irrespective of the worker's age when they have 42 years and 1 month of contribution for men and 41 years and one month for women. The access to this second kind of pension has been discouraged by the reform with a reduction of the pension in the measure of 1% for each year of anticipation into the first two years of anticipation, and in the measure of 2% in the rest.

3. Financial resources

The adoption of a pay as you go system, where the contributions of active members of society are used to pay benefits to retirees rather than invested to be used from the same individuals in the near/immediate future, has always caused financial problems. The lack of liquidity, the economic crisis, the impoverishment of the entities managing the system, have been the inspiration of all reforms that marked the history of our system.

For example the Dini reform, whose scope was to remedy to the financial problems caused by the earning-based system in which the benefits due to the retirees were calculated on the basis of last years earnings, generally the highest of the hole working life.

Even the regulation and the fiscal advantages connected to the supplementary pension should be consider index that law-maker noticed the failure of the pension financing system, a system that can hardly guarantee only the basic needs, whereas the retention of the lifestyle- led during the working life- has to be supported by eventual voluntary pensions.

As last the 2011 reform, through which the age of retirement has been raised, shows how the growth of life expectancy hurts the financing system that has to pay benefits longer and longer to inactive members of society.

The entire financing system will surely be modified again during the next years and this is a symptom of the crisis of this burdensome system.

Right now the pensions are financed both by public payments and by insured persons' contributions.

The State ordinarily earmarks funds taken from its balance/budget and exceptionally provides loans when there are insufficient funds to cover total pensions due.

Notwithstanding this public participation to the financing system, the real financial resources are originated from workers’ compulsory contributions.

3.1 Contributions

The nature of the obligation to pay contributes to the system has been argued for a long time. This doctrinal dispute led to abandon many theories for example the one that included contribution in the range of insurance premiums. This theory has been rejected because is conflicting with some financing devices adopted by the state, like solidarity contribution imposed on pension funds to the public pension system, by which the subjects that pay contribution are different from the beneficiaries.

The most qualified theory is the one that says that contributions are taxes.

The contribution is a binding obligation that generally is fulfilled through a partial dissociation between the passive subject of the obligation that will be the beneficiary of the future pension and the one that is effectively burdened with the payment; in fact, actually, in the employment sector, the higher amount of contribution is paid by the employer[9], who withholds at source even the sum due from the employee. Self-employed individuals generally contribute autonomously or through the client.

The social security system, in fact, involves a plurality of subjects[10] in the same obligation each of which has a defined role in the realization of social security’s aims. In the employment sector the participation of two different subjects in the fulfillment of the obligation, whose active subject is the social security entity, is the consequence of the historical evolution of the system. At the origin of the system, in fact, an “embryo” of the solidarity that right now involves all the citizens, was realized with the obligation of the employer to pay the insurance in favor of his employees. This was the consequence of the necessity of the employer to front the “professional risk”, in other words to contribute, with his

[9] Art. 2115 cod. civ. If the law does not provide differentely, the employer and the employee contribute equally to social security system. Italian version: Se la legge non dispone diversamente, l’imprenditore e il prestatore di lavoro contribuiscono in parti uguali alle istituzioni di previdenza ed assistenza.

[10] G. Melis, *Sulla incostituzionalità del “contributo” a favore dell’Enpam di cui all’art.1, comma 39, della L. n .243 del 2004,* in *Rass. Trib.,* 2006, p. 59

own finances, to the future and eventual necessity that were connected with risks that the employee could face during the working activity. Since that moment, the solidarity between the employer and the employee has been influenced by the progressive abandon of the principle of “equally contribution” that was introduced in 1942 with the Civil Code. In fact, right now, the great part of the contribution burdens on the employer who also acts as withholder agent for the part of contribution that burdens on the employee.
The evolution of the system shows how, even in the self-employment sector, subjects involved into the “retirement scheme” are increasing. Self-employed individuals contributed autonomously, but right now third subjects that enter in a “working relationship” with them can be burdened by the contribution in favor of the self-employed. This is the case, for example, of some kinds of professions, as the lawyer, that on each fee have to calculate an additional amount, paying it as a contribution. The self-employed will be then able to recover it from the client. The limit that must always be observed is the necessary working relation that has to exist between the third subject and the beneficiary of protection or, otherwise, it is necessary that the third subject is using the public service that the beneficiary is contributing to provide.

3.1.2 How to determine the contribution

The amount of contribution due is determined by the application of rates to the personal income. Different rates are arranged by law on the basis of difference of the activities of the enterprise, of the commodities sector, of the number of employee or on the categories of employees. Whereas for self-employed the contribution is 19% of income resulting from the tax assessment, the rate that applies to employees is 32% of their incomes.
The income includes every kind of benefits received by the employer, both money and fringe benefits when related to the employment relationship. The law peremptorily lists the benefits excluded. It is essential to highlight that the rate applies to the retribution due rather than to the one effectively paid to the employee, when this last is lower than the other.

The law provides even minimum and maximum contributions, with different thresholds for employees and self-employed individuals.

The minimum contribution to pay is based on amount of incomes fixed by laws, regulations or collective agreements stipulated by trade unions. But when this salary is lower than the one due upon collective or individual agreements, it is this last that will be the starting point to calculate contributions.

The safeguard arranged by the lawmaker is addressed even to employers who have not joined the trade union regulations.

The maximal income to which applies the rate is fixed only for individuals that started working after 1995 and it is of 68.172,31 euro, amount subjected to revaluation.

Since 1997[11] the lawmaker statutes the equivalence between base amount to calculate contributions and taxable employment income, some differences still remains[12]. The new art. 12 law 153/1969 says that, to calculate social security contributions due, the basis is the one fixed by art. 49 Tuir, that defines the notion of income from employment for fiscal purposes. The equivalence is, however, limited to the employment income and does not extent to the income assimilated to the employment one.

The differences that still remain in the two basis can be justified by the different aim pursued by tax collection and social security's contribution[13].

First of all, the taxable base looks at effectively paid salary on a cash-basis; contributions' base, instead (except for a case as I said before), keeps looking at the retribution due.

The other fundamental difference[14] is signed by the allocation period, in fact taxes are collected on a cash-basis, whereas the contributions are due on an accrual-basis.

Despite these differences, the basis from which contribution have to be calculated is the income from employment as determined following the Tuir; precisely it is necessary to apply art. 51 Tuir for which " the income is made of all the sums and

[11] D.lgs. 314/1997.12 L.153/ 1969.
[12] M. Cinelli, *Diritto della previdenza sociale*, cit., p. 237
[13] M. Leo, *Le imposte sui redditi nel testo unico*, Milano, 2007, p. 905
[14] M. Cinelli, *Diritto della previdenza sociale*, cit., p. *238*

the values received in the fiscal period, independently from the reason, provided that they are related with the employment". At the second paragraph, art. 51 Tuir lists the items that are not included in the taxable income for which the unifying element can be the fact that they do not cause the employee's enrichment.

The contribution basis will be the one obtained with application of art. 51 Tuir to which, then, will be made changes to increase it, as for example in case of the same social security contributions (in fact art. 51 exclude them from the employment income), or to decrease it. The deductions that will be made are based on the amounts whose relevance for the contribution-basis is expressively excluded by art. 12 law 153/1969.

4. Tax aspects

The taxation system adopted in Italy for the public mandatory pensions is based on the of EET model. According to this model, the contribution phase and the accumulation phase are exempted, whereas the taxation occurs in the last one, the phase in which benefits are paid.

According to this scheme tax affects only the phase in which benefits are paid to the beneficiary, whereas contribution phase and accumulation phase are exempted. The adoption of a model by which only one of the three phases is taxable, guarantees the avoiding of a multiple taxation on money that are several expressions of the same wealth.

The pension taxation framework is depicted in d.p.r. 917/1986, our consolidated law on income taxes, hereinafter Tuir.

The structure of the income tax can be summarized as follows. A progressive rate applies to the total income held by each physical person. This total income is the sum of six different categories of income calculated with specific rules (income from immovable property, income from capital, employment income, self employment income, business income and others income). Before applying the rate to the gross income so obtained there are deductible expenses listed in art 10. The result so gained, is the net income that will be included in one of the five income brackets to which different rates will be applied. This will be the gross tax, from this amount other expenses can be deducted to obtain the net tax due.

4.1 Exemption of contributions

Contribution treatment is regulated differently for employees and self-employed workers.

In the section of income from employment the contribution is not considered a part of this income so that the contribution are totally exempted.

In fact art. 51 Tuir, dealing with the category of income from employment, provides that mandatory contributions paid by the employer, as well as by the employee, are not part of income from employment.

On the other side the provision of taxation of pension balances this exemption: in art. 49 Tuir is said that every kind of pension and similar checks are considered employment income and taxed therefore.

According to art. 51 Tuir, the only condition required to exclude contribution from the income from employment is the fact that the contribution paid has to be mandatory, independently from the public or private nature of the employment.

The taxation model, chosen by the Lawmaker, is legitimated by some doctrinal considerations that show how this model is the one that really matches with the basic values of our taxation system.

A first theory[15] tried to explain that the exemption of contribution from the taxable income is justified only by the necessity of avoiding double taxation: the contributions will be taxed after their transformation into a new taxable wealth, the pension. A second theory[16] finds the reason in the lack of possession of this richness: the worker does not hold it, but it is, provisionally, at the disposal of the public entities that manage the system. Consequently the holding requirement would be fulfilled only when pension is paid. The criticism that can be appointed to this justification, is based on the reflection that, in our juridical system, there

[15] A. Boidi, *Commento alla legge sulla imposta complementare progressiva sul reddito*, Torino, 1937, p.175

[16] L. V. Berliri, *Sul regime fiscale dei contributi e dei frutti accreditati ai fondi di previdenza*, in *Riv. Dir. Fin*., 1940, I, p. 105 ss; F. Marchetti, *La previdenza privata nel sistema delle imposte sui redditi*, Padova, 1989, p. 44 ss

are similar situations that encounter a different treatment. For example the insurance premiums that the employer pay in favor of the employee are part of the taxable income from employment, despite, even in this case, the ownership requirement is not fulfilled. Another example can be the one concerning with the contribution paid for the health service that, according to art. 51 para 2 Tuir, are excluded from the income from employment till the maximum amount of euro 3.651,20. For the part that exceeds this amount they contribute to form the income from employment. Even in this case there will be the lack of the ownership of the asset, they are paid out, but the law-maker admits the exclusion up to the amount indicated above, ignoring the lack of possession.

A later theory[17], starting and developing the previous one, explains that the exemption, has reasonable ground in the social purpose for which contribution is paid. The most favorable treatment is based, according to this theory, on the aim that social security contributions want to realize. It is the aim of contributions, realizing the goal promoted by Constitution at art. 38, that distinguishes contributions from other situations in which there is not the ownership of the wealth taxed. It has, moreover, been said that the exclusion of contribution from the employment income is the way to implement the principles of our taxation system, whose scope is to levy taxes on the effective income. By the exclusion of contribution the gross income from employment will be taxed purified of the cost of production of this income.

This latter explanation has been criticized[18] because art. 51 Tuir limits the exemption to mandatory contribution and not applies to voluntary contribution that similarly shares the same aim and strip the worker of possession of this richness. In fact the voluntary contribution, such as the one paid as surrenders of years of graduation, for a long time encountered a different treatment, they were not totally excluded by the income total income. Only from 2001, the D.lgs. 47/2000 modified article 10 Tuir, admitting the total deductibility of these contribution and, in general, of all the optional contributions paid to the entity managing the mandatory system, like the contributions paid for the voluntary

[17] F. Marchetti, *La previdenza privata nel sistema delle imposte sui redditi*, cit. p. 44; S. Dedola, *Disciplina fiscale della previdenza complementare*, in *Boll. Trib*., 2003, 1379

[18] see P. Puri, *Destinazione previdenziale e prelievo tributario,* cit., p. 192

prosecution or the ones paid for the voluntary reunion of contributions paid to different public mandatory system.

Therefore if art 49 Tuir limits the exemption to mandatory contribution, the compulsoriness of this contribution is the starting point to justify the tax treatment adopted. Contributions are paid under law provisions and therefore they can be themselves considered as a tax claim from the state to pursuit the duty of solidarity to which all citizens are submitted by art. 2 and 3 of our Constitution. [19]

Hence if contributions are taxes, the ability to pay principle, fixed in art. 53 constitutional, prevents the law-maker to tax an amount of money that is not an expression but a consequence of this ability, that is to say that a tax can not be claimed upon another tax.[20]

The theory that acknowledges to contributions the nature of taxes is based on the recognition of the constant features of contributions and of their substantial essence[21]. As happens for taxes, the contributions are sums mandatorily paid to an entity, that carries on a public activity, when conditions fixed by law are fulfilled.

The doctrine[22], in fact, asserts that contributions realize the solidarity duty fixed by Constitution, being they taxes due *ope legis* (in force of the relationship between the entity managing the mandatory pension system and particular categories of citizens) that supply the entity with the financing needed to develop the social security public aim. The taxes in the shape of contributions, accordingly, can be claimed from each single worker in respect of the ability to pay principle fixed by art. 53 Constitution[23] and they will be used to guarantee to workers, who are in a state of need, the adequate means promised by art. 38 Constitution.

The self-employed tax treatment is partially different. The taxation operates as well in the moment of benefits payment and the legal base is the same: art 49 Tuir, admitting the state to tax every kind of pension, considers pensions an income from employment.

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[19] P. Puri, *Destinazione previdenziale e prelievo tributario*, cit., p.195 ss

[20] G. Falsitta, *Manuale di diritto tributario*, Padova, 1999, p. 20; F. Moschetti, *Sul concetto di corrispettivo ai fini IVA*, in *Boll. Trib.* 1982, 1613; Cass. SS.UU., 29 Aprile 1997, n. 3671, in *Foro it.*, I, c., 1372.

[21] P. Puri, *Destinazione previdenziale e prelievo tributario,* cit., p. 121.

[22] See G. Melis, *Sulla incostituzionalità del "contributo" a favore dell'Enpam di cui all'art.1, comma 39, della L. n .243 del 2004*, cit., p. 11 ss.

[23] Art. 53 Const.: Every person shall contribute to public expenditure in accordance with their capability. The tax system shall be progressive.

Despite this similarity, the exemption of contribution finds another explanation. In the section dealing with the self-employment income there isn't any provision that excludes contribution from the income, so that the exemption would rest on art 10 Tuir that enables person to deduct from the total gross income all the contributions paid upon law provisions or even by choice of the worker.

Otherwise another theory [24] admits the deduction directly from the self-employment income and not from the total one, basically by virtue of attribution to contributions of nature of "operating expenses". Even the Supreme Court has recently approved this latter theory in the sentence 26 February 2001 n. 2781. In fact, the Court acknowledged the inherence of these expenses to the self-employment activity, notwithstanding the fact that they are addressed to satisfy personal aims of the beneficiary of the future pension. The concept of inherence adopted by the Court is, therefore, different from the one commonly adopted to admit the deduction of costs from the self-employment income, in fact, according to the common interpretation of the inherence requirement, the deduction of a cost can be operated only when (and if) this cost is directly connected to the production of an earning (the link between the cost and the earning should be of cause and effect). In the sentence the Court acknowledges the inherence of the cost because it is related to the activity performed by the self-employed worker, adopting[25] the doctrine's suggestion for which the inherence of a cost must be valued considering if it is an economic effect of the activity carried on. In this sense the contribution is a consequence of the activity, in fact, in the absence of the job, it would not be due at all.

4.2 Taxation of benefits

The benefits payment is the final step of the pension system and it has the form of an annuity. The principle that inspires it is the automatism of payments in fact

[24] N. Forte, *Il reddito dei professionisti*, Milano, 2001, p. 232 ss; L. Bellini, *La deduzione dei contributi obbligatori dei professionisti*, in *Corr. Trib.*, 2001, p. 3155 ss.
[25] L. Lodi, *Inerenza all'attività professionale dei contributi obbligatori versati alla cassa di appartenenza*, in *Corr. Trib.*, 2001, p. 1815 ss.

benefit is a right of the employee even when the employer has not regularly paid contributions.[26]

Art. 49 para 2 Tuir says that “pension of each kind and sums that are equivalent to pension, are considered employment income”, this entailing that they will be subject to the same rules applied to tax the income from employment.

The equivalence between pensions and employment income leads to consider owners of an employment income also the persons that had never owned it before stop working as all the self-employed people and persons who, before the termination of the working activity, owned a business income.

The equalization made in 1973 by art. 49 Tuir, actually, codified what already was the idea of pensions. In fact, Ministry of finance’s circular n.1/r.t. 1973, circular that can till now be considered as an explanation to the fiscal concept of pension adopted in Italy, specified that the concept of pension includes each kind of emoluments that follow the end of the working activity, that originated by a previous activity, different from the employment.

As examples, the circular indicated the self-employed individuals’ pensions, artisans’ pensions, but even the reversibility pension or the disability pension.

The Revenue agency circular n. 326/E 997, confirming and illustrating article 49 para 2 l. a), acknowledged that every time the law-maker, in regulating some aspects of the employment income, does not explicitly exclude the incomes equalized to the employment one, the regulation will apply even to pensions. So, after the calculation of the total pension due to a beneficiary, the taxation rules applicable will be the ones that regulate the employment income.

The gross pension for each year is calculated by multiplying the individual “montante” (sum of total contribution during the working life and their revaluations) by coefficients of transformation depending on age of retirement and life expectancy.

This gross pension is fiscally treated as an employment income and it is subjected to taxation rules of that category: the gross employment income, without specific

[26] Art. 2116 le prestazioni indicate nell’art 2114 sono dovute al prestatore di lavoro, anche quando l’imprenditore non ha versato regolarmente i contributi alle istituzioni di previdenza ed assistenza, salvo diverse disposizioni delle leggi speciali. English version: The benefits are due to the employee even when the empolyer did not pay regurarly contributions to social security’s entities.

deduction, will contribute to the result of total gross income subjected to general deductions as before explained.

Nevertheless, to remedy to the fact that the employment income, even when it has the shape of pension, contributes to the gross income of each individual free of any deductions, in other words ignoring the costs born by the employee or by the retiree, after the application of the tax rate to the net income owned, the taxpayer can reduce the gross tax due with specific deductions that are arranged by the lawmaker as flat-rate substitutions of those costs[27].

The retiree's deduction[28], that is higher when the retiree is younger than 75 years old, cannot be cumulated with the deduction connected to employment income, and it decreases to the increase of total income owned by the retiree.

Generally, to simplify the application of this deduction, the retiree can ask the body supplying the pension to exercise this right. In fact the tax is withheld at source by the paying entity.

To implement the constitutional dispositions, the lawmaker introduced in 1960 a social pension for over 65 years old citizens who does not have sufficient income[29], giving up its taxation power on this amount of money This social assistance instrument has now been replaced by the social check introduced by the Dini's reform. To claim the right to the social check the individual has to be an Italian citizen, older than 65 years. He is also asked to give proof of his state of need.

PART 2: INTERNATIONAL ASPECTS

1. Social security.

Since 1971, the EU has been adopting regulations in the matter of social securities to realize the purposes of actual articles 45 and 48 TFUE.

[27] F. Tesauro, *Istituzioni di diritto tributario*, Vol.2, Torino, 2012, p. 30
[28] Art. 13 para 3,4 D.P.R. 917/1986

The reg. 883/2004 has substituted the previous one and applies to "nationals of a Member State, stateless persons and refugees residing in a Member State who are or have been subject to the legislation of one or more Member States, as well as to the members of their families and to their survivors" and, since 2011, it will apply to nationals of non-EU countries legally resident in Member States.

The applicability to these subjects will be covered by all the principles arranged by regulations so that pension claims can be transferred from another Member State towards Italy and from Italy to another Member State. The rules applicable are the ones directly introduced by the Regulations:

1) *lex loci laboris* according to which the only legislation applicable is the one of the State in which the worker's activity take place: the contribution and the social security system applicable will be defined on the base of this legislation. An important exception concern with the public employment, in fact in this case the legislation applicable will be the one of the Employer.
2) *Equal treatment/ non discrimination principle:* enjoy the same benefits and be subject to the same obligations of nationals.
3) Art. 7 Reg. 883/2004 Waiving of residence rules: pension paid "can not be subject to any reduction, amendment, suspension, withdrawal or confiscation" on the base that the beneficiary resides in a State different from the one from where pensions are paid out.

Once a worker mature the right to pension the competent institution to pay it will be the one of the mandatory social security system to which the worker is subjected in that moment. When the legislation of the competent institution ask for the fulfilment of conditions in order to pay the pension, the competent institution will operate the aggregation of periods, so, they will take into account all the periods matured in other States to verify the fulfilment of these conditions.

The competent institution determines, when it receives a request for award, the benefits due computing all the rights to benefits matured under different States. The calculation of amount of the pension will be based on a *fictio*, in fact the competent institution will firstly determine *theorical amount* corresponding to the amount that would arise if all the right was matured under its legislation. Then it will verify the *actual amount* for which it is effectively obliged, according to the *pro rata* benefits system (the other amount will be paid by the other States). In the calculation should not be considered the overlapping benefits.

The transfer of pension claims from or to Countries other from the EU Member States, can be generally done only when Italy is bound to the other State by a Social security convention. The social securities conventions are treaties that guarantee the free movement of workers, through the mutual obligation to apply the social security system to the migrant workers.

Before the issuing of the European regulations, Italy was bound to most of the Member States by bilateral conventions, but they were cancelled by the Regulations that, expressively, provides for the replacement of the previous Conventions.

Generally most of the Agreements signed by Italy are bilateral, but there are also some[30] "multilateral" agreements, that are, actually, bilateral conventions that allow the possibility of aggregation of contributions paid in all other countries linked by Conventions both to Italy and to the third State.

The conventions are generally inspired by principles[31] that reflect the principles of European Regulations such as the equal treatment between national and non national, the territoriality of the insurance obligations, aggregations of period, export of benefits.

If between the States there is a Convention the workers can operate the transfer of pension claims. If conventions are not in force, the only solution that can be found to avoid the loosing of contributions paid to different States (when naturally the contributions paid in each State are not enough to let the worker obtain the pension according to the requirements asked by the States' legislations) is to exercise a "surrender", asking for a retroactive payment of the contribution paid abroad[32].

[30] Argentina, Uruguay, Tunisia, Cape Verde.
[31] G. Corasaniti, *Tax treaties and social securities conventions*, in *La mobilità transnazionale del lavoratore dipendente: profili tributari*, Padova, 2006, p. 577
[32] G. Corasaniti, *Tax treaties and social securities conventions*, cit., p. 576

2. Taxation

The criteria of taxation on income find a different solution towards resident and non-resident persons. The tax claim over a resident[33] captures, according to art. 3 para 1 Tuir, his worldwide income, whereas the tax claim over a non-resident person is admitted only on the income borne in Italy. In this second case the tax claim is based on an economic attachment that links the non-resident to the State. Art. 23 Tuir lists the cases in which an income is borne in Italy and, so, Italy is considered to be the source State. The tax over a non-resident is levied on the total incomes produced in Italy, from which only some deductions are admitted.

According to art. 23 para 1 l. c) Tuir, the employment income is produced in Italy when the working activity was exercised in Italy.

According to the fact that art. 51 Tuir excludes from the income from employment the mandatory contributions paid by the employer and by the employee, to the non-resident employee working in Italy applied the same rules applicable to the resident employee so, all the mandatory contributions paid will not be part of his taxable income. Any importance has the nationality or the residence of the taxpayer.

In case an Italian resident, different from an Italian citizen, has to pay contributions to a foreign pension scheme it has to be acknowledged, through interpretation, the deductibility of mandatory contributions, according to the fact that the Ministry's circular n. 137/ 1997 admitted the deductibility of voluntary contributions paid to a foreign social security system. If the deductibility has been admitted for voluntary contributions, even more it has to be acknowledged for mandatory contributions[34].

Being the exemption of contribution operated on the assumption that the tax will be levied on the pension, when the pension is paid to the beneficiary Italy levies the tax. The taxation of benefits, in fact, involves all the Italian pensions received

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[33] Art. 2 para 2 T.u.i.r. Are considered to be residents, for the purpose of taxation on income, the persons who, for most of the tax period, are enrolled in the register office of resident population or persons who have in Italy their domicile or their resident according to the Civil Code prescriptions. Art.2 para 3 T.u.i.r. Neverthless are considered to be residents, in the absence of evidence to the contrary, italian citizens, cancelled from the register office, who mooved to States or territories different from the ones listed in the Decree of the Ministry of economy and finance.

[34] A. Cotto, G. Odetto, G. Valente, *Guide e soluzioni TUIR,* 2010, p. 158.

by non-resident, but even the foreign pensions received by Italian residents.

Art. 23. 2, in fact, listing the incomes produced in Italy (and taxable herein) by non-residents, includes the pensions. It says that a pension is produced in Italy every time it is paid by the State, by an Italian resident or by an Italian PE of non-resident subject. The taxability of residents' foreign pensions is based on the unlimited liability that the links residents to the State.

In case of foreign pension, the fiscal treatment, that normally is the one provided by the internal system, changes if a Convention is in force between the source State and the Residence State. In any of the two cases, before proceeding to tax the pension it is firstly necessary to verify, according to Italian taxing rules, if an amount received by a resident is effectively a pension, being only in this case justified the taxation[35]. As a matter of fact, the taxing rules applicable are the Italian ones, this entailing that no relevance has the *nomen juris* given by the source State to the amount paid to the Italian resident. To be a pension taxable in Italy, in fact, it has to be a revenue income, being by Art. 6 para 2 Tuir excluded from taxation "the amounts obtained as compensation for damages related to permanent disability or death". The Revenue Agency circular n. 41/E 2003, clarified that are not taxable the foreign pensions paid, to Italian residents, that are related to an accident or a disease caused by the working activity.

Anyway, in absence of a Convention, according to art. 3 Tuir that statutes the taxation on the worldwide income of the resident, the resident that receives a foreign public pension is taxed on the pension even when the pension has already been taxed in the source State.

To avoid or mitigate the double taxation that can arise when the source State has already taxed the pension, art. 165 Tuir, acknowledges to the resident a tax credit on the tax paid to the source State.

According to art. 165 Tuir, in fact, when part of the total income attributable to a resident is made of foreign income, the tax paid, definitely, in the source State, will constitute a tax credit. This means that the tax paid is deductible from the net tax due by the beneficiary in a measure that cannot exceed the part of the tax due equal to the ratio between the foreign income and the total income.

[35] P. Saggese, *Le pensioni estere,* in *La mobilità transnazionale del lavoratore dipendente*, Padova, 2006, p. 211

The deduction will be included in the return act of the beneficiary of the fiscal period to which correspond the income produced abroad and taxed thereof, but only if the tax paid in the source State becomes definitely by the time till which the Italian return act must be delivered to the competent authority. Despite, no provision rules the specific matter, it has to be excluded the possibility to loose the right of exercise the foreign tax credit, in case timing arranged is not respected.

The Revenue agency, explaining the above mentioned article, explained that the tax credit is conceded till the part of the Italian gross tax that mirrors the ratio between the foreign income and the total income taxable, but this tax credit can not exceed the Italian net tax due in the year in which the foreign income arises. For the operability of the tax credit it is necessary that the income is effectively foreign; according to art. 165 para 2 Tuir the income is considered to be foreign on the base of reciprocal criteria of art the ones expressed by art. 23 Tuir (that is the one that lists the income for which Italy considers itself to be the source State). The reciprocal application of the sourcing rules, leads to consider foreign a pension that, according to art. 23 para 2, l. a, is paid by foreign States, by non-resident subjects or by foreign PE of resident subjects.

Anyway, these rules are rarely applied because the matter is generally regulated by conventions that are stipulated by Italy, following the OECD model.

The difference in collocation of pensions for tax purposes that exists between the internal regulation and the OECD model causes the abandon by Italy of the internal criterion. In fact, according to Italian tax system, as before explained, all the pension are considered employment income, whereas in the OECD model the pensions are treated differently from the employment income.

The OECD model in art. 15 rules the employment income and in art. 18 and 19 suggests the taxation rules respectively for pension deriving from private employment and for pensions deriving from public employment. In case of private employment the State that can levy taxes is the State of residence of the beneficiary, in case of public employment the State for which the working activity was exercised.

Following the OECD model arranged in art. 18, Italy taxes private pension received by Italian residents and gives up its taxation power in case the Italian pension is received by non-resident.

Despite this general adherence to art. 18 OECD model, thanks to which Italy should be the only State able to tax foreign pensions paid to Italian resident and vice versa in case of non-resident, sometimes the conventions arrange different rules, acknowledging the taxation right of both the States when some conditions are fulfilled or other times[36] without any conditions.

In the convention in force various kinds of conditions are inserted to legitimize the taxation power of both the resident State and the source State[37], such as the ones that acknowledge the exclusively power of the resident State till a certain amount of the pension[38], or the ones that submit the source State concurrent power only when the Italian resident is a national of the other State and had his residence in this other State for minimum period fixed by the convention[39].

When dealing with public employment, the OECD model arranged a different sourcing rule, in fact public pension are taxable only by the source State.

The distinction between private and public employment[40] pensions lies on their origin, coming public pensions from services rendered to the State, or to its political subdivisions or a local authority.

This means that, when the conventions fully respect art. 19 OECD model, Italian will give up its taxing power towards residents, except for the case in which the Italian resident receiving the pension is even an Italian citizen. When the double conditions of Italian residence and citizenship are fulfilled, contrarily, Italian will be the only State to levy the tax, according to art. 19 para 2 b) OECD model.

In case the Italian public pension is paid to a non-resident, Italy will be able to tax the pension unless the non-resident has both the residence and the citizenship in the other Contracting State.

Other times to entitle the Residence State to tax the foreign public pension it is required in addiction to the citizenship in the Residence State, even the lack of

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[36] Convention Italia-India ratified by l. 319/1995, Convention Italia-Kenya ratified by l. 666/1981

[37] See P. Saggese, *Le pensioni estere*, cit., p.194-195

[38] Convention Italy-Brasil ratified by l. 844/1980, Convention Italy-Canada ratified by l. 912/1978

[39] Convention Italy-Denmark ratified by l. 170/2002 where the minimum period of residence in the source State is of 5 years.

[40] The distinction is not inserted in all the conventions, so, in these cases it will apply the model of private employment pensions. See conventions Italy-Australia ratified by l. 292/1985, Convention Italy-Canada.

citizenship in the source State[41]

Other times the conventions provides the exclusively right of the residence State every time the beneficiary does not have the nationality of the State paying the pension [42].

CHAPTER II: SUPPLEMENTARY PENSION SYSTEM

PART 1: NATIONAL ASPECTS

1.Function

Since the beginning of nineties our pension system has been deeply modified to answer to changes in the life expectancy and to the slowing down of the economic growth.

These factors led the lawmaker to rise the age of retirement and to abandon the earning-based system. The contribution based system, adopted since 1995, caused a reduction of the amount of pension, with a replacement rate (in respect of the last remuneration) much lower than during the earning-based system.

On the other hand, the law-maker tried to promote the supplementary pensions schemes with consistent fiscal advantages, to push people to appeal to private savings that (together with the public pension) are supposed to make it possible to maintain the previous life-style, no more guaranteed by the simple public pension.

In fact, after a long dispute, our Constitutional Court[43] inserted the supplementary pension schemes into the art. 38 para 2 Constitutional, so that the second and the third pillars are essential to satisfy the public interest in ensuring adequate means to workers.

The D.Lgs. 124/1993 made the first organic regulation of the matter introducing

[41] Belgium, Denmark, France, Germany, Ireland, Lussemburgo, Netherlands, Russia, South Africa, Syria.

[42] The residence State's power, in this case, is based only on a negative condition and not positive like in the other cases, see. P. Saggese, *Le pensioni estere*, cit. p. 202.; see Convention Italy Switzerland ratified by law. 943/ 1978

[43] Corte Cost. 28 luglio 2000, n. 393.

the open and closed pension funds. It was followed by changes made in 2000 and 2001.

Current regulation, that repeals the earlier ones, is in the D.Lgs. 252/2005 that was adopted by the government on the base of the delegation of legislative power from parliament contained in law 243/2004[44].

The participation to supplementary pension scheme is free and voluntary, it is submitted to individual subscription.[45]

The person carefully has to decide whether or not to participate to the pension scheme, considering even which scheme is better fitting with his needs. To let him decide information report has to be at his disposal and furnished by each fund.

Generally the choice relies on a combination of elements, first of all the participation costs and the benefits granted.

This freedom is mirrored even in the possibility (that must clearly be highlighted by the pension schemes' statutes) for the subscriber to change the pension scheme chosen. In fact after 2 years of contribution the participant can freely move to another scheme, preserving all the right accrued without any sort of modification.

To prevent forms of obstructionism from the pension schemes, art. 14 para 6 D.lgs. 252/2005 forbids the schemes from setting up clauses that can obstacle, even *de facto*, this right and, under certain conditions, it excludes these clauses from being operative. [46]

2. Supplementary pension schemes: in general

Before analysing the punctual aspects of the regulation, it is better to start by giving an introduction of the matter. Supplementary pension schemes can be divided into two categories, the occupational pensions and the individual schemes.

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[44] Agenzia delle entrate Circolare n.70/E 2007 the basic principles fixed by L. 243/2004:

1. promote the supplementary pension
2. promote the financing of these pensions through the destination, tacit or explicit, of TFR.
3. admit workers to continue the voluntary contributions for 5 years after the retirement.
4. Change the taxation model, increasing the deductibility of contributions and providing an advantageous tax treatment for the accumulation phase

[45] P. Puri, *Destinazione previdenziale e prelievo tributario*, cit., p. 85 The subscription of supplementary pension schemes does not derive, *ope legis*, from the employment.

[46] In case of employee moving to another scheme, the TFR and the eventual contribution from the employer follow the employee to the new scheme chosen.

That must be said because it has consequences on the individuals admitted to participate: the first scheme can not, in fact, be joined by unemployed people.

Four different kinds of schemes can presently be instituted: closed/exclusive, i.e. negotiation funds; open funds; IPP and, at last, the pensions funds pre-existing to the reform.

According to the way they are set up, they can be distinguished between collective or individual pensions schemes.

In the collective schemes the participation is regulated at a collective level and it addresses to a group of workers, identified by common belonging to a particular company, group of companies or to a similar production section/area. They can have the shape of closed pension funds, open pension funds, and pre-existing pension funds (in all these cases the concrete participation is submitted to the worker's choice).

In the individual schemes instead, the subscription is based on individual choice and action. The participation is admitted only to open schemes and to IPP.

Differently from the public pension system, the supplementary pension system is based on a capitalisation system, by which contributions paid are invested by the pension funds and their returns will be part of pensions paid to the beneficiaries.

The lawmaker has opted for a funded system based on investments placed in financial markets, rather then in real estate, this last being a sector precluded to the investment activities.

2.1 Benefits

The 2005 reform brought a unification of benefits regulation[47], which now applies to all private pension schemes[48]. As already said, this is a consequence of the will to create a level plain field, by which it can be granted to the individuals to freely move from one system to another, that, in turn, is the essential presupposition to exercise a free and individual choice.

Art. 11 para 1 says that pension schemes are free to fix the requirements and the

[47] V. Tursi, *La terza riforma della previdenza complementare in itinere: spunti di riflessione*, in *Prev. Ass. pubbl. priv.*, 2005, III, p. 513 ss.

[48] Before 2005 PIP could not grant anticipations.

ways to obtain benefits in respect of general provisions arranged by the law.

A first limit, that comes up against the freedom of pension schemes in fixing the requirements to access the pension, is the need to have at least five years of contribution, when the right to obtain public pensions arises; before this moment and in the lack of 5 years of contribution people are prevented from obtaining benefits.

Despite that, in case the beneficiary stop working, whichever is the reason, and he is unemployed for more than 48 months, he can claim the pension in advance of maximum 5 years to the retirement age fixed by law.

Differently from the public pension, benefits connected to supplementary pensions schemes can be paid as lump-sum payments (rather than in the normal way, annuity) in both arrangements adopted, “defined contribution” or “defined benefits”[49]. This lump-sum payment however cannot now exceed the 50% of the actual value of individual montante accrued.[50]

Being the participation related to voluntary subscription, the law admits the beneficiary to claim advanced benefits in three different cases. These anticipation can be combined and asked even more than once till the threshold of 75% of total contributions paid to the pension fund.

Firstly, an anticipation, in the maximum rate of 75% can be asked at every time to front medical costs for very serious problems related to the beneficiary, spouse or sons.

Not at every time, but only after 8 years of contributions, anticipation can be obtained in the maximum rate of 75% to buy an house (only when this house will be the first house of the beneficiary or, alternatively, of his sons), or for other needs, without preconditions, but in the limit of 30%.

In all these cases, the contributions will not be anymore used to pay the future pension so that, to prevent the avoiding of taxation that applies in the moment of payment, the anticipation are withheld at source. This particular prudence of the

[49] G. Corasaniti, *Diritto tributario delle attività finanziarie*, Milano, 2012, p. 639 “a distinction may be made between *defined contribution* arrangements and *defined benefit* arrangements. In first type scheme contribution is fixed the amount of benefits is related to funds’ performance, in arrangements of the second type, the contribution is changeable, but amount of benefits is fixed since the moment of subscription.

[50] Art.11 paragraph 2, the anticipations eventually paid have to be put in the 50% limit.

law-maker is justified by the fact that it is up to beneficiary the choice to replenish his savings, diminished by the anticipation.
In fact art. 11 para 8 admits the beneficiary to pay-back to the fund, whenever he wants, the sums that he obtained as anticipations, in order to recover the position that he had in the fund before the payment of the anticipation.

2.2 Participants and beneficiaries.

Despite this system concerned with pensions, at certain conditions even individuals who are not workers can subscribe a pension scheme. In this case the pension can not be considered supplementary to the public one, but it will be the only personal earning of the individual, probably the only one that he has had during his life: he is not a worker and the pension will not be to him the substitution of a job income.
The individuals admitted by art.2 to participate to a pension scheme are public and private employees and new kinds of workers [51], self-employed workers, cooperative companies' shareholders, and unpaid workers that do care-jobs for familiar reasons if this is the only activity they do and they do not have any direct pension.
Art. 13 paragraph 2 admits individuals, who are not included in art. 2, to subscribe only individual pension schemes *i.e.* to participate to an open pension fund or to a investment pension planning, *hereinafter* IPP: this provision opens supplementary system to unemployed persons and join the provision of art. 8 paragraph 1 that allows worker to pay contributions in the interest of his dependents.

2.3 A common supervisory system

The supervisory agency on pension funds –hereinafter COVIP- is a public body endowed of the control of all kinds of supplementary pension schemes. This body replaced (when and to the limit to which entities act for social security aims) the

[51] D.Lgs. 276/2003 lists new kinds of job contracts.

Supervisory agencies, who normally control entities that can carry on the management of open pension funds and individual pension schemes.
COVIP's main aim is to ensure the transparency of the system, granting for a prudential and sound management of supplementary pensions schemes.
Among COVIP tasks, one of the most important is the arrangement of requirements needed by pension funds to be enrolled in a specific register administered by the COVIP.
In its supervisory activity, the COVIP approves statutes and regulations of pension schemes and defines procedures to obtain authorization to carry on activities.
It has even consistent powers in fixing criteria that must be observed by management agreements and it can check these agreements to ensure their correctness.
Generally it has regulatory power and exercises a control activity on the management of pension funds, whose effectiveness can be ensured even thanks to inspections and requests of information and details.

3. Subjects authorized to establish a pension fund

Art. 3, dealing with the legal subjects that can establish a pension fund, is a symptom of the lawmaker's choice to levelling the importance and the relevance of different pensions schemes[52]: the entities able to run open pension funds and the insurance companies are included in this list.
The subjects can be diversified according to the features of beneficiaries:
1) the main source for the private employment sector is represented by the collective agreements, stipulated even at a company level[53]. When there are not these previous kinds of agreements the funds can be settled by workers agreement, promoted by trade unions.

[52] A. Bollani, *Fonti istitutive e autonomia collettiva nella riforma della previdenza complementare*, in *Le nuove leggi civili commentate*, Padova, 2007, p. 595 ss.
[53] In case of collective agreements stipulated at a company level the adehesion is limited to individuals or workers that subscribe the agreement. The limitation imposed by art. 3 can be considered useless because, the validity of company agreements is naturally limited to the subscribers: it is not erga omnes. See A. Tursi, *I problemi giuridici delle fonti istitutive nella riforma della previdenza complementare*, in *Osservatorio giuridico*, n.10, Suppl. alla Newsletter Mefop, n. 24, 2005, p. 4

2) The workers' agreement (promoted by trade unions or representative association or by national association representative of the cooperatives) are pensions funds' main source in the sectors of self-employed workers and cooperative companies' working shareholders

3) By regions

4) By agreements between individuals who carry on "care activities", when these agreements are promoted by their trade unions or representative association.

5) The private entities that manage the mandatory pension system in the self-employed sector that can directly set up a pension fund, or throughout collective or workers agreements.

6) The public employment sector has consistent limitation: the only supplementary pensions scheme admitted can be set up only by collective agreements.

3.1. Pension funds' structure.

The framework designed by the law makes dissociation between the subjects admitted to promote the fund and the constitutive source of the fund, but the will of the promoting subjects is immanent in all regulation aspects of the fund, so the constitutive acts are actuation of this will.[54]

All the dispositions that rule the matter have the scope to protect the fund's aim, that has to realize the social security needs of participants, arranging limits/restrictions to the earmarking of funds' property. That can be also the reason for which the lawmaker listed a *numerus clausus* of organisational sets up[55] in art.4.

The shape, between the ones arranged by the lawmaker, cannot always be chosen by the promoting entity because there are some obliged choices required from the same legislator or by nature of the promoting subjects.

The ordinarily model is the association one, but some funds, such as the ones promoted by the private entities managing the mandatory pensions, the one that

[54] M. Bessone, *Previdenza complementare*, Torino, 2000, p. 50; A. D. Candian, *I fondi pensione*, Milano, 1998, p.27

[55] A. Bollani, *L'assetto delle fonti costitutive*, cit. p. 612-613

are considered open funds and the individual pension schemes[56], can be instituted with formal decision to create a “segregation of assets”: this entails that, into the same promoting entities, there would be an assets separate and autonomous from the entities’ ones[57].

The choice is not free even between the categories of association; in fact despite the possibility to operate throughout non-recognised associations or recognised bodies, this latter shape is the only one that can be opted by the categorical funds- both for employees and self employed-.

The recognised bodies become legal persons at the end of a procedure ruled by the COVIP.

At any case, the activity of all the funds has to be authorized by the COVIP

4. Closed pension funds.

There is a large gap between the management of closed pension funds and, on the other hand, open and individual pension schemes.

The closed pension[58] management is regulated by art. 6 D.lgs. 252%2005, by which the policy-maker clearly preferred an indirect management to the direct one adopted in the open funds and individual pension schemes.

The direct management from the closed funds, in fact is limited to four cases: the first case is a temporal consequence of the time needed to conclude “management agreements”, till which the entities can run autonomously the funds’ business.

The second case runs into a subjective limit: direct management can be carried on autonomously only for pension funds instituted into the Supervisory Agencies asked to control funds’ managers[59].

[56] In the last two cases, the nature of the promoting subjects, seems not to leave other choices: there is neather an agreement at the base nor a community of workers that could give born to an association. See A. Bollani, *L’assetto delle fonti constitutive, cit., p.* 615; Direttive COVIP 18 giugno 2006

[57] The segregation does not prevent the manager to break this limit, but it will be responsible for it. See A. Tursi, *La configurazione soggettiva delle forme pensionistiche*, in *Le nuove leggi civili commentate*, Padova, 2007, p. 274

[58]The article does not give specific instructions in case of defined benefits funds but restricts itself to ruling the defined contribution schemes. In the defined benefits funds the regulation is committed to conventions with insurance companies.

[59] CONSOB, ISVAP, Banca d’Italia see R. Vianello, *Modelli di gestione delle risorse dei fondi*

The last two cases are admitted for all the funds: they can hold shares in developing companies or in investment companies (real estate and securities)- in these cases the share can not exceed the 25% of investment companies' assets and cannot be bought for more then 20% of funds' assets.

The ordinary way to manage closed pension funds is the indirect management through entities (chosen at the end of a competitive tender regulated by COVIP instructions) authorized by art.6 D.lgs. 252/2005

1) Entities that can manage, on behalf of third parties, investment portfolio[60]
2) Insurance companies
3) Investment management company

The access to the management is open to all similar entities settled up in the European Union.

The management is based on a "management agreement"[61] stipulated between the parties and based on a model prearranged by the COVIP.

When the management is so carried on, the funds' resources must be entrusted to a bank (chosen at the end of a competitive tender opened to all European banks) thanks to an agreement subscribed by the fund and the bank. The bank is asked to implement the instructions given by the manager and can refuse to act on behalf of the manager only when the instructions infringe the law, the fund's statute or the D.M[62].

While the concrete operations are made through the banks, assets (that are still in the funds' ownership[63]) are managed by the entities entrusted and are, at any case, subjected to a segregation of assets, thanks to which manager's creditors can not claim it. The assets entrusted have to be accounted at fair value.

In order to safeguard the unique aim for which resources are invested, the assets allocation is boxed into specific limitations. It has been excluded the possibility to invest in real estate, being the investments admitted absorbed in the financial

pensione, in *C. Cester* (a cura di), *La riforma del sistema pensionistico,* Torino, 1996, p. 433-434

[60] Banks, societa di intermediazione mobiliarie e società fiduciarie di gestione see V. Righini, *La gestione finanaziaria del patrimonio dei fondi pensione chiusi*, pp 46-48

[61] the relationship between the parties reflects the principal/agent model see Carnioi, *La gestione dei fondi pensione: la visione degli operatori finanziari*, in *Le nuove leggi civili commentate*, Padova, 2007, pp168-169

[62] D.M. is asked to give guidelines on allocation assets, allocation criteria, and rules on conflict of interests according to principles fixed in Directive 2004/39/CE.

[63] Funds can neither provide and take out loans, nor provide a guarantee for somebody.

instruments.

Firstly they can invest in shares of each participated company only up to certain percentages, in order to avoid that the original aim is supplanted by will to manage the participated company[64].

Secondly they can not buy- for more then 20% of fund's resources- shares from subjects that have to pay contribution to the scheme, or from subject that are directly or indirectly controlled by the them.

The third limitation is stricter and prevent the pensions fund, whose beneficiaries are employees of a specific company, to buy financial instruments for more then 5% or 10% of fund's total asset, when these financial instruments are respectively issued from that company or from companies of the same group. This is the way to safeguard workers of that company from double damages in case of crisis of the company.[65]

The last limitation, that cannot even be considered a real limitation is the necessity to address investments mainly to regulated markets and the necessity to act carefully in investing in activities not admitted to these markets.

5. Open pension funds

Open pension funds' main feature is that the creator coincides with the manager of the fund. The subjects qualified to set up an open pension scheme are peremptorily listed[66] and they are admitted to create the scheme by a segregation of assets[67]. Apart from that difference, the regulation is almost similar, and the dispositions on financing, benefits and taxation that apply to closed funds are the same that apply to open and individual pension schemes.

To initiate the activity, indeed, an authorisation by COVIP is required.

The biggest difference from the closed funds is that the participation to open

[64] V. Enriques, *La gestione delle risorse dei fondi pensione negoziali a contribuzione definita: finalità, effetti e limiti della disciplina*, in *Banca, impr., soc.*, pp 211-212

[65] An example of this risk is what happened to Enron workers'. See B. Mangiatordi e E. Giacomel, *Il dissesto dei piani pensionistici della società Enron: alcune riflessioni sul sistema dei fondi pensione negli Stati Uniti e in Italia*, in *Quaderni tematici*, COVIP, 2002, 1, p.40

[66] SIM, SGR, Italian banks, PE of authorized extra-community banks, italian insurance companies or pe UE insurance companies.

[67] See note 35.

pension schemes can be decided both on a collective base and on an individual base, so that they are not limited to a category of beneficiaries.

The management of the funds has to respect the criteria dictated in regulation prearranged by the creator itself and approved by the COVIP.

The COVIP's influence in this sector is particularly pointed, according to the fact that funds' regulation must respect the COVIP guidelines.

The guidelines [68] ask the funds to segregate as much assets as the investment sectors in which funds' resources are placed in. Substantially, the number of segregations, entirely autonomous by each others, will mirror the number of independent managements of the same resources.

The effect of that segregation is the one defined in art 2117. cc[69] so that all the segregated assets will be autonomous from each other and from the manager's assets and they cannot be the moneybox to satisfy creditors, other then the funds' creditors.

Administrative and accounting bodies and system may be the same that run the creators' activities; in case the option is to set up a different and autonomous structure it will be easier to identify, at first sight, funds' activities, otherwise it is undisputed[70] the necessity to adopt allocation criteria that can assure the financial flows traceability back to the funds.

The limitation concerning the investments and the role of the entrusted bank, as previously said for closed funds, apply to open pension funds too.

6. Personal individual private savings

Personal individual private savings can be realized both by participating to an open pension scheme and by signing a life insurance contract with authorized insurance companies[71], thanks to an investment pension planning-hereinafter PIP-. By this contract the insurance company assures to give benefits as regulated by

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68 COVIP, deliberazione del 28 giugno 2006, "Direttive generali alle forme pensionistiche complementari"

69 B. Inzitari, *I patrimoni destinati ad uno specifico affare*, in *Società*, 2003, n. 2 bis, p. 295.

70 A. Pandolfo, T. Treu, *Aspetti giuridico-istituzionali della previdenza integrativa*, in Treu (a cura di), *La previdenza integrativa in Italia*, Milano, 1988, p. 61 s.

71 the authorisation comes from the ISVAP, the insurances' supervisory agency.

the art.11, even if the right accrues only[72] if the beneficiary is still alive when he turns the age of retirement- when he is not a worker it must be considered the normal age of retirement-.

The law-maker opted for entrusting the COVIP to approve a regulation on which insurances' regulations have to be based on –the COVIP regulation is integral part of each insurances' regulations- before being approved by the COVIP itself.

The participation is granted by paying contributions- in the amount fixed at the moment of stipulation and always changeable-; the insurance company acquires the ownership of these contributions and they are enabled to invest this money as they prefer but observing the provisions of insurance law[73]; they are not subjected to limitations fixed by art.6, but only to the one concerning the conflict of interests.

7. Directive 2003/41 CE: implementation

D.Lgs. 28/2007, issued in implementation of Directive 2003/41 CE, modified D.lgs. 252/2005. The most important changes are related to investment of resources, to information that pension funds must give to the participants and to the new possibility, for pension funds, to stipulate conventions with EU management entities and to entrust to an European bank the funds' resources. Talking of investment of resources, it has been introduced the necessity of a Decree (of Ministries of economy and finance and of Labour and welfare) fixing the activities in which the funds can invest their resources and the rules concerning conflict of interests. Moreover it has been introduced the necessity to address resources mainly to regulated market.

It can be pacifically noticed that the most significant news deal with the regulation of cross boarder pension funds in fact three new articles have been introduced in D.lgs. 252/2005:

1) Art. 15 bis: Italian open, closed and pre-existing pension schemes, who are legal persons registered by COVIP and operate according to an accumulation system, can, with the previous authorization of COVIP, carry on their activities

[72] The *an debeatur* is not sure: the benefits have to be paid only in case of survival to that age.
[73] D.lgs. 209/2005; M. Pallini, *Le "altre" forme pensionistiche complementari: fondi pensione aperti e forme pensionistiche individuali*, in *Le nuove leggi civili commentate*, Padova, 2007, p 778.

towards workers and employers of other member states.
The fund can obtained the authorization through a written request addressed to COVIP by which it is indicated the Member State in which the fund wants to operate. The COVIP, within three months, will transmit the request to the competent Authority of the other Member State.
Once obtained the authorization, the fund will act within the limits of the other member state's regulation concerning with the investment allocation. COVIP must control the implementation of these limits.
The fund must even respect other state's regulation on information to participants and the social security and job provisions that can be applied to foreign companies. The foreign state's authority controls the respect of this observance.
At any case the fund must have adequate resources to operate abroad.
The COVIP is also endowed of the possibility to deny the authorization (or revoke it once released) every time it supposes that the fund can not be adequate to operate abroad having regard to the fund's administrative structure, financial situation or members of administrative and control bodies.
2)Art. 15 ter: European pension schemes, authorized by the member states' competent authority to operate abroad may collect collective accession to the fund. The fund must provide the competent authority with the information concerning with principle features of the pension scheme, information that will be transmitted to COVIP directly by the competent authority. The foreign funds can not start their activity in Italy before COVIP provides the foreign competent authority with the information concerning with the Italian legal provisions applying to foreign pension funds. At any case, after two months from the reception by COVIP of the information, the fund can start its activity in Italy.
Italian provisions on beneficiaries, financing, benefits, collective adhesion and transferability, and the transparency requirements fixed by COVIP will apply to these funds. The respect of these provisions is subjected to COVIP's control.
3)Art. 15 quarter: All the information owned by COVIP are under professional secrecy. Agreement on assistance (to facilitate the proper authorities' functions) and on exchange of information between can be stipulated between competent authorities of different member states, by which authorities can entrusted each

other to supervisor.

PART 2: NATIONAL TAXATION SYSTEM

1. Taxation system

The taxation framework can be found in the D.lgs. 252/2005 and in the D.p.r. 917/1986, as it resulting after the changings made by the first referred law.

The issuing of D.Lgs 252/2005 brought modifications to the tax system applied to supplementary pension funds, and somehow it can be considered to violate the prescriptions made by the Parliament to address the activity of the Government of drafting the law [74]. The Parliament, in fact, with the Law 243/2004[75], beyond incrementing the contribution deductibility, planning effectively developed by the Government, wanted to realize a lowering of tax in the accumulation phase, request totally put aside by the Government, that, instead, modified the taxation of benefits providing this phase with a better treatment.

This government's choice of omitting the review of the taxation on the accumulation phase, modifying the taxation of the third phase, wreaks havoc on taxation of second and third pillars pensions, that cannot be enclosed in the model ETT. Italy can be therefore described with the formulas E(l)-T(r)-E(t) [76]:

1) E(l) where E stands for exemption and (l) for limitation of the exemption to a fixed threshold
2) T(r) where T stands for taxation and (r) stands for regular taxation of pension funds
3) E(t) where E stands for exemption of contributions and financial returns already taxed and (t) stands for taxation, but with a substitute tax.

The principles of our constitutional and taxation system refuse the double taxation of the same richness *ergo*, the wealth represented by contributions, will be taxed

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[74] G. Corasaniti, *Diritto tributario delle attività finanziarie*, cit., p.654
[75] See back to note 27
[76] F. Marchetti, *Il regime tributario delle forme pensionistiche complementari*, in *Le nuove leggi civili commentate,* Padova, 2007, p. 949

only after its transformation into pension to the extent to which it has not been taxed in its original form. The same reason prevents the taxation of financial returns in the moment they will become pension.
The architecture chosen by the lawmaker is to defer the taxation of contribution and, this time, the reason can surely be identified in the lack of possession[77] of contribution, that is the essential precondition to claim a tax on a income, because the theory adopted to justify the exemption of mandatory contribution cannot here be recalled, being the voluntariness of contribution the essential element that characterizes the supplementary pension system: contribution can not be considered taxes.

1.1. Contribution phase

Before analysing the exemption of contributions some premises must be done, to understand who is the beneficiary of the exemption. These premises concern with the financing of funds is unconditionally, at least at the beginning, realized by contributions or/and by the TFR.
To enter a pension scheme and, consequently, to obtain the pension, there must be a financing in favour of the beneficiary.
Being the supplementary pension schemes opened to everybody, accordingly, the 2005 reform individuated the financers of those schemes providing the possibility to pay contribution even to individuals who do not have a job or a business income and to individuals depending on others, being, in this last case, the contribution paid by the individual they are depending on.
With a general provision the law identify that normal way of contributing in contributions paid by workers, employers and clients.
When the beneficiary is the employee, the financing can have the shape of beneficiary’s contribution or/and employer’s contribution or can even be made by the sole transferring of severance payment –hereinafter TFR-.
The 2005 reform, truly modified the modalities of transferring the TFR to the

[77] F. Marchetti, *La deducibilità fiscale dei contributi alla previdenza complementare. Disciplina generale*, in *Le nuove leggi civili commentate*, Padova, 2007, p. 902

pension scheme. Since 2005, in fact, the law-maker opted for an automatic "conveyance" of TFR to the collective pension schemes individuated by the collective agreements[78], whenever the employee, within six months from the hiring, does not express his will to maintain this amount at the employer or to devolve it to another pension scheme. According to the Revenue Agency circular 70/E 2007 the devolution of TFR to the supplementary pension schemes can be operated even for the amounts matured before 2007, that is the year from which the 2005 reform is in force.

Now, what must be analysed are the consequences of financing by the employer. First of all, as it happens for mandatory contributions paid by the employer, the voluntary ones are deductible (art. 95 Tuir) from the business income as costs of production named under the voice "social security contributions". The employer has to pay a solidarity contribution in the measures of 10% of supplementary contribution. This solidarity contribution will be, partly, deferred to financing a guarantee fund created at INPS to safeguard employees in case of employer's breach of duty of contribution.

The puzzling matter is the way to deduct the TFR; art. 105 para 1 Tuir, in fact, admits the deductibility for the whole part matured during the fiscal year, having it the nature of a production cost, but art. 105 para 3 Tuir says that the amount of TFR annually devolved to pension schemes is deductible till the limit fixed by D. Lgs. 252/2005 art.10, that would mean till the limit of 4% becoming 6% in case of enterprises with less than 50 workers. Actually it is commonly accepted that that was a lawmaker's blunder and that the deductibility till the 4%-6% is an additional one that is a sort of compensation conceded to the employer for the automatic, premature, financial outlay[79]. In fact the same art. 10 D.lgs. 252/2005 is entitled "countervailing measures".

From the point of view of the employee, TFR is a deferred retribution, subjected to a "separate taxation" when it is received by the employee at the termination of employment, except for the anticipation obtained by the employee that are immediately taxed. To avoid the taxation of amount of TFR devolved to the

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[79] F. Marchetti, *Le misure compensative per le imprese,* in *Le nuove leggi civili commentate*, Padova, 2007, p. 920

supplementary pension funds, the lawmaker specifically excludes this devolution of TFR from being anticipation taxable.

Talking, instead, about the deductibility of contributions, it is specifically regulated by the 2005 reform only towards workers but, notwithstanding this limitation, in force of the general provision of art 10 TUIR that enables everyone to deduct from the gross total income contributions paid to supplementary pension schemes in the limits fixed by the 252/2005, the provisions of 2005 reforms apply to everyone, being they workers or not, so even to the individuals who do not own a job or business income.

That means that the maximum deductibility of contribution is fixed in the amount of euro 5.164, 57 per year[80], to calculate which, have to be considered each form of contribution paid in favour of the beneficiary, independently from who is the payer or from the eventual multiple schemes (individual plus collective) to which the contributions are split by the beneficiary. In this limit have to be included even the contributions paid in favour of family members that are fiscally depending[81] on the payer, but only for the amount that cannot be deducted by the same beneficiaries.

This plafond can never be exceeded so, in case contributions go beyond this ceiling, they will not be taxed at the moment of benefits payment thanks to a communication that the beneficiary must do to the pension scheme. The same communication can be sent in case the deduction is voluntary limited to just a part of contribution paid, lower than the plafond. Because this future exemption of benefits stands on a communication that must be done by the end of the year following the one in which the payment took place, the reliability on worker's diligence can lead to an internal double taxation when he was inactive.

In case the deduction concerns with an employee the calculation of contributions must include first of all the deferments made by the employer to the scheme

[80] The plafond is operative even when contribution is voluntary continued after the age of retirement.

[81] The family members are the one listed in art.12: 1) spouse not legally or effectevely separated; 2)sons, and assimilated, that live with the payer or who received an alimony; 3)parents, sisters and brothers in law, parents in law, brothers and sisters, if cohabitants or beneficiary of an alimony. All of them must have a total gross income lower than euro 2.840,51

constituted into the enterprise that respect the conditions asked by art 2117 cc[82] (only in case this fund is split into personal accounts for each beneficiary); secondly the inclusion concern also with the contributions paid by the employer or by the same employee.

According to the fact that even the contribution paid by the employer is part of the retribution due to the employee, being in force an all inclusive notion of retribution, theoretically this contribution should be part of the taxable employment income. But Tuir, in the section of employment income, provides that, when employee's amounts (that would be deductible from the gross total income thanks to art.10 Tuir, that is the one that makes contributions deductible) are "withheld" at source by the employer, these amounts will not be anymore deductible but they will not be considered any more employment income. This provision leads contributions not to be considered employment income, if withheld by the employer, to the extent to which they do not exceed the plafond; otherwise they will be taxable.

It is essential to underline that the deduction, as depicted by the reform, applies, after a change to art.10 para 1 l. 6 bis made by law 244/2007, also to contributions paid to EU and SEE pension schemes, this representing a total adherence to the EU principles, that, conversely, can not be observed in case of transferring of position to a foreign pension scheme[83].

The incompatibility with the EU freedoms of movement within the member states comes to light in the applicability of fiscal neutrality, in case of transfer to another pension scheme, given that the 2005 reforms acknowledges the neutrality to the extent to which the transfer is in favour of funds regulated by its provisions, condition that is not met when the foreign fund is not operating in Italy with the application of the procedure requested by art. 15.ter. That means that when the beneficiary's transfer is to a foreign pension fund that does not carry on its activity in Italy, Italy will apply a tax to avert the danger of loosing the power of taxation forever, due to the eventual transfer of residence of the beneficiary to another

[82] Art. 2117 cc. The funds constituded by the employer can not be used for aims other than the one for which they were constituted and they can not be subject to execution by the employer's creditors or by the employee.
[83] It will be explained better in the part concerning with the taxation in cross boarder situations.

member state.[84]

1.2. Accumulation phase

Being the supplementary pension system a system based on capitalization, the pension schemes invest the contributions in resources or, it is better to say, as before seen, in financial instruments, having the lawmaker excluded the possibility to invest in real-estate (this limitation operates only towards pension schemes created since 1992). The tax is levied on the financial returns of those investments at a rate of 11%.

In fact, to the pension funds applies a particular tax that is considered as a substitution of the income tax; the low rate, limited to 11% against the 20% rate that applies to financial returns of investment funds, is deemed to be justified by the aim of pension funds. The pension funds share with investment funds the vocation to invest private savings, carrying on a purpose that the Constitution at art. 47[85] drives to pursue, thus deserving a better fiscal treatment in respect of the normal income tax rate; but, beside those other funds, the pension ones achieve a further constitutional interest identified in art. 38 Const., being their investment oriented to the social security's benefits, that make them worthy of a even better treatment.[86]

The substitutive tax applies to all pension schemes that are all threated as independent taxable entities; it is only the way to determine the taxable base that differs among them.

For defined contribution funds the tax basis is net income of each fiscal year that is the difference between the net equity at the end of the fiscal year and the net equity at the beginning of it. Since the function of the substitutive tax is to levy the financial returns of investments, the net equity resulting at the end of the year

[84] F. Marchetti, *La neutralità fiscale dei trasferimenti tra forme pensionistiche complementari*, in *Le nuove leggi civili commentate*, Padova, 2007 p. 943-945

[85] art. 47 Const. The Republic encourages and safeguards savings in all forms. It regulates, co-ordinates and oversees the operation of credit.

[86] F. Rasi, *La disciplina fiscale delle forme pensionistiche complementari*, in F.Marchetti, M.Marè, *Previdenza complementare e disciplina fiscale*, 2009, p.154.

has to be sterilized of all amounts whose source is not a financial investment[87], in other words purifying the equity of all the amounts that are not revenue incomes of the fund, this entailing that the final net equity will be:

1) increased of amount supplied for surrenders, social security benefits and the amounts transferred to other pension schemes;
2) decreased of contributions paid[88], amounts received from other pension schemes

To avoid a double taxation or a taxation of revenue incomes that have not to be taxed for any reason, the final net equity will be

3) decreased of incomes subjected to a withholding tax, exempted or not subject to any tax.

The eventual loss can be used by the fund:

a) to decrease the results of the following fiscal years for the full amount that is in their capacity
b) to decrease results of other investment compartments, using it wholly or partly, starting from the same fiscal year it accrued.

The calculation of net income of the defined benefits funds[89], and of IPPs is equal. In fact, defined benefits funds do not manage autonomously the contributions paid by participants, but entrust insurance companies of their management through specific conventions stipulated with these companies. Therefore the net income, in both cases, is determined by deducting from the value of the "processing" annuity (at the end of the calendar year, or at the date from which the benefits started to be paid), diminished of contributions received during the year, the value of the annuity itself at the beginning of the same year.

The eventual loss, also in this case, can be used to decrease the result of the following years.

According to Revenue Agency circular n. 29/E 001, the value of an annuity is equal to the capital constituent of the annuity itself, in other words to the amount that an individual should be paid, as a single premium, to an insurance company,

[87] F. Marchetti, *Il regime tributario delle forme pensionistiche complementari*, in *Le nuove leggi civili commentate*, Padova, 2007, p. 950
[88] The contributions are considered at their gross amount. see F. Rasi, *La disciplina fiscale delle forme pensionistiche complementari*, cit., p.160
[89] Art. 6 para 5 defers the management of these funds to agreements with insurance companies.

for obtaining, starting from a certain period and till the end of his life, a payment of a certain amount per year of annuity.
It has to be noticed that for determination of the present value of the annuity, the insurance companies attribute the returns matured by the current management, annually, only at prefixed date of the year, that changes accordingly to the company, so, only at this date, it would be possible to determine the present value of the annuity.
According to this peculiarity, it will be necessary to refer to the difference between the current value of the annuity (valued at the date of the anniversary of the policy) determined by taking into account also premiums paid during the year since the last anniversary, and decreased of premiums paid during the year, and the current value of the annuity itself at the date of the previous anniversary of the policy (this current value must be taken into account decreased of the substitutive tax levied).
Nevertheless when at the end of the year it is possible to calculate the effective value of the policy it will not be necessary to refer to the value of the annuity at the last anniversary.
Despite these are the main ways to tax the pension funds, different system apply to "old" funds according to their peculiarities.

1.3. Benefits phase

The current taxation system on benefits is the result of changes made by the 2005 reform that wanted to introduce a simplified system.
Firstly it must be said that, according to art. 50, para 2, l. h, supplementary pension benefits (both in the form of annuities or in the form of lump-sum payments) are considered income assimilated to the employment one.
Art.52 .1 d Tuir, regulating the taxation for income assimilated to the employment one, says that the taxation system is the one defined by art 11 and art 23[90], Dlgs

[90] Art. 23 makes applicable to the benefits corresponding to the "right" accrued between 2000 and 2007 a system arranged by the d.lgs. 47/00: to the benefits corresponding to the "right" accrued

252/2005. Differently from the previous regulation, art. 11 provides a common system for lump-sum and annuity payments: a substitute tax (of the normal income tax) applies to those benefits at a rate of 15% that can decrease till 9% depending on the permanence in the pension scheme[91]. According to the Revenue agency's circular n. 70/E 007, the permanence should be calculated on the base of years of participation, including even the years in which any contribution was paid.

The tax is withheld at source[92] but the withholding agent is different according to the kind of benefits: the withholding agent in cases of lump-sum payments is the pension scheme, whereas, in case of annuity, it is the benefits distributor to act as withholding agent, this being important in case of defined benefit funds for which the distributor agent will be the insurance company rather than the pension scheme itself.

The tax basis is the amount of benefit, naturally diminished of the part already taxed (for reasons of taxation during the accumulation phase or for not having deducted contributions).

Annuity benefits will be taxable for their total amount:

1) decreased of the non-deducted contributions only if the beneficiary had communicated to the pension scheme the non- deduction of contributions paid, by the end of the year following the one in which the payment took place
2) decreased of the financial returns taxed in the accumulation phase. The returns, according to the Circular 70/E 2007, are calculated decreased of the substitutive tax applied.
3) decreased of incomes indicated by art. 44 para 1 l. g-quinquies Tuir, if definable: income corresponding to financial returns, related to the beneficiary position into the pension fund, accrued when the annuity has began to be paid.

The financial returns that are excluded from the annuity will be subject to a

between 1995 and 2000 the taxation arranged by L 335/1995.

[91] The rate is reduced in the measure of 0.30%- till a maximum of 6% - per year, starting from the sixteenth year of partecipation.

[92] See art. 24 1 quater d.p.r. 600/73

substitutive tax at a rate of 20%. The tax basis to which applies the substitutive tax, according to art. 45 para 4 ter Tuir, is the difference between the amount of the single payment of the annuity and the amount that would be paid without taking into account the financial returns.

Being the taxation of annuities spread out over the multiple payments, the withholding agent will withhold at source the substitute tax on the financial returns that are paid with each single annuity.

In case of lump-sum payments the taxation will take place only once at the moment of the single payment. It is useful to remember that a lump-sum payment can be obtained only till the limit of 50% of total amount attributable to the beneficiary, the other part of benefits must be paid as an annuity. To calculate the 50% limit it must be taken into account the effective position matured from the beneficiary, computing even the eventual anticipations that the beneficiary omitted to replenish.

Even in case of lump-sum payments the withholding agent, in applying the substitute tax, will exclude from the tax basis the part corresponding to the financial returns already taxed and to the contributions non-deducted.

1.3.1. Anticipation and replenishing of sums anticipated

If the beneficiary asks for anticipation, art.11 D.Lgs. 252/2005 admits the pension scheme that distributes the anticipation to withhold a substitutive tax that follows the model of taxation arranged for benefits, even if this model is plenty revived only in case of anticipation for medical expenses. The anticipation can be asked, as already explained, in three different cases: to pay medical expenses, to buy an house and for other needs, without any precondition on the relevance of the need.

The treatment of anticipations for medical expenses reflects the one applicable to normal benefits payments: the substitute tax is withheld at a rate of 15% reducible till 9% (depending on the permanence in the pension scheme).

Anticipation related to the house or to the “personal” needs of the beneficiary are taxed differently. In these cases the anticipations will be subject to a substitute tax, withheld at source by the payer, at a rate of 23% of the amount given to the beneficiary.

In all cases the amount anticipated, before being taxed, is decreased of non deducted contribution (if communicated on time to the pension scheme) and financial returns already taxed that are proportionally related to the amount of anticipation.

The better tax treatment that applies to the anticipation for medical expenses, in respect of the tax treatment of the other two cases, can be explained with the will of the law-maker to discourage disinvestments from the supplementary pension schemes, considering their rule in granting a better lifestyle after the retirement.

Once obtained the anticipation, the beneficiary can, whenever he wants, replenish his position with one or more contributions that will let him recover the position that he had at the pension scheme before the anticipation. According to this function, when the contribution annually paid by the beneficiary exceeds the amount deductible (5.164,57 euro), the participant gains a tax credit on the sums that are not covered by the deduction and that will replenish the sum withdrawn as anticipations. The measure of the tax credit is equal to the tax paid for the anticipation, proportional to the amount effectively paid back to the pension scheme.

PART 3: TAXATION IN CROSS-BOARDER SITUATIONS

1. Introduction

The criteria of taxation on income find a different solution towards resident and non-resident persons. The tax claim over a resident[93] involves his worldwide income, whereas the tax claim over a non-resident person is admitted only on the

[93] Art. 2 para 2 T.u.i.r. Are considered to be residents, for the purpose of taxation on income, the persons who, for most of the tax period, are enrolled in the register office of resident population or persons who have in Italy their domicile or their resident according to the Civil Code prescriptions. Art. 2 para 3 T.u.i.r. Neverthless are considered to be residents, in the absence of evidence to the contrary, italian citizens, cancelled from the register office, who mooved to States or territories different from the ones listed in the Decree of the Ministry of economy and finance.

income borne in Italy. In this second case the tax claim is based on an economic attachment that links the non-resident to the State. Art. 23 Tuir lists the cases in which an income is borne in Italy and, so, Italy is considered to be the source State.

Because the State can levy taxes on the worldwide income of a resident some devices have been adopted by Italy to control and monitoring the flows of money that can exit the Italian territory escaping from Italian taxation. In fact an individual who is an Italian resident has to fulfil a specific part, called Quadro RW, of his assessment act when he is in the circumstances indicated by the d.l. 167/1990[94]:

1) his transfers of money, certificates and securities both from or to another State, that exceeds in total 10.000 euro for each fiscal year.
2) he owns abroad investments or financial activity from which he can obtain incomes, taxable in Italy, whose source is another State and their total amount at the end of the fiscal period exceeds 10.000 euro.

According to the aim of this declaration, the resident is exempted from the fulfilment whereas an intermediary, who has the obligation to communicate its activity, participated at the operation or collected the incomes.

According to these provisions, in case of Italian residents participating to a foreign pension scheme, they could need to indicate, in their tax return, the contribution paid to foreign schemes, the shares owned of the foreign pension schemes and the benefits payments from abroad, when these "activities", together with other foreign activities of the residents overtake the amount of euro 10.000.

2. Contribution: Italian residents

The first issue that has to be analysed is the deductibility of contribution paid to foreign pension schemes by Italian residents.

Art. 10 para 1 l. e-bis Tuir, listing the costs deductible from the gross income, nominates the contributions paid to the supplementary pension schemes within the limit of art. 8 D.lgs. 252/2005 (5.164,67 euro per year) and explicitly

[94] Decree converted into law by law 227/1990.

acknowledges the same deductibility to contributions paid to the supplementary pension schemes instituted within the E.U. or in the States participating to the agreement on the European economic area that are listed in the decree of the Ministry of economic and finance based on art.168 bis Tuir[95].

The Revenue agency[96], interpreting this prescription, attributes the right to deduct contributions from the foreign supplementary pension schemes only in case they respect[97] the requirements arranged by the Directive 2003/41, thus meaning that the fund:

1) has to be different from the enterprise that promoted it or from the categorical association in which it found its born.
2) The aim for which it has been instituted is the payment of supplementary pensions.
3) It adopts a capitalization system.

It has to be highlighted that the deductibility of contributions paid to foreign pension scheme was introduced only by D.lgs. 252/2005 for EU pension schemes, and by law 244/2007 for EEA pension schemes. The change was made to avoid breach of the EU freedoms, in fact the previous system acknowledged the deductibility only for contributions paid to Italian pension funds, resulting, for this reason, as an obstruction to the EU freedoms and to the functioning of the EU market of occupational pensions that the Directive 2003/41 aims to realize.

In fact, as specified by Infringement procedure n. 2002/2291, "the tax discrimination against foreign pension funds was unacceptable because workers should not be forced for tax reasons to take out new pension insurance when they take up a job in another Member State and employers should be able to set up pan-European pension funds".

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[95] The decree has not been enacted yet, so it will be applied the d.m. 4 september 1996 that lists the State with whom there is the exchange of information.

[96] Circolare 18 dicembre 2007, n. 70/E actually presented two different possible interpretations: the first one admits the deduction to pension schemes who fulfill the requirements of the Directive, the second one, stricter, acknoledges the deduction only if the pension scheme was effectevely authorised to operates in Italy.

[97] F. Rasi, *I profili internazionali della previdenza complementare*, in *Archivio Ceradi*, Roma, 2012, p. 11. The burden of proof is on the beneficiary.

2.1. Contributions: non-residents.

When a non-resident individual pays contributions to an Italian pension scheme, the issue on the pertinence of deductions can arise, according to the limited tax liability of non-residents, only when it has an income taxable in Italy. This situation can arise when he owns an income among the ones listed in art. 23 Tuir, for example when a non-resident employee pays contributions to an Italian pension scheme. The problem exists because art. 24 Tuir says that the non-resident is taxed on his total income produced in Italy, without having the right to deduct contributions paid to an Italian pension scheme. On the other hand, Italy claims the right to tax the benefits that will be paid by Italian pension funds to non-resident because art. 23 Tuir considers these benefits as produced in Italy and, therefore, taxable herein.

The non-deductibility could be discrimination towards non-residents, when their situations is similar to the situation of a resident, *ergo* in case Italy is able, for any reason, to overview the non-resident total tax capacity, as It is able to do in case of residents.

When the non-resident is a EU resident, this circumstance can be, within certain limits, a breach of the EU law, when there are not substantial differences between the resident and the non-resident that can explain and justify a difference in their treatment. In fact a difference of treatment cannot exist, according to the existing ECJ case law[98], when the resident and the non-resident are substantially in the same positions.

According to the fact that the aim of deductions is to let the State taxing an individual in respect of his effective capacity to pay[99], therefore, when a State has the possibility to tax a non-resident, it should be aware of the necessity to value if the Italian incomes, owned by the non-resident, makes him comparable to a resident, granting, in this case, the deductions. So Art. 24 Tuir should be considered incompatible with the E.U. law, to the extent to which the non-resident is treated differently from a resident when he is mostly in the same situation of a

[98] Schumacker C-279/03, Wielocks C-80/94, Zurstrassen C-87/99, Commission c/ Estony C-39/10, Wallentin C-169/03

[99] see F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 16

resident.

However it is necessary to consider the recent ECJ case law that acknowledged, as cause of justification to the discrimination, the coherence of the national tax system in fact, although the existence of discrimination, the Court said that the State could refuse to concede deductions in view of the future absence of tax power on benefits.

As before said, Italy claims tax power on pension benefits paid by the Italian pension funds to non-residents, so it could not apply the defence of coherence, except for the case in which Italy gave up its power to tax the future benefits through a Convention with the State of residence of the beneficiary.

In any other cases, standing on the non-deductibility of contributions paid by a non-resident, the only solution[100], disregarded by the practice of Italian pension schemes, would be to apply the art. 8 of D.lgs. 252/2005, looking at the principle that inspires this law: prevention of double taxation of a same wealth.

Applying this last article, the pension schemes, when taxing benefits, should exclude the taxation on contributions non deducted.

A solution to this kind of situations can be found in the Convention between Italy and the USA[101] that regulates the case of employees, residents of a contracting State, working in the other contracting State. When the employee participates to a pension scheme in his country of residence, he will be admitted to deduct contributions paid to this pension scheme from the employment income arising in the working State, at the same conditions and under the same limitations that rules the deductibility of contributions of residents of the working State. In case of contributions paid by the employer they will not be part of the employment income taxable and the employer will be able to deduct the contribution paid from his income in his resident State.

The convention grants this treatment when two conditions are fulfilled:

1) the contribution have to be "paid" before the employee arrives to the working State[102]

[100] F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 20-21.
[101] The convention was ratified by Law 20/2009.
[102] F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 24 This disposition should be interpreted as ackowledging the deduction when the employee is already a partecipant of the pension scheme before mooving to the contracting State

2) the competent authority of the working State “approves” the pension scheme.

2.2. Transfer to another pension scheme

The issue of transferring can be analysed from two different points of view: the transfer from an Italian supplementary pension scheme to a foreign one and the transfer from a foreign supplementary pension scheme to an Italian one.

The conditions upon which the transfer may be exercised and the fiscal treatment of transfer are the ones fixed by the law of the State of provenance, thus meaning that in Italy the transfer will be:

1) voluntary when the worker freely chooses to move to another pension scheme, after two years of participation to the previous one
2) obliged when the worker looses the participation’s requirements

This second situation can arise, for example, when the employee stops working for an Italian employer, loosing the requirements to participate to the negotiation fund.

When and in case he begins to work in another State for another employer he will join the supplementary pension fund related to the new employer.

Italy recognises the fiscal neutrality only when with the transfer the worker joins a supplementary pension scheme regulated by D.lgs. 252/2005. To define a pension scheme as regulated by this law, it must be an Italian pension scheme, accordingly instituted, or it must be a European pension scheme that has been authorized to operate in Italy thanks to the procedure descripted in Art. 15 ter D.lgs. 252/2005 .

In any other case, the situation will be treated as a total surrender of the position matured in the pension fund and taxed accordingly, so, according to art. 14 para 5 D.lgs. 252/2005, the sums will be withheld at source by the fund at a rate of 23%.

This situation is disregarded by the OECD, that, in the point 68 of the commentary to art. 18 of OECD model convention on income and capital, suggests to the States to insert, in the conventions, a clause thanks to which the cross boarder transfers should take place on a tax-free basis likewise in purely domestic transfers. Right now Italy has not inserted any of these clauses.

When the transfer operates towards a EU pension scheme that is not included in Art.15 ter D.lgs. 252/2005, apparently it could be said that the taxation, operated on the transfer, is a breach of the EU law, being the beneficiary of the fund discouraged from participating to a EU supplementary pension scheme that has not been authorized to operate in Italy. This situation, in fact, causes the taxation of the amounts withdrawn from the original pension scheme only because the transfer is operated towards EU schemes not operating in Italy. The tax so levied could be assimilated to an exit tax on a single income that is levied by Italy to avoid the future loosing of taxing power in case of the following transfer of beneficiary's residence to the other Member State[103].

In the reality, to value the effective compatibility of the taxation of cross-boarder transfers, it has even to be taken into account the effective will of EU law: with the Directive 2003/41 the European institutions wanted to promote a single market of supplementary pension schemes, but this aim is submitted to conditions, first of all the authorization to operate abroad that must be given from the Supervisory Authority. The aim of the Directive in fact is the protection of the beneficiaries that can be obtained only requiring the schemes to respect the essential conditions depicted in the same Directive. The authorization has the function to control the fulfilment of these conditions. According to this interpretation of European principles[104], the Italian legislation can be considered compatible with the EU law because the neutrality is granted when the future fund is an authorized one.

When the transfer operates from a foreign fund to an Italian fund, the situation differs according to the nature of the original fund. If it is a fund authorized to operate in cross-boarder situations the whole position matured by the beneficiary in the original fund will be retained, without any changes, in the Italian fund thanks to exchange of information between the funds and thanks to the transferring, from the original fund to the Italian fund, of amounts (related to the beneficiary) that will not be considered new contributions paid at the moment of

[103] F. Rasi, *I profili internazionali della previdenza complementare, cit.*, p. 30 In this case probably the coherence of excise system can justify the taxation, even if some doubts arises according to the latest case law by which this cause of justification, adopted towards personal exit taxes has constantly been rejected.
[104] F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 33

transferring, but pre-existing contributions.
In case the fund is not an authorized one, the adhesion to the Italian fund has to be considered a new inscription, this entailing that the amounts transferred will be considered new contributions paid to the new fund and, consequently, they will be deductible till the threshold of euro 5.164,57.
The transfer of positions between USA and Italy is regulated by the 2009 Convention that opts for the fiscal neutrality of cross-boarder transfers thanks to a mechanism of mutual recognition that is similar to the one operated between Member States. This could be the basis for the inclusion of the US funds into the funds regulated by D.lgs. 252/2005 with the consequences before explained: the cross-boarder transfer will take place, both from or towards Italy, on a tax free basis and with the preservation of the position matured in the original fund.

3. Accumulation phase

The first question that arises is the applicability cross boarder situations is the applicability of Conventions, in case they exist, to the pension funds.
Art. 1 OECD model convention, dealing with the person covered, statutes that “this convention shall apply to persons who are residents of one or both contracting States”.
Art. 4 OECD model, says that the term resident of a Contracting State means any person who, under the laws of that State, is liable to tax therein by reason of domicile, residence, place of management or any other criterion of a similar nature.
The commentary to art. 4, directly referring to the liability to tax of pension funds and other exempt persons, says that the term liable to tax must be interpreted according to the State internal law, in fact in many States a person is considered liable to tax even if the Contracting State does not, in fact, impose tax. For example the pension funds may be exempted from tax, only if they meet all of the requirement for exemption from the internal tax law, otherwise they will be taxable.
Reading these provisions the question of applicability to pension funds of

Conventions following the OECD model has been positively answered by the Revenue Agency circular n. 29/E 001. The circular, in fact, verified the fulfilment of the three conditions required by the OECD model to apply the conventions. The pension funds can be considered a person to which the convention apply if it is resident according to art. 73 Tuir[105]and liable to tax. Being the convention applicable, according to art. 2 OECD model convention, “to taxes on income and on capital” and to “any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes”, the circular acknowledged the inclusion of pension funds in the Convention ratified because art. 17 D.lgs. 252/2005 says that the substitute tax that applies to pension funds is a replacement of the normal income tax.

When the foreign pension fund fulfils the same requirements, according to its national law, the Convention will apply to it, this entailing the non-applicability of the Italian system of taxation of incomes earned by foreign pension schemes.

In the absence of Conventions, the Italian income of a foreign pension scheme arising in Italy will be taxed therein, according to Tuir, at a rate of 27,5%. Art. 73 Tuir, individuating the entities that are subject to the corporate income tax, includes “ non-resident companies and entities”. The taxable income will be the total income produced in Italy with the exclusion of income exempted and of income subject to a withholding tax or to a substitute tax. The way to calculate the total income attributable to the funds will, therefore, be the one ruled by art. 154 Tuir, that determines the taxable income of non-commercial entities. Art 154 Tuir says that the way to determine the total income is the one applicable to physical persons, so there will be the addiction of all the categories of income earned in Italy by the pension fund, with the exclusion, naturally, of the income from employment. Only some deductions, both from the gross income and from the gross tax, are admitted

Among the incomes subjected to a withholding tax, that therefore will not be part of the total income subject to the 27,5%, it is important to consider the profits related to shares or similar financial instruments owned, by foreign pension funds,

[105] Art. 73 para 3 “are considered to be residents companied and entities that for the great part of the fiscal period have their registered office, or the centre of administration or the principal subject of their activity in Italy.

in Italian entities.

According to art. 27 para 3 D.p.r. 600/1973, as resulting by changes made in 2009, two different systems apply to Italian dividends earned by foreign pension funds, depending on their being EU or EEA funds or other foreign funds.

In fact, the subject that paid out profits related to shares, or financial instruments similar to the shares, to a non-resident fund (different from EU and EEA funds) will withhold these profits at source at a rate of 20%[106] (until 2012 the rate was of 27%).

On the contrary, when these profits are paid out to EU and EEA pension funds, the Italian entity will withhold them at source at a rate of 11%. This different rate was provided to avoid the breach of EU freedoms.

Before 2009, in fact, the same withholding tax (at a rate of 27%) applied to profits paid out to all foreign pension funds (without any distinction on their being EU pension funds or others), but European Commission opened the infringement procedure IP/08/1022, that led Italy to change the taxation of profits paid out to EU and EEA pension funds. The law n. 88/2009, in fact, modified art. 27 D.p.r. 600/1973, providing the application of the withholding tax at a rate of 11% . The European Commission, in fact, highlighted the incompatibility of the Italian system with the EU principles: "The higher tax on income from dividends, received by foreign pension funds may dissuade these funds from investing in the Member State levying the higher tax. Equally, companies established in these Member States, may face difficulties in attracting capital from foreign pension funds. The higher taxation of foreign pension funds thus results in a restriction of the free movement of capital as protected by Article 56 EC and Article 40 EEA. In the case of controlling participations by the foreign pension funds, it may also result in a restriction of the freedom of establishment, protected by Article 43 EC and Article 34 EEA. The Commission is not aware of any justification for such restrictions"

From the point of view of the Italian pension funds the problem of double taxation

[106] To partially avoid double taxation on these profits when they are taxed in the residence State of the fund, Italy admits the possibility to obtain the refund of the tax paid in the residence State till the maximum amount of ¼ of the tax withheld in Italy, when the foreign found can prove the definitely taxation in the residence State with a certification of the fiscal foreign authority.

can arise when the fund owns foreign incomes. According to the fact that the investment sectors in which Italian pension funds can operate is limited to financial instruments, the kind of foreign incomes that a pension fund can own are ascribable or to art. 44 Tuir, income from capital, or to other incomes, art. 67 Tuir. These incomes will be part of the net income taxable of the pension fund. When these incomes come from abroad a problem of double taxation can arise. In fact in case the incomes come from a State with whom no Conventions are in force, Italy will tax the foreign income and the source State will respect the national provision, taxing or not the incomes exiting from Its territory. Even when there are Conventions in force between Italy and the source State, a double taxation can arise due to the fact that OECD model convention, after saying that, in general, the passive incomes may be taxed in the residence State of the recipient, provides for a splitting of the taxation power among the residence State and the source State, limiting, by the way, the source State power to percentages of the income. The solution that, in theory has to be applied to eliminate the double taxation of the same income, would see the residence State of the beneficiary giving up is taxing power on the income already taxed in the other State. Anyway, the foreign tax credit, that art. 165 Tuir acknowledges to physical person, cannot be used by the pension funds. In fact, circular n. 29/2001 excluded the applicability to pension funds of the above mention credit, so the Italian pension fund will be definitely taxed twice on the same income even if the way to determine the substitutive tax plays an important role in the mitigation of double taxation: the tax is levied on the financial returns that are attributed to the fund decreased of the tax withheld at source abroad. The circular refused the application of art. 165 Tuir to pension funds according to the fact that the foreign tax credit is acknowledged when the income for which the credit can be claimed will be a part of the total income of the taxpayer, whereas, in the specific case of pension funds, the taxation occurs on the difference between the net equities of two different moments.

4. Benefits phase

In case of transfer of residence of a beneficiary of a supplementary pension, the differences of taxation models adopted by the States may cause a favourable situation when the individual move from an EET system to a TTE system or just the reverse in case of an individual moving from a TTE State to an EET State. Starting by saying that Italy has not found any solutions to avoid the above mention situations and that I refer to situations to which a Convention is not applicable, I consider that a problem of double non-taxation can not arise. In fact in case Italian residents transfer their residence to another State that does not levy tax on the pension benefits, it will be Italy to tax their pensions because they will be considered as produced in Italy, according to art. 23 para 2 Tuir (art. 23 para 2s) admits Italy to tax non-residents on supplementary pensions produced in Italy, so when they are paid by an Italian pension scheme). In the case of a non-residence transferring his residence to Italy at the retirement age, it is impossible to talk about double non-taxation because Italian system is characterized by the taxation of benefits.

By contrast, it can arise a problem of double taxation in case of non-resident transferring his residence to Italy at the retirement age when, in his previous residence State, he was taxed on contributions and their returns: moving to Italy, in fact, he will acquire the unlimited liability that it is reconnected to the *status* of resident and he will be taxed on the foreign pension received.

4.1 Benefits treatment in absence of a Convention

Going through the problems of double taxation, a problem of juridical double taxation can arise when there is a dissociation between the source State of the pension and the residence State of the beneficiary that are not linked by a Convention. Naturally this problem can exist to the extent to which both of the State polarise their taxing power on the benefit phase.

So, in case a Convention does not exist, the Italian resident that receives a foreign pension, being liable on his worldwide income, will be taxed on the supplementary pension. In fact, supplementary pension benefits are assimilated, according to art. 50 Tuir, to employment income. The resident will be taxed on the total pension received (without taking into account the eventual contributions that he could not deduct in the previous phase, according to Italian legislation), at a rate of 15% of the pension received. The rate can be reduced till 9% in consideration of the permanence in the pension scheme only when the pension is paid by an harmonised fund[107].

In the absence of Conventions, in fact, it will be applied exclusively the internal legislation, notwithstanding how the other State treats the benefits payment received from Italy. In fact, after a Resolution of the Ministry of finance n. 1022/ 1982[108], concerning with the applicability of the principle of mutuality, it has been excluded that, in the lack of a Convention, a different treatment (from the one applicable in force of internal provisions), can be applied in view of the behaviour of the other State.

The juridical double taxation that is caused by the contemporaneous taxation in the two States, can be solved only through the application of art. 165 Tuir that acknowledge to physical person a tax credit on the tax definitely paid abroad.

In the opposite case in which a non-resident receives an Italian pension, the double- taxation can be eliminate only if the residence State gives up, totally or partially, its taxing power, exempting the income taxed in Italy or acknowledging a foreign tax credit on the tax paid in Italy. In fact, every time a non-resident receives an Italian pension[109], he will be taxable in Italy for the income produced herein. According to the fact that the financial returns produced in the pension fund after the beginning of the payment of the annuity, are taxed separately from the annuity, when they will be paid to a non-resident they will be withheld at source by the Italian pension fund as well as happens towards Italian residents, so at a rate of 20%. This rate and this autonomous taxation of financial returns accrued after the beginning of payment of the annuity can be understood

[107] The reduction of the rate can be admitted under the same condition it can be applied in case of transfer to another pension scheme see F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 69.

[108] Resolution 7 January 1982, prot. 1022, see F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 64-65

[109] Art. 23 para 2 Tuir says that supplementary pensions benefits are considered to be producted in Italy every time they are paid by the State, by an Italian resident or by a PE of a non-resident.

according to the fact that Italy considers these financial returns as an income from capital (art. 44 para 1 l. g quinquies Tuir) autonomous from the income equal to the pension received.

4.2 Benefits treatment when a Convention is in force.

When, between the source State and the residence State, there is a Convention based on the OECD model, the allocation of taxing right generally follows the model, even if problems may arise in order to the categorisation of the pension.

According to the OECD model the interpretation that must be applied to categorise an item of income among the articles of the Convention should be the one of the source State[110]. Being this reconstruction discussed and uncertain, it can not be excluded that, being Italy the residence State, It could give an autonomous qualification of the item, worsening the situation of the Italian resident that may be not able to use the foreign tax credit[111], for example in the case in which the source State qualifies the lump-sum payments as income from employment in front of an Italian qualification as pensions. This can lead to a breach of the principle to eliminate double taxation that is the main scope perceived by the Conventions. The foreign tax credit, explicitly arranged by the OECD model will not be applicable in this case, because Italy would consider to have the exclusive right to tax the pension.

The possibility of addressing pensions in the articles of the model tax convention is, in fact, multiple. It is accepted by all Countries that annuity payments fall within art. 18 model convention (naturally when they are not public pension, in this case they will be inserted in art. 19).

Art 18 says that "pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State". In case of annuity payments the non-resident that can prove, furnishing a certification of fiscal residence in the other State, to the Italian pension funds, will obtain the exclusion of the application of the withholding

[110] This interpretation is criticized by the doctrine because it does not assure the legal certainty see G. Melis, *L'interpretazione nel diritto tributario,* Padova, 2003.
[111] F. Rasi, *I profili internazionali della previdenza complementare,* cit., p. 70.

tax[112].

The same uniformity of views lacks in case of lump-sum payments. A lump- sum payment is, in fact, treated, by some States as an employment income, and by some Others as a pension.

In case the lump-sum payment is considered an employment income, art. 15 model convention says that "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 it derived therefrom may be taxed in that other State". This means that the Resident State has not an exclusive taxing right, whereas in case the lump-sum payment is considered to fall in the provision of art. 18 OECD model, it will be taxable only in the Residence State of the beneficiary.

The uncertainty is caused by the vagueness of the commentary to art.18 model convention, that assert "various payments may be made to an employee following the cessation of employment. Whether or not such payments fall under the Article will be determined by the nature of the payments", "while the pensions, under the ordinary meaning of the word, covers only periodic payments, the words other similar remuneration are broad enough to cover non-periodic payments. For instance a lump-sum payment in lieu of periodic pension payments… may fall within the Article".

The freedom, left to the States, to include the lump-sum payment into art. 15 or art 18, may lead to a non-eliminable double taxation caused by the different sourcing rules adopted by art. 15 and 18 when, in the concrete situation, the States have different points of view on the Article applicable. In fact, for instance, a definitely double taxation may exists when the Source State, considering the lump-sum payment an employment income, taxes the pension and the Residence State, considering it a pension, taxes it without acknowledging the foreign tax credit.

This problem is particularly meaningful in Italy because the Revenue Agency seems to consider the lump-sum payment as an employment income. The

[112] The applicability by the withholding agent is not compulsory but optional.

resolution n. 40/E 2009[113] refused to include the lump-sum payment into art. 18. The reasons adopted by the Revenue agency can be criticised[114] because the do not respect the principles that inspire the supplementary pension system and, because they invoke the EU principle in a wrong way.

Firstly, the Revenue Agency based the assertion on the similarity that subsists between TFR (that falls under the provisions of art. 15 OECD model) and the lump- sum payment. This equivalence, however, cannot exist because while TFR is necessary related to the previous employment, the supplementary pensions, according to the system defined by D.lgs. 252/2005 it is not, compulsorily, related to a previous employment[115]. Even if it were related to the previous employment, the pension is not an automatic consequence of the termination of the working activity, because the participation to the supplementary pension scheme is based on an individual choice.

The second critic that can be appointed to the Resolution is based on the fact that the Revenue Agency appeals to the coherence of the national tax system. The coherence to which the Revenue Agency refers is the one defined in the ECJ' sentence Bachmann, by which the coherence of the national tax system could be the mean to justify the taxation of pensions when the State had previously granted the deduction of contributions. Nevertheless it has to be noticed that with a Convention the State can renounce definitely to exercise its taxing power and that, in the specific case, the Revenue Agency interpreted the notion of coherence in this way just to preserve Italian taxing power.

[113] The resolution answered to a question of a German resident who was receiving an annuity from Italy. The annuity was taxable only in Germany in force of the Convention Italy-Germany. He wanted to know if, in case of lump-sum payment, Germany would have preserved the exclusive right to tax.

[114] F. Rasi, *I profili internazionali della previdenza complementare*, cit., p. 74 and next.

[115] Because even self-employed workers can partecipate to supplementary pension schemes.

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Exchange of information versus withholding tax

Enrico Fleres

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PART I - WITHHOLDING TAXATION

INTRODUCTION

There are two main methods of collecting income tax: on the basis of a tax return, usually through information provided by taxpayers, or by a withholding. If tax is withheld at source, the payor has to deduct the amount from the payment and to hand it over to the tax authority. Albeit the tax duty is fulfilled by the payor, the recipient is the sole taxpayer, bearing the economic burden.

The withholding tax method ensures that the tax is paid as soon as the income is transferred to the recipient, it can be somehow deemed as a prepayment of income tax; in such a case the withholding is defined "*creditable*": the taxpayer has to file his tax return, reporting the income and computing his tax due, against which it will be credited the amount of the tax already paid through the withholding. Alternatively the tax withheld is a "*final*" withholding tax, it means that the recipient is discharged from the responsibility of reporting that income in his return; he has therefore no tax liability in respect of it.

Withholding taxes are often levied on the gross amount of income, without taking into account any personal circumstances which may reduce the tax burden. However, in order to tax salaries, most States use a hybrid form of withholding: employers are required to withhold tax from their employees' salaries, but the withholding is not, as usually, levied on the gross income, since the payor has to take in account employees' personal circumstances affecting their tax liability, as interests paid on a loan or the number of children[1]. The employee is required to inform his employer of relevant circumstances to enable him to operate. If the system is correctly applied, it can remove the need to file tax return in favor of those employees that have no other income to report, or whose other incomes are subject to final withholdings, otherwise they are requested to file a return in order to correct their tax burden.

[1] See, for instance, sec. 23, par.. 2, lett. a), Presidential Decree 600/73.

Chapter I – Domestic law

1.1 Incomes subject to withholding taxes

Under the Italian law several groups of income, both active and passive, are subject to withholding taxation. The relevant source of law is the Presidential Decree 600/1973 sections from 23 to 30.

There are not any differences of treatment among resident taxpayers based on subjective circumstances, withholding taxes are applied on the basis of objective requirements: some groups of income are subject to them, such as employee's and self-employment income, others, as corporate income or those derived from immovable property, are not included, therefore they are taxed through the tax return.

1.1 Active incomes

1.1.1 Income from employment

Employees' salary represents the major category of income subject to a withholding[2]. Whoever receives a salary from an individual, a company or other legal entity, is compulsorily subjected to a withholding tax on his payment. This kind of withholding is surely creditable, as stated also by the law; therefore employees are required to file a tax return in order to assess their final tax due.

The amount of the withholding is calculated with regard to the whole payment received by the employee from the employer, fringe-benefits included[3], but

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[2] Sec. 23 of Presidential Decree 600/1973. See F. PETRUCCI, *Le ritenute fiscali nella qualificazione della natura del rapporto di lavoro*, in *Corr. Trib.*, 8, 2009, p. 638 – 640.
[3] Benefits are taxed on the base of their fiscal value, evaluated in accordance with sec. 51, par. 3-9, Presidential Decree 917/1986.

without considering any other item of income received by the employee from other sources, such as dividends or incomes from immovable property. Since this withholding is meant to partially substitute the ordinary taxation, the rate is progressive, and the amount depends from the salary itself; moreover the tax is levied on the whole payment received in money or in kind, since the Italian tax law considers employees as not bearing production costs, therefore without the possibility to deduct anything from the tax base.

In addition, given the strong personal linkage between the employee and the income, personal allowances, like those for burdens of family, health expenses etc.[4], are admitted: the employee must inform, through a formal declaration, his employer about which allowances he has the right to. The employer directly takes into account this information when he calculates the withholding. On the other hand, deductions are not taken into account in levying the withholding, since under Italian law they are related to specific expenses incurred by taxpayers[5], for this reason deductions are reported in the tax return in order to reduce the tax base, but they are not relevant in calculating the withholding.

Non-resident employees' salaries are subject to a different kind of taxation: a final withholding, levied at the rate of 30%[6]. The withholding is final since non-resident individuals are not fully liable under Italian tax law, so they fulfill their whole tax due through a withholding at source. No allowances or deductions are allowed, because Italy, as source state, is not able to take into account the global situation of non-resident taxpayers, hence the non-resident will have to report his personal circumstances in his domestic tax return[7].

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[4] Sec. 12-16 bis, Presidential Decree 917/1986.

[5] Sec. 10, Presidential Decree 917/1986.

[6] Sec. 24, par. 1-ter, Presidential Decree 600/1973

[7] But see European Court of Justice, 14 February 1995, *Schumacker*, C-279/93, which has stated that "*article 48 of the Treaty must be interpreted as precluding a provision in the legislation of a Member State on direct taxation under which the benefit of procedures such as annual adjustment of deductions at source in respect of wages tax and the assessment by the administration of the tax payable on remuneration from employment is available only to residents, thereby excluding natural persons who have no permanent residence or usual abode on its territory but receive income there from employment*." Hence the court has imposed to treat in the same way residents and non-residents whenever their global subjective situation can be compared in accordance with domestic tax law, since the non-resident, receiving his whole income in the Source State, has to be treated as the resident in respect of taxation.

1.1.2 SELF-EMPLOYMENT INCOME

Payments in favor of self-employed, even for occasional professional service, are compulsorily subjected to withholding tax too[8].

As for employment income, also in this case the withholding is described as creditable by the law, but unlike the previous category, the rate is proportional: 20% of the gross income received by the self-employed.

The flat rate does not mean that this kind of income is taxed less than the previous one, because the withholding will be followed by a tax return, whose result, after deductions, will be the base for the application of the progressive rate, whose amount increases more than proportionally with the raise of the income[9]; in the end the gross tax calculated will be reduced by the 20% of withholding already paid[10]. Since the rate is proportional, no allowance is taken into account for calculating the withholding tax, it has to be reported, together with deductions, in the following tax return.

As for employment income, professional service rendered in Italy by non-resident self-employed are subject to a final withholding of 30% rate, levied on the gross income. For the same reasons explained above, no allowance is admitted.

1.2 PASSIVE INCOMES

Among the definitions of income, the thesis of income as consumption had a particular influence in the Italian system, thanks to the support offered by Luigi

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[8] Sec. 25, Presidential Decree 600/1973. See D. LIBURDI, *Compensi e costi professionali e ritenute alla fonte*, in *Corr. Trib.*, 2007, 27, p. 2167 – 2170; R. LUPI, G. VERNA, *Spese di produzione del reddito professionale, anticipazioni da parte del committente ed obblighi di ritenuta*, in *Dialoghi di dir. trib.*, 2006, 7-8, p. 1059 – 1070.

[9] In accordance with sec. 11, Presidential Decree 917/1986, the rates are:

- Up to 15.000 €, 23%;
- From 15.000 to 28.000 €, 27%;
- From 28.000 to 55.000 €, 38%;
- From 55.0000 to 75.000 €, 41%;
- Over 75.000 €, 43%.

[10] Sec. 22, Presidential Decree 917/1986.

Einaudi in his work "*Saggi sul risparmio e l'imposta*"[11]. The theory supports the taxation of the sole part of income addressed to consumption, in order to avoid taxation on that part kept as savings: therefore the tax base is the result of the difference between the income received and the part addressed to savings. Among the arguments for the exclusion of savings from the tax base, the main one is the double taxation of savings: according to the supporters of the theory, to tax the whole income, that is, both the consumption and savings, means to pay taxes twice on that amount saved. The first time when the entire income is taxed, and the second time when interest from savings is taxed.[12]

Even if it does not exist a tax system which takes into account the sole income consumed, it can be stated that Italian tax system has somehow embraced this concept, with the adoption a sort of "dual" income tax[13]: almost all passive incomes are not subject to a progressive taxation, but to a withholding tax with a flat rate, since they derived from saving, nothing but incomes already taxed.

With respect to cross border incomes, as dividends and interests, a fundamental role has been played by the European legislation, especially through the Directives 90/435/CE and 2003/48/CE.

1.2.1 DIVIDENDS

Dividends are taxed in different ways, depending on the recipient: if it is a company, or other legal body subject to IRES, the Italian corporate income tax, dividends become part of the whole tax base, therefore they are not subject to withholding at source[14]; if the recipient is an individual, resident or not, dividends distributed are subject to this kind of taxation.

Dividends, distributed by companies or other legal entities subject to the IRES, the Italian corporate income tax, are subject to a final withholding at a 20% rate

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[11] See L. EINAUDI, *Saggi sul risparmio e l'imposta*, Torino, 1941.
[12] See F. TESAURO, *Istituzioni di diritto tributario. Parte speciale*, Torino, 2012, p.6.
[13] See F. TESAURO, *Istituzioni di diritto tributario. Parte speciale*, cit., p.7.
[14] Sec. 89, Presidential Decree 917/1986, in respect of dividends Italy grants a nearly full exemption through the *pex* (*participation exemption*): if the recipient fulfills the requirements asked by par. 3 of the article, dividends are taxed on the only 5% of the amount, hence, the 95% is saved by taxation.

on net income, if received by individual residents owning non-qualified participation[15]. The same withholding is applied on incomes deriving from financial instruments, whose contribution is not higher than the 5% (in listed companies) or 25% (in non-listed companies) of net assets as resulting from the last balance sheet approved before the contract is drawn up. Moreover, the withholding is applied to individual entrepreneurs, on dividends received as part of their business activity, and on dividends received by "*società in nome collettivo"* or "*società in accomandita semplice"*[16]. If dividends are distributed in kind, shareholders have to calculate the amount of the withholding on the basis of the fiscal value[17] of the goods received.

The withholding becomes final, and the rate increases up to 27%, with regard to resident recipients who are exempt from tax on the corporate income.

Dividends received by non-resident individuals are subject to a final withholding at a 20% rate, the same taxation is applied to incomes deriving from financial instruments previously described; however, shareholders, with the exception of preferred shareholders, can demonstrate, through a validation of the competent tax office in their residence state, that they are further taxed on the same incomes by the residence state, they have the right to obtain a refund up to one fourth of the amount levied through the withholding[18].

If the recipient is a non-resident company or other legal entity and it is resident in a EU member State, or, if it is located in the European Economic Space, the withholding tax is limited to 1.375% of net income.[19] Notwithstanding what

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[15] In accordance with sec. 67, par.1, letter c), Presidential Decree 917/1986, participation (preference shares are not included) […] is considered qualified if it represents at least 5% of capital or 2% of voting rights in listed companies, or at least 20% of capital or 25% of voting rights in non-listed companies or in other legal entities subject to CAIT.

[16] These two forms of partnerships can be respectively compared to general partnership and limited partnership.

[17] The fiscal value of a good is calculated in accordance with sec. 9, Presidential Decree 917/1986: "It is the price or payment usually applied in regard to same or similar goods or services, in a free-competition situation and in the same stage of sale, in the time and in the place in which goods or services have been acquired or rendered, or in the most next."

[18] Sec. 27, par. 3, Presidential Decree 600/1973.

[19] The same taxation is applied to resident companies, whose received dividends are taxed only to the extent of 5%, with a rate of 27.5% (27,5%*5%= 1.375%). See F. MENTI, *Gli utili distribuiti dalla società controllata alla società controllante e la questione dell'applicazione della ritenuta alla fonte*, in *Riv. dir. trib.*, 2008, 11, pag. 306 – 321; V. UCKMAR, *Diritto tributario internazionale*, Padova, 2012, p. 277,

written above, if a State is not included in the *white list*[20] drafted by the ministry of treasury, the rate will return to 20%. In particular, in the white list there are listed all the States that fulfill the requirements of transparency required by Italian government. The list is divided in two parts: in the first one there are states which grant an adequate exchange of information; in the second part there are states that, in addition to granting a sufficient degree of information, tax incomes with a proper rate.[21]

With regard to cross-border dividends distributed among companies, a primary role has played by the Directive 90/435/CE (Parent-Subsidiary). Referring to the Directive, sec. 27 *bis* of Presidential Decree 600/1973 rules the taxation on dividends distributed to parent companies placed in a Member State. They have to fulfill the following requirements:

- To take one of the forms listed in the Annex of the Directive;
- To be resident in a Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, to be not considered to be resident for tax purposes outside the Community;
- To be subject to one of the taxes listed in the Directive, sec. 2, without the possibility of an option or of being exempt[22];
- To maintain for an uninterrupted period of at least one year a minimum holding of 20% in the capital of a company of another Member State;

they have the right to ask the refund for the amount of dividends withheld at the source[23].

The same right is also granted to the owners of financial instruments, granting rights related to the income of the subsidiary, that fulfill requirements listed above. In order to obtain the refund, companies must provide a validation from the competent tax office in their residence State, moreover they have to produce a

[20] In accordance with sec. 168 *bis*, Presidential Decree 917/1986.
[21] The list is drafted in order to fight evasion and to properly adjust phenomena of double taxation: indeed, if a company is located in a non-white list State, its income is probably not taxed in the residence State (tax heaven), therefore the low rate is no more justified, due to the lack of a double taxation; in addiction, the lack of transparency is deemed as an obstacle for any kind of fiscal collaboration, because of the risk of evasion (e.g. incomes not disclosed) that could be hidden in those countries that not grant an adequate degree of transparency.
[22] Companies can only make use of exemptions, territorially and temporally limited.
[23] Sec. 27-*bis*, Presidential Decree 600/1973. See V. UCKMAR, *Diritto tributario internazionale*, cit, p. 278.

document in which it is stated that the company fulfills the prerequisite required.[24] In order to obtain the refund, the statements have to be sent to the tax authority before the distribution of the income.

In the end, in order to contrast the *conduit company* phenomenon, these provisions are not applied if the mother-company is directly or indirectly controlled by a holding which is not resident in a EU member State, unless the parent company proves to be the beneficial owner of the dividends.

1.2.2 INTERESTS

Interests received by residents are subject to different withholding taxes, according to the source of the income[25]. The standard final withholding is levied at a rate of 20% on incomes deriving from bonds issued by non-listed companies[26]. Interests from deposit accounts and current accounts with banks and post offices, received by residents and non-residents, are subject to a final withholding at a rate of 27%; the same taxation is applied by banks on interest-bearing bonds issued by them[27].

Incomes deriving from repurchase agreements and collateralized loans are taxed through a withholding with a 20% rate. With regard to repurchase agreements, the withholding is also levied on interests and other incomes accrued in the meanwhile[28].

Incomes above listed are subject to a creditable withholding, if the recipient is:

- An individual entrepreneur, if incomes are related to his business activity;
- Società in nome collettivo or società in accomandita semplice[29];

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[24] Sec. 27 bis, par. 1, Presidential Decree 600/1973.

[25] See. G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, in *Report Italy on the annual meeting of EATLP*, Budapest, 2006, p. 8.

[26] Sec. 26, par. 1, Presidential Decree 600/1973. See G. BARBAGELATA, M. PIAZZA, *Ritenute sugli interessi corrisposti a società comunitarie*, in *Corr. Trib.*, 2011, 31, p. 2548 – 2554; M. PIAZZA, *Interessi e altri proventi delle obbligazioni e titoli similari e dei conti correnti e depositi*, in *Corr. Trib.*, 2012, 19, p. 1477 – 1482.

[27] Incomes accrued after 1-1-2012 are subject to a withholding at a rate of 20% on the base of the Law Decree 138/2011.

[28] Sec. 26, par. 3-*bis*, Presidential Decree 600/1973.

[29] See note 13.

- Companies and other legal entities, carrying out exclusively or mainly a business activity;
- Permanent establishments of non-resident companies, legal entities or trusts.

For any other kind of interest[30] a creditable withholding is levied at a rate of 12.50%[31].

On the other hand, some categories of interests received by non-residents are differently taxed. Firstly, the residual clause regarding different kinds of interest bills a final withholding instead of a creditable one, moreover its base is extended even on incomes obtained from the business activities[32]. The same final withholding is applied also on incomes deriving from loans granted to foreign permanent establishments of resident companies, if the permanent establishment is not owned by the loaner company.

Some other kinds of interests are exempt from taxation if the recipient is a non-resident[33]. It is granted the exemption from withholding taxes with regard to:

- Bonds and similar instruments issued by banks, having a duration not lower than 18 months;
- Bonds and similar instruments issued by listed companies, having a duration not lower than 18 months;
- Bonds issued by the State or other public entities;
- Bonds issued by international organizations recognized in Italy on the basis of an international agreement, such as EURATOM, EIB, World Bank;
- Bonds issued by public entities transformed by the law in companies;
- Incomes deriving from deposit or current accounts different from banking and postal ones;
- Incomes deriving from services of guarantee or surety ship;

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[30] Sec. 26, par. 5, Presidential Decree 600/1973.

[31] See. G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 9.

[32] Sec. 26, par. 5, Presidential Decree 600/1973.

[33] Sec. 26 bis, Presidential Decree 600/1973. See G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 9; V. UCKMAR, *Diritto tributario internazionale*, cit, p. 298-302.

- Incomes deriving from repo-contracts and collateralized loans.

In order to obtain the exemption, the non-resident has to be the beneficial owner of these incomes, and to fulfill subjective requirements:

- To be a resident of States that grant an adequate exchange of information with Italy;
- To be central banks or entities who manage official reserves of a State;
- To be a qualified investors, even if not liable to tax in Italy, if resident in a State which grants an adequate exchange of information.[34]

Moreover, payments made by resident banks, or Italian branches of non-resident, to non-resident banks or foreign branches of Italian banks are exempt from withholding taxes: in this respect, because of the sole exemption from the withholding, and not the exclusion of the whole income, it has been stated that non-resident recipients have to file a tax return in Italy in order to pay their tax due; however, the doctrine agrees that the exemption from the withholding tax shows the intention of the Italian legislator to opt the whole taxation out[35].

In accordance with sec. 1, Legislative Decree 239/96, the withholding of 20% is not levied on interests and other related incomes deriving from bonds issued by:

- banks;
- listed companies, resident in EU States or in other States listed in the *white list*;
- public economic entities, transformed by the law in companies, with the exemption of finance bills;
- Italy;
- States included in the *white list*;
- non-residents;
- special Purpose vehicles, after a securitization;
- treasury bills issued by “Regioni” and “Comuni”[36].

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[34] Sec. 26 bis, Presidential Decree 600/1973.
[35] See V. UCKMAR, *Diritto tributario internazionale,* cit, p. 300.
[36] Regioni and Comuni are administrative subdivisions of the national territory; the first ones cover large sections of the Italian territory (as Sicily, Lombardy, Lazio, etc.), whereas the second ones are limited to a sole city/town (Milan, Rome, Turin, etc.).

It has to be underlined that under Italian tax law, the part of income that derives from profits gained by the issuer cannot be deducted[37]; this notion of interest appears in contrast with the definition accepted both in the OECD model and in the Savings Directive where it is made no distinction with those credits which contain a right of participation in the issuer's profits[38].

In the end, cross border interests and royalties are exempt from any taxation if they fulfill the requirements of Savings Directive[39], which will be described later.

1.3 CONCLUSION

We can sum up the previous paragraphs through the following points:

- Some active incomes are subject to creditable withholdings, usually levied with a progressive rate, given the aim to link part of the taxation to the moment in which payments are made. Therefore allowances are admitted, even if the taxpayers have to file a final tax return in order to assess their global ability to pay, and, consequently, their tax due.
- However, passive incomes are often subject to final withholdings, levied with a proportional, flat rate. Due to the lack of linkage with the personal situation of taxpayers no allowance is admitted, the taxation is levied on the whole income received, with no regard to any other relevant circumstances of taxpayers.

In order to justify the different, and lower, rate applied on passive incomes, we have to quote two streams of thought.

The first, which derives from the notion of income-consumption, supports a dual approach in favor of passive incomes, because they represent the result of the investment of savings: if the State taxed with a progressive rate these incomes, it

[37] Sec. 109, par. 9, Presidential Decree 917/1986.
[38] See V. UCKMAR, *Diritto tributario internazionale,* cit, p. 302.
[39] Sec. 26 *quater,* Presidential Decree 600/1973.

would mean to tax twice the same wealth, firstly as active income (from which savings derive), then as passive incomes (which derive from savings)[40].

Secondly, more practical, doctrine states that, in order to attract investments, taxation needs to be proportional[41] and at a flat rate. It cannot be forgotten that investments, thanks to capital mobility, are attracted by favorable tax systems, where they are taxed notwithstanding the amount of wealth invested, hence proportionally, not progressively.

Finally it must be reminded that in no case the withholder is refunded for the incurred costs, the Italian legislation does not grant him any kind of compensation; costs incurred may be economically shifted to taxpayers as part of the overheads.

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[40] See I. MANZONI, G. VANZ, *Il diritto tributario. Profili teorici e sistematici*, Torino, 2008, p.146-147; F. TESAURO, *Istituzioni di diritto tributario. Parte speciale*, cit., p.7.

[41] For a justification of the proportional taxation in a system based on the progressivity principle, see G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 2.

2. TAX TREATIES FEATURES

Italy has signed **108 agreements** (**102 DTC** and **6 TIEA** agreements) providing for the exchange of information and double taxation contrast.[42]

Italy, by these treaties, does not usually modify its rules regarding the calculation of the tax base, preferring to negotiate the division of tax claims, and consequently, tax rights with the counterpart.

With regard to Italian DTCs, the base-model applied is the OECD one, hence there are not any particular provision about the calculation of the withholding base. However, some specific clauses, referring to the recipient, as the beneficial owner of those incomes, strongly limit the rate of the withholding levied by the source State; in addiction, the withholding is also limited if the recipient fulfills the requirements of the EU Directives such as 435/1990 or 49/2003.[43]

Italy's DTCs surely follow the OECD-MC model regarding artt. 10, 11 and 12. However, part of the scholars[44] raised a problem of compatibility between the notion of interest in the OECD model and the Italian one: as foresaid in paragraph 1.2.2, Italy does not consider as interests incomes partly deriving from a right of participation in the issuer's profits, which are deemed as dividends[45] and hence not deductible, whereas the OECD Model defines interest as "*income from debt*

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[42] OECD: *http://www.eoi-tax.org/jurisdictions/IT#agreements*, site last updated on 16/1/2013.
[43] Cases of reduction of the tax base can be found in: France-Italy DTC, sec 10, 11, par. 8, 12, par. 7, 24, par. 1; Germany-Italy DTC, sec. 11, par. 7, 12, par. 7, 24. The UK-Italy DTC subordinates the reduction of the tax base to the existence of a tax credit given by the recipient's State of residence, moreover, no withholding is levied if the recipient is the beneficial owner of that income: sec. 10, par. 7, 11, par. 8, 12, par. 6. See P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, Milano, 2012, p. 1107-1196. For a complete list of withholding levied by Italy in accordance with its DTCs, see P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, cit., p. 48-72.
[44] See V. UCKMAR, *Diritto tributario internazionale*, cit, p. 302.
[45] Sec. 109, par. 9, letter a), Presidential Decree 917/1986 does not admit "the deduction of incomes deriving from securities, which directly or indirectly derive from the participation in the issuer's profit".

claims of every kind […] whether or not carrying a right to participate in the debtor's profit"[46].

With regard to tax credit, some of Italian treaties contain a tax sparing clause, by virtue of that Italy grants a home-country foreign tax credit for specific foreign taxes that would have been payable but that, thanks to tax exemption in the foreign country, have not. Tax sparing provisions are included in treaties with the following nations: Albania, Algeria, Argentina, Brazil, Bulgaria, China, Cyprus, South Korea, Ivory Coast, Denmark, Egypt, Estonia, Ethiopia, Philippines, Finland, Georgia, Ghana, India, Israel, Yugoslavia, Kenya, Macedonia, Malaysia, Malta, Morocco, Mauritius, Mexico, Mozambique, Pakistan, Portugal, Singapore, Syria, Sri Lanka, Sweden, Tanzania, Trinidad & Tobago, Tunisia, Turkey, Uganda, Uzbekistan, Venezuela, Vietnam, Zambia[47].

For instance tax sparing in the treaty with Argentina is so described:

"The Argentine tax shall be always deemed as paid at the rate of:

a) 15% of the gross amount of dividends […];

b) 20% of the gross amount of interest […];

c) 20% of the gross amount of royalties […].

If, by virtue of Argentine law, the Argentine tax on profits of enterprises referred to in Article 7 of this Convention is, during a specified period of time, wholly or partly uncollected, such tax shall, for the purposes of paragraph 2 of this Article, be deemed paid to a limit of 15% of such profits."[48]

2.1 NOTION OF BENEFICIAL OWNER

With regard to the notion of beneficial owner, Italy, in its DTCs, inserts the standard clause about the interpretation of terms not defined by the convention: sec. 3, par. 2 of the OECD Model. In accordance with this provision "*terms not defined by the convention itself shall have the meaning that it has […] under the*

[46] Sec. 11, par. 3, OECD Model. See F. AVELLA, *La qualificazione dei redditi nelle Convenzioni bilaterali contro le doppie imposizioni stipulate dall'Italia*, in *Riv. dir. trib.*, 2010, 6, p. 45 – 71.
[47] See P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, cit., p. 766-775.
[48] Sec. 24, par. 4-5, DTC Italy-Argentina.

law of the State [...]"; hence, the matter shifts from the international to the national level, because it is in Italian law that the definition has to be found.

However, Italian doctrine is discordant whether a notion can be found or not; eminent authors stated that there isn't a national concept of beneficial owner, therefore Italy simply refers to the conventional notion or to that given by Directives[49]. Others[50] have contested this stream of thought, giving much more relevance to those Italian provisions, which, implementing the Savings Directive, has inserted in our tax legislation the notion of beneficial owner. The relevant provision is the section 26 *quater* of the Presidential Decree 600/1973, which considers beneficial owner:

- companies, if they receives the payment as beneficial owner and not as *intermediary, agent, delegate or fiduciary of another person*;
- permanent establishments, if the royalties which generate incomes are truly and effectively related to these P.E.s and these incomes are taxable under the tax law of the State where the establishments are placed.

Hence, we have not a positive definition of beneficial owner, but a negative one. Italian tax law cares to define what a beneficial owner is not, underlining the borders of the notion, or relating the notion to taxability.

However, there is just one DTC, concluded with Germany, which contains a full definition of the concept. In accordance with the sec. 9 of the Protocol: "*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 therefrom is attributable to him under the tax laws of both States."* This notion is quite different from the domestic one,

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[49] See G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 11. Moreover the authors refer to the definition given by the Legislative Decree 84/2005, implementing Savings Directive, where beneficial owner is deemed who is *the final beneficiary of such interest* (sec. 1). Italian tax authority has released a circular letter (30 December 2005, n. 55), where it has simply defined the role of beneficial owner as who, resident in a Member State, receives interest payments by a paying agent resident in a different Member State (point 1.1). See A. DE PISAPIA, *Beneficial owner, beneficiario e beneficiario effettivo: diverse espressioni in cerca di un significato unitario nelle Convenzioni contro la doppia imposizioni*, in *Riv. dir. trib.*, 2010, 4, p. 3 – 26.

[50] See F. AVELLA, *Il beneficiario effettivo nelle convenzioni contro le doppie imposizioni: prime pronunce nella giurisprudenza di merito e nuovi spunti di discussione*, in *Riv. Dir. Trib*., 2011, 4; B. BAGNARDI, *Il concetto di "beneficiario effettivo" nella direttiva sulla tassazione del risparmio*, in *Dir. prat. Trib. Int.*, 2003, 1, pp. 185 – 198.

since it refers to the imputability of incomes under tax legislation, whereas the previous notion refers to the effective power to have the use of these sums.

There are just few judgments about the international notion of beneficial owner. In 2009 the *Corte di Cassazione*[51] has applied the concept in a very narrow way with regard to the text of the convention[52]: even if the judges have recognized that the recipient fulfilled the definition of beneficial owner in economic terms, as provided by the DTC between Japan and Italy, however, due to the use of a conduit company, the notion could not be considered fulfilled in juridical terms, because a US subsidiary had been the first recipient of the dividends distributed, so that it has been impossible to grant the exemption. Another important case law, regarding the notion contained in the Germany-Italy convention, is the judgment on the 14th July 2010 of the *Commissione Tributaria Provinciale*[53] of Torino, in which the judges decided to look at the domestic notion of beneficial owner, whereas, in the opinion of some authors[54], they would have differently decided, because the object of the judgment was the DTC between Italy and Germany, which, as foresaid, contains a specific notion of beneficial owner. For this reason, in accordance with the Vienna Convention on the Law of Treaties: "*A special meaning shall be given to a term if it is established that the parties so intended"*[55]. Finally the most recent decision[56] is that taken by the *Commissione Tributaria Regionale*[57] of L'Aquila on the 30 August 2012, in which the judge has recognized as beneficial owner the English parent company of the Italian subsidiary, assessing that the participation has been held by the owner since the foundation of the subsidiary, that the bank account is registered in the owner's name, that the dividends were, with the distribution, transferred to a US bank account before reaching their final destination, the treasurer of the company.[58]

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51 The Italian High Court of Justice.
52 Cass., 26 February 2009, n. 4600.
53 The tax court of first instance.
54 See F. AVELLA, *Il beneficiario effettivo nelle convenzioni contro le doppie imposizioni: prime pronunce nella giurisprudenza di merito e nuovi spunti di discussione*, cit., p. 25.
55 Sec. 31, par 4 of the Vienna Convention
56 Comm. Trib. Reg. Abruzzo, 30 August 2012, n. 958.
57 The tax court of second instance.
58 D. AVOLIO, B. SANTACROCE, *Il "beneficiario effettivo" nella giurisprudenza nazionale e internazionale*, in *Corr. trib.*, 2010, 6, p. 429 – 433.

2.2 RIGHT TO REFUND

Our DTCs do not contain any special provision with regard to refund against withholding according to an applicable double treaty. Italy limits itself to grant the refund to the residents of the other contracting State *if the refund is requested, within the time limits fixed by Italian law*[59]. In accordance with the Italian legislation[60], refunds against direct withholdings levied not in accordance with the DTCs have to be requested within 48 months from the origin of the right to the refund.

In order to obtain the refund, the applicant has to prove that he is entitled to the refund. In particular, he has to demonstrate that, in accordance with the criteria fixed in the DTCs, he fulfills the requirements of residence established by one of the contracting parties and that the DTC grants a particular treatment (e.g. exemption from withholding) to the item of income regarding which the refund is asked.

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[59] For instance, we report sec. 10 (*Dividends*), par. 5 of the DTC between Italy and Germany:
5. *A company of the Federal Republic of Germany which directly owns at least 25% of the capital of a company resident in the Italian Republic and which receives dividends distributed by this company is entitled to a refund of the amount equal to the "maggiorazione di conguaglio" attributable to these dividends, subject to the deduction of the taxes mentioned in paragraph 3 and provided that the "maggiorazione" on these dividends has actually been paid by the company.* **The refund is to be requested, within the time limits fixed by Italian law, through the intermediary of the distributing company, which in such a case is to act in the name of and on behalf of the company resident in the Federal Republic of Germany.**

[60] Sec. 37 Presidential Decree 602/1973.

CHAPTER III - EUROPEAN TAX LAW

3.1 DIFFERENCE OF TREATMENT BETWEEN EU AND NON-EU RESIDENTS

Passive incomes received by non-residents are differently treated according to the residence of the recipient.

If the non-residents' State is not a Member of the European Union, the taxation is levied as explained in par. 1.2.1.

On the other hand, if the non-Italian resident is resident in a Member State, the taxation has to deal with two important directives: 1990/435/CE (Parent-Subsidiary) and 2003/49/CE (Interest and Royalties).

Starting with the first, cross-borders dividends distributed by a subsidiary to its parent benefit from a full exemption from the standard withholding if parts in the transaction fulfill the following requirements:

- The parent directly owes at least 20% of shares in the distributing subsidiaries;
- Both the companies are incorporated in one of the form listed in the Annex of the Directive;
- Both the companies are fully liable to taxation under the respective national tax systems;
- The shares are held by at least one year[61].

In order to obtain the exemptions, companies have to produce documents which certify the fulfillment of the requirements[62].

With regard to interests paid to non-residents, the difference is the same: not-EU residents are taxed as described in par. 1.2.2.

Residents in Member States are instead not subject to withholding if they fulfill the requirements asked by the Interest and Royalties Directive[63].

Hence, if:

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[61] Sec. 27 *bis*, par. 1, Presidential Decree 600/1973.
[62] Sec. 27 *bis*, par. 2, Presidential Decree 600/1973.
[63] Sec. 26 *quater*, Presidential Decree 600/1973.

- both, the payor and the recipient, are resident in a Member State and they are incorporated in one of the form listed in the annex of the Directive;
- the recipient directly owes at least 25% of the voting rights of the paying company or vice versa, or
- a third company owes at least 25% both, the payor and the recipient;
- the voting rights are enforceable in the annual general meeting;
- the participation is held by at least a year;
- the recipient is the beneficial owner of the payment;

sums paid are free from any taxation in the source State (Italy)[64].

3.2 THE IMPACT OF THE ECJ JURISPRUDENCE ON ITALIAN WITHHOLDING TAXATION

As it was explained, Italian tax system grants a particularly favorable treatment to investments made by EU resident. This difference of treatment is surely justifiable at the light of the freedom of movement granted to wealth.

To invest in Italy as a non-resident or as a resident has to be neutral in relation to tax impact, so cross borders incomes, direct to European investors, has to be treated like a purely internal situation, no discrimination is allowed.

With regard to the respect of this fundamental freedom the ECJ has often issued its opinion through some capital judgments[65]. With regard to Italian withholding system, the most important decision is surely the judgment C-540/07, *Commission of the European Communities vs. Italian Republic*[66],19 November 2009.

The previous Italian withholding system levied a particularly high tax on passive incomes received by non-residents[67], whereas the same payments received by residents became part of the tax base up to the 5% of the amount; it was

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[64] Sec. 26 *quater*, par. 2, Presidential Decree 600/1973.
[65] For instance: *Scorpio*, C-290/04; *Group Litigation*, C-374/04; *Denkavit*, C-170/05; *Amurta*, C-379/05; *Orange European Smallcap Fund*, C-194/06.
[66] A. DEL SOLE, *Riflessioni critiche sulla pronuncia di incompatibilità con il diritto comunitario della ritenuta italiana sui dividendi "in uscita" verso soggetti comunitari.*,in *Dir. prat. trib.*, 2010, 4, p. 830 - 848
[67] 27% on dividends, 12,5% on dividends deriving from preference shares.

possible to ask a refund up to four ninths of the amount withheld in case of explicit provision included in DTCs, but the taxation remained higher than that levied on internal distributions. The Court has stated that: "*by imposing on dividends distributed to companies established in other Member States a tax regime less favorable than that applied to dividends distributed to resident companies, the Italian Republic has failed to fulfill its obligations under Article 56(1) EC*".[68]

After that judgment the legislation has been changed in order to balance the internal and the cross borders distribution of income: since an Italian percipient is taxed at a rate of 27,5% on a tax base formed by the 5% of the dividend, the same taxation in now levied on dividends received by EU resident[69].

At the moment our tax law does not seem to be in contrast with the European system, since incomes are exempt from withholding if they fulfill the Directive requirements, otherwise, as said, they are subject to a withholding on the net income at a rate of 1.375%[70], likewise Italian residents ones.

No further cases regarding withholding taxes are pending before the ECJ.[71]

[68] Point 64 of the judgment.
[69] Sec. 3 ter, Presidential Decree 917/1986.
[70] See note 15.
[71] Cases pending register updated on the 18th January 2013.

PART II - PAYING AGENT SYSTEMS

INTRODUCTION

The Savings Directive (2003/48/CE) means to improve the transparency on savings and capitals held by agents, like banks, mutual funds, etc.

The new regulation does not change the previous taxation on these items of income; it just imposes procedural duties on financial agents, in order to grant that savings, located in other States, will not escape from taxation in the account holder's residence-State.

Some States[72] raised the issue of constitutional compatibility between duties of information deriving from the Directive and the banking secrecy, which, in their systems, has a constitutional significance; not so Italy, where the same right to the saver's privacy has been considered not able to contrast the public and budgetary interest to taxation.

Even before the Directive, Italian banks and subsidiaries of foreign ones had to fulfill the requests applied by the tax authority and to disclose their data-bases in order to supply the information relevant to the assessment.

Today Italy grants a full disclosure of information held by its paying agents through the procedure as expected by the Directive; no chance of anonymity is left, not even through the application of the Euro-withholding[73], an alternative method not implemented in our country.

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[72] Belgium, Austria, Luxemburg.

[73] The so-called European Union withholding tax is a withholding tax which is deducted from interest earned by European Union residents on their investments made in another member state, by the state in which the investment is held. (The European Union has no taxation powers, so the name is strictly a misnomer). The aim of the tax is to ensure that citizens of one member state do not evade taxation by depositing funds outside the jurisdiction of residence and so distort the single market. The tax is withheld at source and passed on to the EU Country of residence. All but three member states disclose the recipient of the interest concerned. See P. BORIA, *Diritto tributario europeo*, Varese, 2010, p. 286-287.

CHAPTER I - DOMESTIC AND CROSS BORDER SITUATIONS

1.1 DOMESTIC SITUATIONS

As already explained in paragraph 1.2.2, taxes on interests are often collected through a final withholding levied by the payor of the income, so it may be stated that Italian tax system somehow applies the mechanism of paying agent, in case of payments made, as debtors, by banks. Outside this hypothesis banks are not requested to intervene, for instance, in a transaction between the account holder and a third, since the effective debtor is entitled of the duty to levy the withholding.

Italy has transposed the Directive in terms of complete transparency of information held by banks and other paying agents, periodically sent to the Italian tax authority, so as this informs the authorities of the residence-countries of the account holders.[74]

No refund is granted by law to paying agents, hence costs burden due to the duties of communication may be economically shifted on account holders as part of the overheads.

1.2 BANK SECRECY AND CONSTITUTIONAL ISSUES

Italy has not a specific provision about bank secrecy, however, it is considered as a banks' customary duty, which impose the secrecy about their clients. This duty could be waived for tax purposes, particularly in case of assessment[75]. In 1991, the Law 413/1991 has introduced the ability for the *Agenzia delle Entrate* and *Guardia di Finanza* to infringe the secrecy in relation to tax inquiries.[76] In

[74] N. ARQUILLA, *Attuata la direttiva di tassazione dei redditi di risparmio*, in *Corr. Trib.*, 2005, 25, p. 1969 – 1973.
[75] Former sec. 35 Presidential Decree 600/1973.
[76] See N. NITTI, *Accertamento fiscale esecutivo e caduta del segreto bancario*, in *Nuova rass. leg.*, 2012, 3, p. 304.

1995 another reform has introduced taxpayers' right to be requested about their relationships with banks before the inspections are started, in order to reduce the number of inquiries, and, consequently, the burden of work on the tax offices.[77]

In order to carry out the inspection, tax offices have to require the authorization of the Director of the regional office of the tax authority, or that of the regional Commander of the *Guardia di Finanza*[78].

There are several streams of thought regarding the origin of the bank secrecy: some scholars consider it as deriving from professional secrecy, others from the office secrecy, the distinction has quite a relevance, because the different origin, from private or public law, change the possibility to waive it[79]; in 1974 the Corte di Cassazione has defined it as birth from the customary praxis to keep an absolute secrecy about clients' information[80], nothing more.

A fundamental judgment about bank secrecy is the decision of the Corte Costituzionale in 1992[81]. In the judges' opinion, the secrecy is nothing but a contractual duty to keep the secrecy about clients' situation, in relation to clients' financial transactions, bank accounts and other information about the services rendered; however, as a contractual duty, it does not grant a constitutional protection, nor a full right to privacy against public inquiries, such as the tax ones, which, pursuing public interests, appear to be overriding the first one. Hence, the Court has specified that the legitimacy of such infringement is subordinate to the pursuit of a public interest, such as the collection of tax, the fight of the evasion or the tax avoidance.

The legislation about bank secrecy has been substantially changed again in 2011.[82]

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[77] Sec. 3, par. 177-178, Law 549/1995, which introduced the new par. 6 *bis* in sec. 32, Presidential Decree 600/1973.
[78] The document must be filed in accordance with the instructions provided by the circular n. 1/6826/1992 issued by the Minister of Treasury. See N. NITTI, *Accertamento fiscale esecutivo e caduta del segreto bancario*, cit., p. 304.
[79] See N. NITTI, *Accertamento fiscale esecutivo e caduta del segreto bancario*, cit..
[80] Cass., 18 July 1974, n. 2147.
[81] Corte cost., 18 February 1992, n. 51.
[82]See N.BORZI, *Le banche sveleranno al Fisco il nostro salvadanaio. Con buona pace della privacy*, in *Il Sole24ore*, 12 February 2013; U. PERRUCCI, *Fine del segreto bancario o stato di polizia (fiscale)?*,in *Bollettino tributario d'informazioni*, 2012, 8, p. 591-593..

First of all, banks, Poste Italiane S.p.a. and other financial intermediaries have to keep their clients' data, TIN included, in order to grant transparency in case of inspections, or requests of information applied by the tax authority.[83]

Moreover, the Law n. 148/2011[84] has extended powers of the tax authority, adding cases in which inspections can be carried out; however, the most important change has been surely happened with the Law Decree n. 201/2011, imposing, starting from the 1st January 2012, to the financial intermediaries, banks included, to periodically report information about clients' transactions[85] to the Anagrafe Tributaria, so that the tax authority will be able to cross these data with the tax returns or other documents at its disposal, in order to find the discrepancy and consequently to react.

1.3 CROSS BORDER SITUATIONS

In implementing the Directive[86], Italy does not maintain the double choice between exchange of information or taxation through the so called "Euro withholding".

Italian paying agents have to periodically transmit all relevant information about their foreign clients to the Italian tax authority *"Agenzia delle Entrate"*, so as this is able to hand the information over the other national agencies. Italian

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[83] See G. FALSITTA, *Manuale di diritto tributario – Parte generale*, Padova, 2012, p. 485-486.

[84] It has implemented the Law Decree 148/2011, so-called Manovra *bis*, in particular sec. 2, par. 36-*undevicies*. See N. NITTI, *Accertamento fiscale esecutivo e caduta del segreto bancario*, cit., p. 305.

[85] The list of the transactions, to which the duty of information is applied, is provided by par. 5 of sec. 7, Presidential Decree 605/1973.

[86] Italy has implemented the Directive with Law Decree 18 April 2005, n. 84 (the "Decree"). The Italian Tax Administration then added some clarification with two formal acts on 8 July 2005 (concerning the technical aspect of the exchange of information between the paying agent and the Italian tax authority, implementing art. 6 of the Decree , and the formal request that residual entities must file in order to be treated as a harmonized UCITS (art. 4, par. 3, of the Directive), implementing art. 1 of the Decree; a third one on 25 July 2005 (concerning the formal request through which an Italian beneficial owner can certify his status, implementing of art. 9 of the Decree) and a circular letter (30 December 2005, n. 55) which contains some formal clarification on the content of the Directive. See G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 10.

policy is based on a complete, mutual financial transparency among Member States.

Moreover, even if an Italian resident, having a banking account in one of the States which have implemented the Euro withholding system, has been subject to the above-mentioned withholding in the source State, he is still liable for taxation on his worldwide income under Italian legislation, hence, even on capitals subject to the withholding. However, if he manages to prove that he has already been subject to the withholding in the source State, Italy grants a tax credit up to the amount withheld by the first State, in addiction, if our tax rate is lower than that applied by the source State, the beneficial owner has the right to a refund for the exceeding amount of income withheld.

1.4 PROS AND CONS OF EXCHANGE OF INFORMATION AND PAYING AGENT SYSTEM

In order to make a comparison between the two systems, I am going to describe firstly the features of the mechanism implemented in Italy: exchange of information[87].

Transparency is surely a powerful mean against evasion: all capitals are traced, fairly taxed and they can be moved throughout the European Union without negative consequences according to Italian tax law[88]. However it is true that transparency compromises the account holders' privacy, due to the duty to communicate any change in terms of assets or incomes.

Moreover, it is also true that transparency does not mean taxation: the information exchanged makes the tax authority able to know the global tax liability of the account holder, but then it is up to the authority to correct the burden of tax, taking into consideration the information received and the other

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[87] See P. VALENTE, *Il dibattito internazionale su scambio di informazioni e base imponibile unica*, in *Corr. Trib.*, 2011, 29, p. 2379-2386.

[88] Moving capitals outside the EU can be considered as an attempt of evasion if the State of destination is not included in the *white list*, because they do not grant an adequate degree of information.

items of income, positive or negative, which the taxpayer holds. Bureaucratic issues may arise, especially in the interpretation of the transmitted datas, for instance, if the financial legislation is deeply different between States, the interpretation may result misleading.

On the other hand the Euro withholding grants that the income is taxed as soon as the payment is made; it probably fulfills the budgetary interest better than the exchange of information. However, applying such system, the residence State has no mean to know the effective wealth of one of its residents, having to trust the accuracy and the honesty of the paying agent. Moreover the latter system does not resolve the problem of "black funds", deriving from evasion or other criminal activities, because it does not allow any kind of tracing or communication[89].

In the end, Italian government has showed its absolute opposition against the Euro-Withholding[90], which is considered a failed compromise in the fight against evasion[91], so that in 2011 the Ministry of Treasury has threatened to use his veto power in order to tackle the ECOFIN works about this alternative mechanism provided by the Savings Directive.

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[89] M. V. SERRANÒ, *Direttiva sulla tassazione del risparmio: tra euroritenuta e scambio di informazioni*, in *Bollettino tributario d'informazioni*, 2009, 5, p. 343-345.
[90] D. PESOLE, *No italiano all'Euroritenuta*, in *Ilsole24ore*, 18 May 2011, p. 4-5.
[91] Actually, with tax amnesty of 2009 the amount of assets brought back in Italy was hugely greater than the amount registered and declared by foreign banks, this fact has obviously reduced the trustworthiness of the Euro-withholding, and, in general, of foreign banks placed in tax-heaven; see J. S. PASTORIZA VÀZQUEZ, *La nuova direttiva sulla tassazione del risparmio: applicabilità ed efficacia*, in *Rass. Trib.*, 2005, 4, pp. 1095 – 1127.

2.1 EUROPEAN LAW

With regard to the compatibility between the paying agent system and the European tax law, no problem seems to arise from the match of these two branches of the legislation.

The unique doubt which may arise pertains to one of the fundamental freedoms: the free movement of capital.

It is surely true that the new Directive 48/2003 hits against the freedom of movements, imposing new, piercing duties on financial intermediaries; however these provisions, placed in order to grant a higher degree of transparency, cannot in any way impede or aggravate the movements of financial assets, because banks and other intermediaries have no power to forbid a commercial transaction on the basis of the new Directive.

The Directive has dug a deep gap in relation to the exchange of information with non-EU States. The duty of information, in fact, is in force only among EU States, whereas the connections with third States have to rely on conventional instruments, such as art. 26 of the OECD Model. Even if the automatic exchange of information is becoming increasingly important, it cannot be compared to the mechanism implemented by the Savings Directive: information keep on being transferred by the sole State, and not directly by the paying agent, with all the bureaucratic problems that such an exchange may involve. Hence, if an Italian bank rend an accounting service to a non EU resident, it shall not send the information to the *Agenzia delle Entrate*, as provided by the Directive; the datas will be exchanged only after a formal request applied by the third State and the consequent researches made by the Italian authority: this kind of situation is obviously more muddled than that provided by the Directive[92].

[92] See G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 18.

In order to fill this gap, Italy has already signed six TIEA, and others are meant to be negotiated in the next future. These TIEA are meant to increase the exchange of information, usually referring to sec. 26 of the OECD Model, but also taking as sample the new FATCA Model about the automatic exchange.

2.2 TAX TREATY LAW

As already said above, the Italian system of paying agent does not include a withholding taxation. Our treaties are meant to divide tax claims between the contracting parts, usually in accordance with the international principle and the OECD Model. Withholding levied in one of the States is usually compensated by the grant of an equivalent tax credit in order to avoid phenomena of double taxation.

PART III - EXCHANGE OF INFORMATION

INTRODUCTION

"Italy has a long history of developing its capacity to exchange information for tax purposes in an effective manner. It has an extensive network of 85 bilateral exchange of information (EOI) arrangements contained in its DTCs and covering 91 jurisdictions. [...] It is noted that the timeframe to bring the treaties signed into force can in some cases take several years. It is nevertheless also noted that the time frame to bring the recent protocols signed with Cyprus and Malta was about one year and Italy will continue its efforts to ensure the ratification of its treaties expeditiously. As a member of the European Union (EU), Italy is covered by the provisions of the EU Council Directive 77/799/ EEC of 19 December 1973 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums. Italy is also a party to the Council of Europe and OECD Convention on Mutual Administrative Assistance in Tax Matters and a signatory of the protocol to this convention."[93]

The Italian tax legislation grants broad powers to revenue authorities to compel the collection of information and these measures can be used for EOI purposes in the same way as for domestic purposes. This information can be accessed by various means; in writing (questionnaires), visits to the premises of businesses, during tax examinations or by testimonies. As regards EOI, the competent authority is the *Dipartimento delle Finanze*, one of the Directorates of the Italian Ministry of Economy and Finance, with two authorized representatives, the *Agenzia delle Entrate (AE)* and the *Guardia di Finanza (GDF)*[94]. These two

[93] 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, p. 7-8.
[94] A 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

authorized representatives have strictly the same powers to answer incoming requests.

In its *Peer Review*, the Global Forum of transparency has certified that: "*The Italian legal and regulatory framework ensures the availability of ownership information concerning companies and partnerships. This is due to multiple requirements to maintain information imposed on registration authorities (Chambers of Commerce, Prefectures and Agenzia delle Entrate), the businesses themselves, and all entities and professions covered by the requirements of the anti-money laundering/combating the financing of terrorism (AML/CFT) legislation. Ownership information on trusts and foundations is also available thanks, in particular, to the registration requirements imposed on these entities and arrangements. Similarly, a good framework exists which requires full accounting records, including underlying documentation, to be kept for ten years. Financial institutions are required to maintain records of individual transactions and, under AML/CFT legislation, customer identification records are maintained for ten years.*"[95]

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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. 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, p. 16.

[95] 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, p. 9.

CHAPTER I - ADMINISTRATIVE ASSISTANCE AND COLLECTION OF INFORMATION IN DOMESTIC TAX MATTERS

1.1 TREATMENT OF INFORMATION IN INTERNAL SITUATIONS

Italy has one tax authority, *Agenzia delle Entrate*, which grants the collection of tax information throughout the territory through its local offices, whom competence is territorially defined.

Hence, the authority has a database which contains all the significant information about taxpayers. Moreover, another powerful mean is the *Anagrafe Tributaria*, a data warehouse where all information useful for tax purposes is stored. The information maintained in this system is available to the revenue authorities through IT tools allowing for the extraction of data[96].

These data can be crossed even for aims different from tax, for example, in order to verify the coherence of the taxpayer's patrimonial situation in relation to its social security position[97]. With regard to the use of the related information, the sec. 12 of the law 212/2000 recognizes to the taxpayer the right to be informed in case of tax audits; however it is true that this provision has been interpreted in a very narrowly way, therefore today the taxpayer is informed only in case of assessment, and not at every turn that his information are used or verified.[98]

Another important provision is sec. 7 of the law 241/1990, regarding administrative procedure; this section grants to those who are involved in the procedure the right to be informed about the existence of the procedure itself. This

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[96] Sec. 7 of Presidential Decree 605/1973. 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, p. 22.

[97] E.g.: The social security administration could consider a taxpayer as without any property, granting him a support pension, even if he, in accordance with data of the Anagrafe Tributaria, is the owner of several real estates.

[98] In favor of an extension of this praxis, see A. R. CIARCIA, *L'accesso partecipativo e l'accesso conoscitivo dal diritto amministrativo al diritto tributario,* in *Dir. prat. Trib.*, 2011, 6, p. 1172-1191.

section cannot be applied in tax matters, due to section 13 of the same law, but it could be important in case of non-tax information used in tax audits, namely in those cases not covered by sec. 12 of law 212/2000.

1.2 EXCHANGE OF DATA IN DOMESTIC MATTERS

Given the uniqueness of the tax authority, the information can be transferred among the different offices without the need of a formal request between the applicant and the requested office, that because the data warehouses are accessible from each office, having to be respected just an internal procedure.

In order to list which kinds of information can be changed, a preliminary consideration has to be done: which categories of information can be collected?

Italian law[99] allows the tax authority to collect an extremely wide range of information, which, once collected, can also be changed *with regard to internal purposes*[100]. Regarding the domestic system, both bank secrecy and trade secrecy can be infringed if the tax inquiry requires it. However, if the bank secrecy is surely in contrast with the budgetary interest, it is quite difficult to imagine a situation in which trade secrecy could have significance in relation to the tax assessment; probably the tax inspector will be much more interested in the accountability of the company.

In regards to professional secrecy, this is still insurmountable by tax inspectors or other public officials; sec. 200 of the Code of criminal procedure grants the unbreakability of the secret even before a Court, the only exception provided regards the judge's possibility to disown the existence of the secret, compelling the secret-keeper to disclose[101].

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[99] Sec. 32 of the Presidential Decree 600/1973

[100] Sec. 26 of the Oecd Model contains some exceptions related to the international exchange of information, par. 3 states: *In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation […] c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).*

[101] Sec. 200, par. 2, c.p.p.; See G. CONSO, V. GREVI, M. BARGIS, *Compendio di procedura penale*, Padova, 2012, p. 336-337.

As foresaid, the taxpayer does not seem to have a specific right to be informed in the case of use of his data, however, there is no consensus about it among the authors.

In the Italian legal system the protection of the taxpayer relies on a deferred appeals with respect to the final acts of the administration, hence part of the doctrine[102] does not accept the hypothesis of an autonomous appeal against a procedural act, as the exchange of information, which is not related to a final act, such as an assessment. Others[103], on the other hand, refer to the development of the Community law, as well as the evolution of the principle of the adversarial in the administrative procedures, in order to justify the usability of precautionary means in order to stop the exchange of information.

1.3 TAXPAYER'S RIGHT TO CHALLENGE

As foresaid taxpayer's protection relies on deferred appeal, hence he cannot appeal in any way before the assessment.

In the Italian tax system, the taxpayer's right to appeal is strictly subordinate to the existence of one of the final acts listed in sec. 19 of the Legislative Decree 546/1992[104], without one of this acts no appeal can be filed.

During the trial the taxpayer can retroactively complain the defects of the procedure, even if he has appealed a following act. During a procedure of assessment, the legislation grants wide power to the taxpayer: right to intervene, to appeal, etc.

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[102] See P. SELICATO, *Scambio di informazioni, contraddittorio e Statuto del contribuente*, in *Rass. Trib*., 2012, p. 340.

[103] See A. BUCCISANO, *Cooperazione amministrativa internazionale in materia fiscale*, in *Riv. dir. trib.*, 2012, VII/VIII, p. 698-706.

[104] The section means to subordinate the appeal to the existence of acts able to cause a damage to the taxpayers, so mere procedural acts are irrelevant in order to file an appeal before the *Commissioni Tributarie*, the Italian tax courts. Even if the list of acts autonomously appealable has been extended by the jurisprudence, the exchange of information is not able to weigh on the patrimonial situation of the taxpayer, so he has to wait the next act autonomously appealable, in order to complain the defects of the procedure. See M. BASILAVECCHIA, *Funzione impositiva e forme di tutela*, Torino 2009, p. 28-36.

With regard to the power on intervention, sec. 12, par. 7 of the law 212/2000 (so-called "Taxpayer's charter"), grants to the assessed the right to send documents containing remarks to the tax authority within 60 days from the end of inspections; the assessment cannot be issued before this terms. Moreover, the jurisprudence has considered void assessments that do not answer analytically to the taxpayer's remarks[105].

With regard to taxpayer's power to appeal, it is, as foresaid, subordinate to the existence of a final administrative act, as an assessment. Sec. 19 lists all appealable kinds of acts; however, the list keeps on growing thanks to the jurisprudence. The act can be appealed in respect of four categories of vices[106]:

- vices related to previous procedural acts (e.g. assessment issued before the deadline of 60 days within which the taxpayer can produce his remarks);
- vices related to formal requirements of the act;
- vices related to the preliminary investigation (e.g. exchange of information);
- vices about the content of the act (e.g. the taxpayer has correctly fulfilled his tax due).

The same protections are guaranteed in international situations, although it should be noted that, if the notice of assessment is issued by the foreign tax authority, the acts of investigation made in Italy will be appealable within the limits of sec. 19.

1.4 POWERS OF THE TAX AUTHORITY

The powers of the tax authority are listed in the sec. 32 of the Presidential Decree 600/1973.

The office can:

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[105] Cass., 18 July 2008, n. 19875. See P. SELICATO, *Scambio di informazioni, contraddittorio e Statuto del contribuente*, cit., p. 335.

[106] See M. BASILAVECCHIA, *Funzione impositiva e forme di tutela*, cit., p. 212-220.

- proceed with the accesses, inspections and checks[107];
- invite taxpayers to appear personally or through representatives to provide data and information relevant for the purpose of assessment issued against them;
- invite taxpayers to provide or transmit data and documents related to the inquiry[108];
- send to taxpayers questionnaires about specific information or data related to the procedure of assessment in progress;
- demand to the public administrations to provide data or information related to specific individuals or groups subject to the procedure of assessment, notwithstanding the rules about the transmission of the above mentioned data;
- demand, with the authorization of the chief director of the assessment division of the *Agenzia delle Entrate* or with that of the regional commander of the *Guardia di Finanza*, to individuals subject to the assessment procedure, to reveal the basic information of all their banking and postal account, such as number of account;
- demand to taxpayers information about relations with financial intermediaries, mutual funds, investment trusts etc.;
- demand, with the authorization of the chief director of the assessment division of the *Agenzia delle Entrate* or with that of the regional commander of the *Guardia di Finanza*, to banks, Poste Italiane, insurance companies and other financial intermediaries, to provide information and data relating to services rendered to individuals subject to the assessment procedure, and, as far as they know, to specify the patrimonial situation of their client;
- demand to third persons, related to the taxpayer in terms of tax duty, information and data relevant to the inquiry.

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[107] See M. BASILAVECCHIA, *Riservatezza e indagini fiscali: dalle norme alla prassi*, in *Cor. Trib.*, 2010, 1, p. 49-52.
[108] Taxpayers who have to keep the accountability can be requested to show it to the inspectors.

In case of request applied by another country, the *Agenzia delle Entrate* and *Guardia di Finanza* can apply the same measures listed above.

If the taxpayer does not manage to supply the requested information, he is subjected to procedural detriments.

If he fails to produce the information requested, his income can be assessed on the base of an estimate, taking in account the expenses incurred, notwithstanding the tax return previously filed; this kind of assessment is called *accertamento sintetico*[109]. Moreover, if he does not answer to the request of documents within the terms established by the law, the documents sent in late cannot be used in his favor, unless he demonstrates that the delay in sending them is not attributable to him.

If he has to keep the accountability, the assessment has to be based on that, but, if registers are not correctly kept[110], or not showed within the terms established by the inspectors, the assessment can be issued notwithstanding the accountability, due to the unreliability of that.[111]

The same measures cannot be applied in cases of exchange of information. This because the procedural detriments hit the taxpayer with the issue of the assessment; but, if the assessment is issued abroad, it is up to the foreign tax authority to punish the taxpayer, with the measures established by the local law.

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[109] Sec. 32, n. 2 and 38, Presidential Decree 600/1973.

[110] The vices of the accountability include the case of registers vitiated by falsity, sec. 39, letter d), Presidential Decree 600/1973.

[111] A particular case of burden of proof is related to the phenomenon of transfer price. Italian tax authority can disown the price applied in commercial transactions between associated enterprises if it does not correspond to the fair value, obtained by the application of the *arm's length principle*. If the price is adjusted by the tax authority, the tax return filed by the associated enterprise is consequently considered untrue, hence the taxpayer should be subjected to sanctions. However, if he, before the start of the procedure, has prepared documents able to demonstrate the fairness of the price applied, he cannot be subject to sanctions, even if the price is adjusted.

CHAPTER II - INTERNATIONAL ADMINISTRATIVE ASSISTANCE BASED ON TREATY LAW

2.1 THE ITALIAN APPROACH TO THE EXCHANGE OF INFORMATION

The Italian mechanism of exchange of information is based on the sec. 26 of the OECD Model. Italy's bilateral exchange of information agreements (EOI) cover 91 jurisdictions including its major trading partners, 44 Global Forum members, all EU and OECD member jurisdictions (with the exception of Chile). It is to report that the timeframe to bring the treaties signed into force can in some cases take several years. But we have also to underline that the timeframe to bring the protocols recently signed with Cyprus and Malta into force was about one year and Italy continues its efforts to ensure the ratification of its treaties expeditiously.[112]

As stated by the *Global Forum on Transparency and Exchange for tax purposes*, six of the 85 treaties in force[113] do not allow for EOI in accordance with the international standards, while 14 others contain some limitations[114].

As a member of the OECD Italy attends to update its DTC, however, just a few of its treaties have implemented the new paragraph 5 of sec. 26 OECD Model, they are: Bermuda, Cayman Islands, Cook Islands, Cyprus, Gibraltar,

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[112] 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, p. 66-87.

[113] Austria, Belgium, Brazil, Luxemburg, Malaysia, and Switzerland.

[114] Ireland, Ivory Coast, Japan, Kuwait, Morocco, Portugal, Singapore, Tanzania, Thailand, Trinidad & Tobago, United Kingdom, former USSR, former Union of Soviet Socialist Republics (USSR) (which remains in force with respect to Azerbaijan, Kyrgyzstan, Tajikistan and Turkmenistan), former Yugoslavia (which remains in force with respect to Bosnia-Herzegovina, Montenegro and Serbia), and Zambia. 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.
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, p. 67.

Guernsey, Hong Kong, Jersey, Libya, Luxembourg, Malta, Mauritius, Mexico, Panama, Russian Federation, San Marino, Singapore.[115]

With regard to TIEAs concluded by Italy, my country prefers the conclusion of a TIEA where there are no significant economic relationships or where there is no risk of double taxation. Therefore, although Italy has never refused to enter into negotiations with a counterpart, it has, on occasion in response to jurisdictions proposing to conclude a DTC, proposed instead to negotiate a TIEA. Six TIEAs have been signed and one more has been initialed. Italy is also negotiating TIEAs with about 20 jurisdictions. None of the TIEAs signed by Italy depart from the OECD *Model TIEA*, with the exception of specific wording requested by common law jurisdictions regarding "legal privilege".[116]

2.2 EXCHANGE OF INFORMATION

The domestic regulation of exchange of information is provided by sec. 31 *bis* of the Presidential Decree 600/1973, inserted in the Italian legislation only in 2005, with a huge delay in respect of the deadline of implementation provided by the Dir. 1977/799/CE. However, this lack of provision has not affected at all the Italian capacity in the exchange. The section allows the tax authority to exchange tax information with other Member States, in order to correctly assess taxes on incomes and assets.

The *Agenzia delle Entrate* can exchange all the data it can collect in accordance with the domestic law, specifically, with art. 32, Presidential Decree 600/1973.

[115] OECD: *http://www.eoi-tax.org/jurisdictions/IT#agreements*, site last updated on the 26th January 2013.

[116] 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, p. 74.

Information can be exchanged within the rules regarding the domestic procedure of assessment[117]. However, the Authority, as also stated by par. 3 of the OECD Model, is not imposed:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).[118]

The information received is covered by professional secrecy, it can be disclosed only in order to use them for the assessment of the tax due. Moreover it allows simultaneous controls, in accordance with the Directive 1977/799/CE.[119]

2.3 TYPES OF EXCHANGE OF INFORMATION

Italy applies the standard mechanisms of exchange of information. In this respect, among the 85 agreements signed, only 6 do not meet the standard. However the exchange of information to the standard could take place upon condition of reciprocity. Finally, Italy, as a member of the European Union, is involved in the exchange of information provided for by the *EU Mutual Assistance Directive* of 1977, now substituted by the Directive 2011/16/UE; moreover, Italy has ratified the *COE/OECD Convention on Mutual Administrative Assistance in Tax Matters*. Even though these EOI conventions do not meet, *per se*, the international standard, nothing in this arrangements prevent two

[117] Taxpayers can receive an assessment within 5 years from the filing of the tax return, however, if the taxpayer has committed a tax crime, in accordance with the Legislative Decree 74/2000, the terms are doubled.
[118] Sec. 31 *bis*, Presidential Decree 600/1973.
[119] See F. PITRONE, *Lo scambio di informazioni e la direttiva 2011/16/Ue in materia di cooperazione amministrativa: innovazioni e profili critici*, in *Dir. prat. trib. int.*, 2012, 2.

jurisdictions, willing to do so, to exchange all types of information, bank information included, without any reference to a domestic tax interest.

Italy exchanges information through all standard mechanisms[120]: on request, spontaneously, automatically.[121]

With respect to the first kind, in the 2007 – 2009 period Italy received a total of 1014 requests for information (628 were received by the *Agenzia delle Entrate and* 386 by the *Guardia Di Finanza*). According to the available figures, in these three years, Italy was engaged in a significant EOI relationship with about 45 partners of which the most significant, considering the quality of information exchanged, are France, Germany, and the United Kingdom, and in terms of the number of requests received, France, Kazakhstan, Greece, Ukraine, and Poland. On average, the Italian authorities fully answered incoming requests within 90 days in 15% of cases. Approximately 25% of requests are finally responded to in between 90 and 180 days and 30% between 6 months and one year. Finally, 30% of the requests received by the Italy were fully answered after more than one year.[122]

Regarding the automatic exchange Italy is involved in exchanging information automatically. These exchanges are wholly the responsibility of the *AE*. They take place under the scope of the *EU Savings Directive 48/2003/EC* under which EU members (with the exception of Austria, Luxemburg, and, until 2009, Belgium), as well as other jurisdictions that are party to agreements, exchange data on an annual basis concerning the interest payments received from Italian paying agents by individuals located abroad. Automatic exchanges also take place under the DTCs signed by Italy or the *EU Mutual Assistance Directive* on a reciprocal basis. In 2010, Italy sent data to 21 countries.

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[120]See A. BUCCISANO, *Cooperazione amministrativa internazionale in materia fiscale*, cit., 677-690. 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, p. 66.

[121] See F. PITRONE, *Lo scambio di informazioni e la direttiva 2011/16/Ue in materia di cooperazione amministrativa: innovazioni e profili critici*, cit., p. 469-474; F. SAPONARO, *Lo scambio di informazioni tra Amministrazioni fiscali e l'armonizzazione fiscale*, in *Rass. Trib.*, 2005, 2, p. 457-466.

[122] 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, p. 79.

Moreover, as a member of the European Union, Italy is involved in the European common VAT system and as a consequence in the VAT exchange of information that takes place under *EU Regulation (EC) 2010/904.* During 2007 - 2009, between 2100 and 2500 requests were received on an annual basis in the field of VAT by the Italian revenue authorities (while an average of 3 000 were sent out each year).[123]

Italian legislation grants wide powers to the *Agenzia delle Entrate*, which can collect information in accordance to sec. 32, Presidential Decree 600/1973. However, in respect to international exchanges of information, our DTCs 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 a legal counselor. Moreover, 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*), in accordance with the international standards.[124]

2.4 TAXPAYER'S RIGHTS

In accordance with the Italian legislation, the taxpayer has no right to intervene or to be informed about the exchange.[125]

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[123] 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, p. 68.

[124] See, for instance, the DTC between Italy and France, sec. 27, par. 2, letter c); or, the DTC between Italy and UK, sec. 27, par. 2, letter c). In addition, 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, p. 78.

[125] Sec. 31 *bis*, Presidential Decree 600/1973 has surely to be updated, given the recent developments in relation to the exchange of information, particularly regarding the new means prepared by States. See F. PITRONE, *Lo scambio di informazioni e la direttiva 2011/16/ue in materia di cooperazione amministrativa: innovazioni e profili critici*, cit., p. 476-484; 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

However, the degree of taxpayers' protection is going to increase. In 2013 the new Directive 2011/16/UE has entered into force, and it grants the specific duty to inform, through a formal notification, the taxpayers about exchange of information regarding their own data.[126]

Even though it does not refer to Italy, the European Court of Human Right has issued an important decision in the case *Ravon*[127]. In its decision the Court has declared in contrast with the Convention the French tax legislation in the part in which it does not allow any judicial appeal against the acts of investigation, limiting the complaint to a mere consultation with the inquiring authority. We have to admit that our legislation is even worse than the French one, because the right to appeal is not granted, neither before the *Agenzia delle Entrate*, nor before an independent court.[128]

In conclusion, if Italy allowed the taxpayer to stop the exchange of information, it would cause an infringement of international duties attributable to Italy, which, indeed, is bound to the international law by sec. 10 of its Constitution. In the Italian system of sources of law, international treaties are usually considered as hierarchically superior to the internal law, hence, it is quite difficult reforming our judicial system in this direction. aHowever, some scholars recognize the existence of the customary principle of the more favorable clause, which would allow taxpayers to benefit from an internal rule, granting wider rights in respect of those provided by the DTCs.[129] This principle finds its legitimacy in sec. 169 of the Presidential Decree 917/1986, which states that, it is to apply, notwithstanding the treaties in force, the more favorable domestic rule. The principle could permit to an internal provision, such as the right to appeal against the exchange of information, to grant a stronger protection to taxpayers,

Exchange of Information for Tax Purposes: Peer Reviews, OECD, p. 78; P. SELICATO, *Scambio di informazioni, contraddittorio e Statuto del contribuente*, cit., p. 337-341.

[126] See S. CAPOLUPO, *Presupposti e limiti della cooperazione fiscale tra gli Stati UE*, in *Corr. Trib.*, 2011, p. 1764-1765.

[127] ECHR, 21 February 2008, C-18497/03. See P. SELICATO, *Scambio di informazioni, contraddittorio e Statuto del contribuente*, cit., p. 339.

[128] In favor to an independent right to be informed see P. SELICATO, *Scambio di informazioni, contraddittorio e Statuto del contribuente*, cit., p. 320. In his opinion a distinct right to be informed raises when the applicant tax authority is about to issue the assessment, in that moment the taxpayer is entitled of a specific interest to join the procedure.

[129] See G. MELIS, *Vincoli internazionali e norma tributaria interna*, in *Riv. Dir. Trib.*, 2004, 10.

notwithstanding the treaty itself, which could provide no defense to the taxpayer, whose information is part of exchange.[130]

2.5 USE OF THE INFORMATION RECEIVED

In accordance with the new text of the sec. 26, par. 2 OECD Model: "*Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorizes such use.*"[131]

Unfortunately, sec. 31 *bis* of the Presidential Decree 600/1973 does not contain such provision, neither the possibility is provided by other sections. However, no provision puts an explicit prohibition to such further use of the information.

Information received has to be properly used, due to the duty of confidentiality that covers them. In accordance with par. 2 or sec. 26 "*Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or*

[130] See G. MELIS, *Vincoli internazionali e norma tributaria interna*, cit., p. 1117-1129.

[131] OECD (2012), *Update To Article 26 Of The OECD Model Tax Convention And Its Commentary*, OECD Publishing, p. 2. The Commentary explain the provision in the following way: *Information exchanged for tax purposes may be of value to the receiving State for purposes in addition to those referred to in the first and second sentences of paragraph 2 of Article 26. The last sentence of paragraph 2 therefore allows the Contracting States to share information received for tax purposes provided two conditions are met: first, the information may be used for other purposes under the laws of both States and, second, the competent authority of the supplying State authorizes such use. […]When a receiving State desires to use the information for an additional purpose (i.e. non-tax purpose), the receiving State should specify to the supplying State the other purpose for which it wishes to use the information and confirm that the receiving State can use the information for such other purpose under its laws. Where the supplying State is in a position to do so, having regard to, amongst others, international agreements or other arrangements between the Contracting States relating to mutual assistance between other law enforcement agencies and judicial authorities, the competent authority of the supplying State would generally be expected to authorize such use for other purposes if the information can be used for similar purposes in the supplying State. Law enforcement agencies and judicial authorities receiving information under the last sentence of paragraph 2 must treat that information as confidential consistent with the principles of paragraph 2.*

prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.” With regard to the duty of confidentiality, sec. 31 *bis* grants it referring to the sec. 7 of the Directive 77/799/CE[132], hence it surely fulfill the secrecy requirements asked by the Model; moreover, from the 1th January 2013 the new Directive 2011/16/UE has entered into force, even more strengthening the duties of confidentiality through the reference to the Directive 95/46/CE[133].

With regard to the domestic legislation, as it will be explained in par. 3.2 of this part, Italy has surely to recast the internal provision, sec. 31 *bis*, Presidential Decree 600/1973.

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[132] Article 7 - Provisions relating to secrecy :
1. *All information made known to a Member State under this Directive shall be kept secret in that State in the same manner as information received under its domestic legislation.*
In any case, such information: - may be made available only to the persons directly involved in the assessment of the tax or in the administrative control of this assessment,
- may in addition be made known only in connection with judicial proceedings or administrative proceedings involving sanctions undertaken with a view to, or relating to, the making or reviewing the tax assessment and only to persons who are directly involved in such proceedings ; such information may, however, be disclosed during public hearings or in judgments if the competent authority of the Member State supplying the information raises no objection,
- 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.
2. Paragraph 1 shall not oblige a Member State whose legislation or administrative practice lays down, for domestic purposes, narrower limits than those contained in the provisions of that paragraph, to provide information if the State concerned does not undertake to respect those narrower limits.
3. Notwithstanding paragraph 1, the competent authorities of the Member State providing the information may permit it to be used for other purposes in the requesting State, if, under the legislation of the informing State, the information could, in similar circumstances, be used in the informing State for similar purposes.
4. Where a competent authority of a Member State considers that information which it has received from the competent authority of another Member State is likely to be useful to the competent authority of a third Member State, it may transmit it to the latter competent authority with the agreement of the competent authority which supplied the information.
[133] Sec. 25 of the Directive 20111/16/UE:
Data protection
All exchange of information pursuant to this Directive shall be subject to the provisions implementing Directive 95/46/EC. However, Member States shall, for the purpose of the correct application of this Directive, restrict the scope of the obligations and rights provided for in Article 10, Article 11(1), Articles 12 and 21 of Directive 95/46/EC to the extent required in order to safeguard the interests referred to in Article 13(1)(e) of that Directive.

2.6 ORGANIZATIONAL PROCESS

Regardless of whether the request is received by the *AE* or the *GDF*, the method of processing of the request is the same. First of all, each case is allocated to a specific official who will be in charge of the case until the final answer is provided to the requesting party. The request is checked to ensure that it complies with the requirements of the applicable treaty. Research using IT tools is conducted to see if the person identified by the request is already subject to an EOI matter or to an audit performed by the other authorized competent authority.

The official in charge of the case then checks the completeness of the request, in particular that all identification information is available and that the context of the request is clear enough to permit its processing by local authorities. If some identification elements are missing, the Italian authorities first try to find them, using in particular the information available in the *Anagrafe Tributaria*. In some cases, even if there are missing elements, the Italian authorities try nevertheless to answer the request from the information provided by the requesting jurisdiction. A response seeking further details is sent to the requesting authorities only in the few cases where missing details are not found and without which the request cannot be processed.

At this early stage, requests are declined in the very few instances where the exchange of information is not covered by the provisions of the instrument under which the information is requested or where the request would not meet the standard (for example a speculative request where the need for the requesting party to get the information is not clearly defined).

Italy has not declined to provide any information requested on any occasions in the last three years.[134]

Once these checks are completed and any additional information obtained, the request is registered in a database dedicated to EOI. Both the *AE* and the *GDF* have dedicated software where all information tied to the request is stored and

[134] 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, p. 81.

where it is possible to manage and monitor the exchanges. These preliminary processes can take from three days to two weeks.

The official in charge of processing the request then decides whether it is going to be processed at the national level or, as in most cases, by local authorities. Indeed, a lot of information is available through the IT tools at the disposal of the revenue authorities, including officials working at the national level (in particular, tax returns, income received, ownership information, and property information).

Where the information is already available to the revenue authorities at the central level, a direct answer can be provided by the official in charge of the case. When the case has to be sent to local authorities, a translation into Italian is required. This is usually the case, as only a small number of requests are received in Italian. Even requests received in English are translated into Italian. This translation is made by the official in charge of the cases (*AE*) or by a translation division (*GDF*). Translating a document can take up to two weeks.

For confidentiality reasons, the requests passed on to local authorities:

- contain only the information needed to answer the request. The original version of the request is never enclosed with this transmission; and
- is usually sent in electronic format either directly generated by the system where this request was registered (*GDF*) or by encrypted secure e-mail (*AE*).

In the case of the *GDF*, as the transmission is directly done through the system, the request goes directly from the headquarters in Rome to the local office territorially competent for the Italian person subject to the request. For the *AE*, the request is first sent to the regional authorities, then to the provincial authorities, and finally to the relevant local office. When the request concerns a large number of taxpayers, it is directly processed at the regional level. This is also the case when an examination of the taxpayer involved in the request is already underway at this level or at the provincial level. In all other cases, the local office is in charge of the information gathering.

Considering the powers to gather information granted by the Presidential Decree 600/1973, the Italian authorities have several tools to collect the information.

Testimony is used only in cases where the requesting party asks for the provision of information under this format.[135] Depending of the type of information requested, the gathering of information by written means or by an audit in the field is usually preferred. Indeed, this is the easiest way to ensure that all information requested is going to be furnished by the person covered by the request. Conversely, the Italian legislation foresees the collection of bank information by written procedure, with the exception of cases where no tax identification number has been provided by the requesting jurisdiction. Considering the various administrative levels involved in answering requests (possibly the regional, provincial and local levels), this procedure is likely to delay the provision of answers of requested information.

Where the information is requested by written means, the Italian legislation grants a minimum of 15 working days to the person subject to the request to provide an answer. However, there is no ceiling in the Italian legislation as regards the maximum number of days a person may have to provide a response. The Italian authorities nevertheless indicated the time taken to respond limit rarely exceeds the 15 day minimum.[136]

Both revenue authorities consider the quality of the answer the most important aim. Therefore the provision of a complete and accurate answer is always preferred even if it leads to a delayed reply. The Italian authorities have also reported that during the 2007-2009 triennium, out of the more than 1 000 requests received and processed, only one response was perceived as incomplete by the requesting jurisdiction and led to a supplementary request for information.

When responses are received by the competent authorities from the local services, the official in charge of the case checks the completeness of the information provided against the information requested by the treaty partner. Where information is missing or the response provided does not fully answer the

[135] 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, p. 82.
[136] 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, p. 83.

request, additional information will be requested from the local offices. Information already provided will be prepared as a partial response.

Finally, the response is translated, usually into English, and sent out to the requesting jurisdiction.[137]

2.7 MULTILATERAL AGREEMENTS

In its effort to improve the exchange of information between international subjects, Italy has signed several multilateral conventions.

First of all, we have signed the Convention of Strasbourg, concluded in 1988; however, despite the importance of the agreement, it had not such a strong impact on the internal administrative practice, probably due to the lack of signature of the major international partners.[138]

Moreover, Italy, is part of the Convention on the Mutual Administrative Assistance in Tax Matter. Italy has ratified the Convention on 31 March 2006; in addiction the amending protocol has been signed on 17 January 2012, and entered into force on 1 May 2012. Unfortunately, not even this multilateral instrument had a concrete impact on our administrative system, but part of it will be probably implemented through the new Directive 2011/16/UE, which partly refers to the Convention.

As part of the OECD, Italy has also joined the Global Forum on Transparency and Exchange of Information for Tax Purposes, which published a Peer Review about Italy in 2011, in which it appreciated the great effort born by Italy in the exchange of information: "*Notwithstanding the sometimes slow ratification of international agreements and the need to answer incoming requests for information in 90 days or to provide an update of status as a routine, comments received on the experience of a number of Global Forum members with Italy*

[137] For a complete description of the procedure, 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, p. 79-85.

[138] S. DORIGO, *La cooperazione fiscale internazionale dopo il protocollo di modifica della Convenzione di Strasburgo: qualche luce e molte ombre,* in *Riv. Dir. Trib.*, 2011, IX, p. 157-181.

indicate that Italy is fully committed to the international standards of transparency and exchange of information for tax purposes. Italy is an important partner, actively exchanging information for international tax matters with a very large network of partners.[139]

CHAPTER III - INTERNATIONAL ADMINISTRATIVE ASSISTANCE BASED ON EUROPEAN LAW

3.1 SAVINGS DIRECTIVE

Italy has implemented the Savings Directive with the Law Decree 18 April 2005, n. 84. In most of its parts the law directly refers to the Directive itself, using the same concepts outlined by the Directive; however, there are still some differences, for instance, the notion of interest[140]. The Italian legislator also refers to the Directive with regard to the notion of beneficial owner and paying agent.[141]

Currently, the European Commission has proposed to modify the Directive 2003/49/CE *(Interest & Royalties)*, in order to create a new harmonized mechanism of taxation on these kinds of passive incomes, particularly balancing the requirements with those of the Directive 90/435/CE *(Parent – Subsidiary)*[142].

If the proposal is accepted, our legislation will have to be updated, because it does not comply with the new standard.

In particular, even if the aims of the Directive will remain the same, limiting the recast to the resolution of some technical problems resulting from the limited

[139] 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, p. 9
[140] See p. 10, note 34 of this paper.
[141] With regard to the implementation of the Directive in Italy see G. MELIS, G. MARINO, *Answers to the questionnaire and special reports on the interest saving directive*, cit., p. 10-18.
[142] The proposal aims to reduce the participation requested from 25% to 10%; sec. 2, letter d) COM(2011) 714 final.

scope of the Directive[143], personal scopes have to be extended in order to include those kinds of legal bodies which are still out of the Annex I.[144]

But the most important change concerns the percentage of participation to be held in the other legal body: the notion of associated company will ask a minimum of 10%, and not, as currently is, of 25%. Moreover, an anti-elusion clause has been added: "*It is necessary to ensure that interest and royalty payments are subject to tax once in a Member State <u>and that the benefits of the Directive should only be applicable when the income derived from the payment is effectively subject to tax in the Member State of the receiving company or in the Member State where the recipient permanent establishment is situated</u>"*.[145] All this changes still have to be implemented in the Italian legislation.

In the end, differences of treatment between EU and non-EU persons are possible, in accordance to sec. 1, par. 8, which excludes the application of the Directive with regard to a permanent establishment situated in a third State of a company of a Member State if the business of the company is wholly or partly carried on through that permanent establishment.

3.2 EXCHANGE OF INFORMATION

[143] "*This recast tries to solve some of the problems resulting from the limited scope of the Directive. There are cross-border payments outside its scope that face withholding taxes at source. Thus, it proposes to extend the list of companies to which the Directive applies and to reduce the shareholding requirements to be met for companies to qualify as associated. In addition, it adds a new requirement for the tax exemption: the recipient has to be subject to corporate tax in the Member State of its establishment on the income derived from the interest or royalty payment. This condition seeks to ensure that the tax relief is not granted when the corresponding income is not subject to tax and thus close a loophole that could be used by tax evaders. Finally, a technical amendment is proposed to avoid situations where payments made by a permanent establishment and deriving from its activities are denied the exemption on the grounds that they do not constitute a tax-deducible expense.*" See COM (2011) 714 final p. 2-3.

[144] A minor modification will regard the inclusion of the SE and SCE in the list, even if, in accordance with the European legislation, these two types of subjects have to be subject to the provisions of Member States' law which would apply to a public-limited company or cooperative formed in accordance with the law of the Member State in which the SE has its registered office.

[145] This is the new Recital 3, in accordance with the proposal.

With regard to the Directive 2011/16/UE, the Italian legislation is strongly obsolete in comparison with the new rules provided by the Directive[146].

First of all, sec. 31 *bis*, Presidential Decree 600/1973 seems to be absolutely insufficient nowadays.

Notwithstanding the need of a renewal, the Global Forum has confirmed the basic role played by Italy in the exchange of information; hence the inadequacy of the rule has not affected the effectiveness of the Italian efforts.

Regarding the personal scope, sec. 31 *bis* does not define the subjective area of application, hence, it could be deemed, through a systematic interpretation, as updated, therefore, in my opinion, the exchange of information can happen even in respect of the new subject included by the new Directive in sec. 3 n. 11.

With regard to the substantive scope, the content of sec. 31 *bis* has surely to be extended, because it refers only to taxes on incomes and assets, whereas the new Directive *shall apply to all taxes of any kind levied by, or on behalf of, a Member State or the Member State's territorial or administrative subdivisions, including the local authorities* [147].

Moreover the new Directive grants a wider use of the information received[148]: the data can be used "*for the assessment and enforcement of other taxes and duties covered by Article 2 of Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, or for the assessment and enforcement of compulsory social security contributions. In addition, it may be used in connection with judicial and administrative proceedings that may involve penalties, initiated as a result of infringements of tax law, without prejudice to the general rules and provisions governing the rights of defendants and witnesses in such proceedings.*" However, the use of information goes beyond tax purposes; indeed, the par. 2 of sec. 16 states that *"with the permission of the competent authority of the Member State communicating information pursuant to this Directive, and only in so far as this is allowed under the legislation of the Member State of the competent authority*

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[146] See F. PITRONE, *Lo scambio di informazioni e la direttiva 2011/16/Ue in materia di cooperazione amministrativa: innovazioni e profili critici*, cit., p. 469-474.
[147] Sec. 2, par. 2, Dir. 2011/16/UE.
[148] Sec. 16, par. 1 and 2, Dir. 2011/16/UE.

receiving the information, information and documents received pursuant to this Directive may be used for other purposes than those referred to in paragraph 1. Such permission shall be granted if the information can be used for similar purposes in the Member State of the competent authority communicating the information." Unfortunately, the Italian legislation has still not implemented this recast; the sec. 31 *bis* provides the exchange for the assessment of taxes on income and assets.

In addition, no term is provided by our national rule, whereas the Directive has established different terms referring to the availability of the information[149].

Finally, with regard to non-EU States, the assistance is subordinate to the existence of a treaty and, if the information derive from another Member State, its consent is needed; therefore differences of treatment are surely possible, they will mostly depend on the network of agreements developed by the Third State.

3.3 MUTUAL ASSISTANCE FOR RECOVERY OF CLAIMS RELATING TO TAXES

Italy has implemented the Directive 2010/24/UE with a specific act: the Legislative Decree 149/2012; we have implemented it out of terms, the deadline, indeed, was on 31th December 2011. In implementing the Community law, we have strictly followed what established by the Directive.[150]

All terms, meanings and terms refer to the Directive without any change.

The scope is exactly the same:

- all taxes and duties of any kind levied by or on behalf of a Member State or its territorial or administrative subdivisions, including the local authorities, or on behalf of the Union;
- refunds, interventions and other measures forming part of the system of total or partial financing of the European Agricultural Guarantee Fund (EAGF) and the

[149] Sec. 7, Dir. 2011/16/UE; See F. PITRONE, *Lo scambio di informazioni e la direttiva 2011/16/Ue in materia di cooperazione amministrativa: innovazioni e profili critici*, cit., p. 478.

[150] See A. BUCCISANO, *Cooperazione amministrativa internazionale in materia fiscale*, cit., 711-714; P. BORIA, *Diritto tributario europeo*, cit., p. 373-376; S. SCIANCALEPORE, *Recupero di crediti UE. Assistenza reciproca dei Paesi UE*, in *Settimana Fiscale*, 2012, 35, p. 21-24; . F. SAPONARO, *Il titolo esecutivo europeo: prospettive in materia fiscale*, in *Rass. trib.*, 2008, 1, p. 86 – 118.

European Agricultural Fund for Rural Development (EAFRD), including sums to be collected in connection with these actions;

- levies and other duties provided for under the common organization of the market for the sugar sector;
- administrative penalties, fines, fees and surcharges relating to the claims for which mutual assistance may be requested in accordance with paragraph 1, imposed by the administrative authorities that are competent to levy the taxes or duties concerned or carry out administrative enquiries with regard to them, or confirmed by administrative or judicial bodies at the request of those administrative authorities;
- fees for certificates and similar documents issued in connection with administrative procedures related to taxes and duties;
- interest and costs relating to the claims for which mutual assistance may be requested.

The same considerations can be made relating to the personal scope, since the Legislative Decree does not make any difference among different types of persons.[151] It is noteworthy the provision which grants the taxpayer's right to be informed about the request received, whereas the same right is not provided in case of exchange of information.[152]

With regard to Non-EU Members States, the final provisions state that the Directive *is without prejudice of to the fulfillment of any obligation to provide wider assistance ensuing from bilateral or multilateral agreements or arrangements, including for the notification of legal or extra-legal acts*[153]. Hence, if non-EU States have already concluded similar agreements with EU States, they

[151] Sec. 3 of the Directive states:
(c) "person" means:
(i) a natural person;
(ii) a legal person;
(iii) where the legislation in force so provides, an association of persons recognised as having the capacity to perform legal acts but lacking the legal status of a legal person; or
(iv) any other legal arrangement of whatever nature and form, which has legal personality or not, owning or managing assets which, including income derived therefrom, are subject to any of the taxes covered by this Directive.

[152] Sec. 7, Legislative Decree 149/2012. See A. TOMMASINI, *Le procedure di riscossione all'interno dell'Unione europea*, in *Corr. Trib.*, 2012, 43, p. 3359-3364.

[153] Sec. 24, par. 1, Dir. 2010/24/UE.

are not voided by the entry into force of this act; otherwise, they have to negotiate a specific convention in order to make use of this procedure.[154]

[154] D'ALFONSO, E. DELLA VALLE, *La riscossione dei crediti tributari esteri e la riscossione all'estero*, in *Corr. Trib.*, 2011, 33, p. 2714 – 2720; G. FULGHESU, *La mutua assistenza alla riscossione dei crediti tributari nell'Unione Europea*, in *Rivista di Finanza*, 2012, 3, p. 17 – 29. E

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