Dipartimento di Scienze giuridiche
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"Fairness and taxation"

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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 Parigi dal 10 al 17 aprile 2014 – il tema "Equità e Fisco", così articolato:

1. Equità tra contribuenti ad alto e basso reddito;
2. Equità e imposizione sui redditi;
3. Equità e misure anti-abuso;
4. Equità e diritto processuale tributario;
5. Equità e ripartizione della potestà impositiva;
6. Equità e tassazione dei residenti e non residenti.

I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti da: Federico Moleti (Subtopic 1), Eugenio Aspidi (Subtopic 2), Alessia Polli (Subtopic 3), Maria Elisa Dragotta (Subtopic 4), Francesca Sipala (Subtopic 5) e Valentina Di Marcantonio (Subtopic 6).

Il dott. Alessio Persiani, il dott. Federico Rasi e il dott. Giuseppe Giangrande hanno assistito gli studenti nella preparazione dei lavori e nella successiva discussione presso l'Università di Parigi.

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

Elenco dei contributi

1. Fairness between low income and high income receivers (including: progressivity, high net wealth individuals (taxing the rich), role of family circumstances, role of trusts, bonuses, excessive compensations, net wealth tax, limits of taxation);
2. Fairness and taxation on different types of income (including: dual income taxation, taxation of business profits and employment income, different kinds of entrepreneurs (entrepreneurs operating merely domestically (often SMEs) versus entrepreneurs operating transnational (MNEs, not limited to large MNEs, but includes also transnational operating SMEs), relevance of the legal form: partnership versus corporation; bank taxes etc), optional tax privileges in respect of transfer of enterprises in the context of gift and estate taxes);
3. Fairness and anti-avoidance measures (including: domestic rules (e.g. GAARs and similar rules and judicial doctrines), treaty GAAR, definition af residence, specific LOB on residents, exclusion of dual residents from treaty benefits, beneficial owner concept, main purpose rules in respect of specific items of income (e.g., dividends, interest, and royalties), subject to tax clauses in respect to specific items of income, interaction between domestic and tax treaty rules, (e.g., conduit companies and domestic participation rules and executive allocation of dividends and capital gains to state of residence, conduit companies and no domestic WHT on interest and royalties and exclusive allocation to state or residence);
4. Fairness and procedural tax law (including: disclosure initiatives, tax collection, protection of tax payers, horizontal supervision (i.e. enhanced cooperation: only for large MNEs?), interest compensation for late payment from the perspective of both taxpayers and tax administration, rulings, retroactivity, right to be heard, right to appeal);

5. Fairness and allocating taxation rights between source and residence states (including: allocation rules of tax treaty law, high versus low withholding tax rates, debt versus equity, e.g. leveraged acquisition with debt-push down and use of intermediate holding companies, distinction between Art. 7 and Art. 17 OECD (no PE in respect of the latter), distinction between Art. 15/18 and Art. 19 OECD);
6. Fairness and taxation af residence and non-residence (including: woldwide taxation, territorial system, taxation of national, exit taxes, extended residence mechanisms).

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Fairness between low income and high income receivers

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Chapter I

1- Historical background of the equality principle: from the French Revolution to the 1948 Italian *Republican* Constitutional Chart

“The men come in to the world and remain free and equal in rights. Social distinctions can be based only on the common utility”.

The meaning of the beginning of *Declaration des droits de l' homme et du citoyen* (1789) is that all man hold the same rights.[1]

It's the concept of general juridical capacity that represent the most important difference between the modern state and the *Ancién Régime* state.

In the *Ancien Règime,* only people that hold a determined status in reason of their birth could be holders of some rights. The laws weren't equal for all, also the tribunals were different, because, for example, a nobleman had to be judged by other noblemen, a clergyman had to be judged by other clergymen.[2] Breaking with that longtime tradition, Article 6 of *Declaration des droits de l' homme et du citoyen* affirms that ”law must be expression of general will... and must be the same for all, in case of protection as in case of sanction.”

Revolutionary France *Declaration,* US Constitution, *Octroi*-Charts[3] and Liberal

1) F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 3.

2) It seems a tale from medieval ages but, for example, in the Piedmont Kingdom this kind of judgement was possible until the '50s of XIX century when it was prohibited by a law promoted by Italian statesman *Camillo Benso Count of Cavour.*

3) *Octroi* Charts were constitutions that people got as a concession from the king that autonomously decided to limit his powers. The first Octroi-Chart was the 1814 France kingdom Constitution. It was a concession of King Louis XVIII, Louis XVI 's brother, that didn't want to restore *Ancién Régime.* This chart was a model even for the Piedmont Kingdom, where king Charles Albert I gave to his people a constitution, *Statuto Albertino,* in 1848. The text was the Italian constitution from 1861 to 1947.

Democratic Constitutions introduced in many juridical systems the equality principle that concerned civil and political rights.[4] These rights could be summarized in the famous expression “liberty-property”.[5] In other words they concern freedom from the State. To respect these principles the State has an obligation to *non facere*; it means that never the State has to do something as a positive conduct to respect these rights.

It was an age when the importance of public expenditure was very low; for example, in 1861 the Italian State spent 13.5% of Gross Domestic Product: *de facto* XIX century State spent money mostly for military purposes and infrastructures (very little developed at that time), while social expenditure was quasi-non existent.

In that situation we can't imagine a juridical system in which the State has obligations to a positive conduct *(facere)* with citizens.

In that State the equality principle was expressed in Art. 24 of *Statuto Albertino*: “All the subjects, independently of their degree or title, are equal in front of the law. They equally enjoy civil and political rights. They are admissible to all civil and military offices unless exceptions defined by laws.” Obviously, it affirms the principle of formal equality as others XIX centuries constitutions.

The conditions changed gradually from the end of XIX century: the State started to use more money for public expenditure[6], and also for social expenditure.[7] The rise of socialist and catholic[8] parties also radically changed the political situation.[9] These conditions and the consequences of World War I were the causes of Liberal State collapse.

4) F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 6.

5) ibidem, 6.

6) When Giolitti came to power, public expenditure was about 20-25% of the Italian Gross National Product.

7) The first country that introduced pensions was Bismarckian German Empire, twenty years after Giolittian Italy (1903-1913) started with a first form of welfare state .

8) I refer to german *Zentrumspartei*, to the Italian People Party, etc.

9) For example, in Germany, SPD got more than 20% of votes from the 90's of XIX century, Italian Socialist Party became the first party in the 1919 Italian general elections...

In an American state, liberal state collapsed some years before the Great War. This state was the Mexican Republic, where, in the '10s, due to a radical socialist revolution[10], the first constitution that established social rights was written and promulgated in 1917.

In that Constitution, the Mexican State had an obligation to hold positive conducts, in some cases regulated by constitutional provisions: Art. 27 established an obligation to promulgate an agrarian reform that would make property accessible to all the citizens, and Art.123 established many obligations for the state, towards the workers.[11]

In November 1918 the military defeat of the German Empire caused the collapse of its institutions; three months later, after the elections for the Constituent Assembly, the largest party was the German Social democratic Party and the second the catholic Center Party. The coalition led by these two forces wrote the Weimar Constitution: the first European constitution in which even social rights were expressed.

It is important to see the preamble that says “The German People [...] to promote social progress, has adopted this Constitution.”. This passage is very interesting because it gives, with the verb promote, the idea that State couldn't only “*non facere*”, but it had to intervene to guarantee substantial equality to citizens.[12]

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10) An uprising, started in 1910, forced one year later president General *Porfirio Diaz* to resign after more than 25 years of presidency. Then radical liberal politician *Francisco Madero* was elected Chief of the State, but in a few months extremist revolutionary groups started a revolt against him. Exploiting the weakness of new president, General *Victoriano Huerta* carried a reactionary bloody *coup d' état* in february 1913. Nerverthless *Huerta* 's initiative resulted in a disaster: radical socialist revolutionaries defeated him and in one and a half year they were able to control the whole Country.

11) For example the State had to guarantee an 8 hr working day, the maternity, a salary satistificatory for the normal necessities of the worker, responsibility of entrepreneurs for work accidents, strike as a right, etc.

12) I report here the rules of articles 142-145 of 1919 German Constitution. In these articles the intention of preamble is confirmed:

“**Article 142**

The arts, science and instruction are free. The State provides protection and participates in its cultivation.

After the dramatic epilogue of World War II these principles became part of most European constitutions, including the 1948 Italian Republican Constitution.

2- Legal basis of the equality principle in the Italian Republic Constitutional System

The principle is expressed in Article 3 of our Constitution, which says:

"All citizens have an equal social dignity and are equal before the law without any discrimination of sex, race, language, religion, political opinion, personal and social conditions. It is the duty of the Republic to remove those obstacles of economic or social nature which, constraining the freedom and the equality of citizens, thereby impede the full development of the human person and the effective participation of all workers to the political, economic and social organization of the country."[13]

Article 143

The education of the youth **has to be provided** by public institutions. In their establishment, Reich, states and communities cooperate. The training of teachers has to be regulated uniform by the Reich, according to principles applying generally for higher education. Teachers at public schools enjoy the rights and share the duties of state Beamte.

Article 144

Schooling is entirely **placed under state supervision**; the state can give a share of that supervision to the communities. School supervision is taken charge of by full-time, professionally qualified Beamte.

Article 145

Schooling is obligatory. This obligation is served by the Volksschule (20) with at least 8 school years and the school for further instruction, following on the former, until the completed 18th year. Instruction and learning aids are, at Volksschule and at schools for further instruction, **free of charge.** "

We could observe the repetition of the verb "provide", which indicates the clear intention of an obligation of a positive conduct for the State towards citizens.

13) The translation is published on Italian Senate internet website (www.senato.it). I report here the Italian text:

"Tutti i cittadini hanno pari dignità sociale e sono eguali davanti alla legge, senza

This very important rule is the legal basis of the equality principle in Republican Italy.

Italian Constitutional Court also affirmed in the historical sentence 1146/1988 that this is one of the founding principles of our democracy that couldn't be changed even with the Constitutional amendment procedure[14] ruled by Article 138 of our Constitutional Chart[15].

In particular, the judgement of the Court said that in our Constitutional System we find expressed limits to Constitutional amendment and unexpressed limits: the supreme founding values of our Constitution.[16]

As also doctrine says, the equality principle is included in these values because it is the main basis of the constitutional system, and without it we would not have the principle of legality.[17]

The Greek philosopher Aristotle said that “In good constitutions the men are under the law, in bad constitution one or some men are above the law”. It also

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distinzione di sesso, di razza, di lingua, di religione, di opinioni politiche, di condizioni personali e sociali. È compito della Repubblica rimuovere gli ostacoli di ordine economico e sociale, che, limitando di fatto la libertà e l’eguaglianza dei cittadini, impediscono il pieno sviluppo della persona umana e l’effettiva partecipazione di tutti i lavoratori all’organizzazione politica, economica e sociale del Paese.”.

14) Constitutional amendament procedure procedure requires double exam of *Camera dei Deputati* and *Senato della Repubblica* and vote of more than the 66% of members of the two legislatures (is also possible with the vote of more than 50% of MP and a successive popular referendum that should confirm the parliamentary vote).

15) It is a passage of very important Italian Constitutional Court Sentence 1146/1988 :

“La Costituzione italiana contiene alcuni principi supremi che non possono essere sovvertiti o modificati nel loro contenuto essenziale neppure da leggi di revisione costituzionale o da altre leggi costituzionali. Tali sono tanto i principi che la stessa Costituzione esplicitamente prevede come limiti assoluti al potere di revisione costituzionale, quale la forma repubblicana (art. 139 Cost.), quanto i principi che, pur non essendo espressamente menzionati fra quelli non assoggettabili al procedimento di revisione costituzionale, appartengono all'essenza dei valori supremi sui quali si fonda la Costituzione italiana.”.

16) Professor Franco Gallo agrees with this thesis in his speech to University *Ca' Foscari* of Venice of 14/06/2013.

17) A. CERRI, *Eguaglianza, (principio costituzionale)* Treccani Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 8;See, also, F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 35. Also A.CELOTTO in *Declinazioni dell' eguaglianza*, Editoriale scientifica, Napoli, 2011,17-18 agrees with the others and remember the words of italian constitutionalist C. MORTATI, who said “the equality rule is a sort of super rule, a closing principle of the juridical system” in *Istituzioni di diritto pubblico,* II, ninth edition, Padova, 1976, 1023.

means that both the citizens and the powers of the State must obey the law.
All laws voted by the parliament must respect this principle, because our Constitution has more importance than a normal law in our law system, according to Hans Kelsen thesis, expressed in his work *The Pure Doctrine of law*[18]

3- The influence of International law in the Equality principle in the Italian juridical system.

The first paragraph of Article 117 of our constitution says: ”The legislative power is exercised by the State and the Regions respecting the Constitution and EU and International law obligations.”[19]
The rule has, as a consequence, that an Italian law can be valid only if is not in contrast with the European Convention of Human Rights.[20] In the other case it violates Article 117 paragraph 1 of our constitutional text. Therefore, an italian rule that violates equality principle is against the provisions of both Articles 3 and 117.[21]
As supporters of Multilevel Constitutionalist Theory say, our constitutional system is becoming “open”[22] to the international and EU dimension. It means that international rules become, in equality constitutional critics, as *tertia comparationis* or indirect parameters.[23]

18) H. KELSEN, *La Dottrina pura del Diritto,* Torino, Einaudi 1966.
19) I add here the original text: ”La potestà legislativa è esercitata dallo Stato e dalle Regioni nel rispetto della Costituzione, nonché dei vincoli derivanti dall'ordinamento comunitario e dagli obblighi internazionali.”.
20) See F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 49.
21) *ibidem*, 2011, 49.
22) *ibidem*, 50.
23) *ibidem*, 50.

4-The wording of provisions that affirm the equality principle.

As we have seen before, Article 3 is divided in two paragraphs: in the first, it is affirmed that all citizens have the same social dignity.

Analysing the word citizens, we could think that in Italy the provision is not applied to stateless and foreigners (and our constitution would be very different from the German one, or other constitution that don't use in the equality rule the word citizen), and also some experts at the beginning of Italian Republic history thought the same.[24]

Therefore, a judgement of Italian Constitutional Court in 1967, on the basis of Art. 2[25] and 10, paragraph 2[26], interpreted in connection[27] with Article 3, extended the principle even to these two categories saying that “equality for fundamental rights should concern even the foreigner”[28].

Doctrine[29] says that foreigner has a different treatment because the situation is different.

It is also important to add that in our system, even for corporations, bodies, association, juridical entities [well described in Article 2, paragraph 1), Art. 3 principle is recognized by the Constitutional jurisprudence[30] (sentence 40/1965; 2/1969; 15/1975 and others...)] that also affirms equality among Regions[31]

24) A. CELOTTO, *Le declinazioni dell' eguaglianza*, Editoriale Scientifica, Napoli, 2011, 19.

25) Relating to the issue Art. 2 says “The Republic recognizes and guarantees the inviolable rights of the person ,...”.

26) Art. 10 paragraph 2 says:”The juridical condition of foreigner is ruled by the law according to international rules and international treaties”.

27) From the paragraph 2 of Constitutional Court Sentence 120 of 1967.

28) From the paragraph 2 of Constitutional Court Sentence 120 of 1967.

29) Sorrentino, *Lessons*, Giappichelli, Torino, 2011, 151.

30)A. CERRI, *Eguaglianza , (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 3 ss.

31) See Italian Constitutional Court Sentence 11/1969; 2/1972;243/1974; 64/1987; 21/1991;

(politic-administrative bodies that compose the Republic[32]) and among Commons[33] (they are the nearest to the citizen entities that are part of the Republic[34] and hold only administrative powers).[35] Recent Constitutional jurisprudence[36] affirms that recognition of the treated principle is also extended to the subjects nationals of other European Union States.[37]

The expression "same social dignity", as says the most recent doctrine[38], means that all must be suitable to be holder of the same rights and that all are equal in front of the law.[39]

The second is an enlightment principle[40] and a founding principle of liberal democratic state of XIX century. According to that principle laws must be general and abstract, without any subjective distinction.[41] As US Supreme Court says, the law must be colour blind[42]. We have, first, to specify that the word "law" means

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277/1995, 303 and 338/2003.

32) From the first paragraph of article 114 of Italian Republic Constitution. I report here for a more clear analysis the Italian text:"La Repubblica è costituita dai Comuni, dalle Province, dalle Città metropolitane, dalle Regioni e dallo Stato.".

33) See Italian Constitutional Court Sentence 61/1958; 113/1970.

34) From the first paragraph of article 114 of Italian Republic Constitution.

35) A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 3 ss.

36) See Italian Constitutional Court Sentences 443/1997 and 86/2004.

37) See A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 36

38) F.MODUGNO, *Principi generali dell' ordinamento*,in Enciclopedia Giuridica, XXIV, Roma,1991, 20.

The expression was considered in the '50s a repetition of the equality in front of the law principle, and the doctrine didn't give to these words the great importance they have now. Differently, Sorrentino says that it means that every citizen merits the same consideration in the community., from F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 30-31.

39) See A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 20.

40) *Egalité devant la loi* is a french expression. A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 3, also C.PERELMAN, *Egalité et valeurs,* I, 323.

41) There is one only juridical system for all the citizens, as A. CERRI says in *Egualglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 4, according with Esposito's thesis, expressed in *Eguaglianza e giustizia nell' articolo3,* in *La Costituzione italiana,*Saggi, Padova,1954, 30 ss.

42)A. CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia

not only parliamentary acts but it includes our whole juridical system.[43] We also add that new doctrine and jurisprudence suggest a dynamic interpretation of the expression[44]: the law must treat equal situations equally and different situations differently.

In particular, Sorrentino defines equality as a relationship-wise principle, and many Constitutional Court sentences see the judgements on this principle even as a reason judgement.[45]

In the second part of the paragraph, it is excluded from our juridical system every ethnic, religious, political, language, national, gender, personal or social condition discrimination: never a person has to receive a worse treatment in reason of ethnics, faith, language, political opinions, social and personal[46] conditions.

It is the so called "Nucleus"[47], a sort of "inner core" of the principle (the description of the most unfair subjective discriminations).

In that case the critic of the constitutional judges is stricter and derogation is not possible even if it is founded on other constitutional principles.[48]

The second paragraph of Art. 3 is one of the most innovative parts of the constitutional text because it introduces for the first time the substantive "equality". It establishes the responsibility for the Republic to remove economic

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italiana, Roma, 1994,XXII, 3 ss.

43) See F. MODUGNO, *Legge in generale*, in Enciclopedia del diritto, XXIII, Milano, 1973, 875 and also A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 25.

44) See F.GHERA, Eguaglianza, CEDAM, 2003, 39ss and also A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 25.

45) F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 21.

46) That word could be interpreted as a general principle against subjective discrimination (like laws *in personam)*, as says Cerri. See A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 5.

47) See A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994, XXII, 3-4. See, also, A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 20 and L.PALADIN, *La Corte Costituzionale e un principio generale di eguaglianza* , Padova 1985, 659.

48) *ibidem*, 4. See also Constitutional Court sentences 32/ 1971. In that case a rule of Italian 1929 State- Church Agreement covered by the article 7 of the Constitution was declared unconstitutional for the contrast with equality principle.

and social obstacles that prevent the full development of person or impede the effective exercise of political, economical or social rights.[49] On the basis of this principle, apparently similar situations could be considered really different.[50] It is a form of equality with a positive and dynamic content.[51] It could be realized with state performances but also with limitations of rights of some persons, for example, it is possible to limit property rights[52] or economic initiative[53] to guarantee their social function.[54]

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49) *ibidem*, 6. See also Constitutional Court Sentences 43/1988, 497/1988 and 768/1988.

50) *ibidem*, 6. For example, if men and women have the same labour schedule, this could disadvantage women, especially for some kinds of work.

51) F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 10.

52) Articles 42 and 44 of Italian Republican Constitution.

53) Articles 41 and 43 of Italian Republican Constitution.

54) F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 10.

Chapter II

The principle of ability to pay

1- Historical overview of the principle of ability to pay.

From the Roman age to the rise of constitutional states, levies were seen only as an unfair burden that the king or legislators dictate[55].

For example, in Pre-Revolutionary France, Noblemen and Clergy didn't pay any tax and Third State paid about 42% of their income in taxes, so the tax system was regressive because the richest part of population were beneficiaries of tax exclusion.

The only basis of levy, at that time, was the law,[56] declared by the Absolute Sovereign.

From the stipulation of *Magna Charta Libertatum* the powers of English king were restricted and levy started to become an obligation to contribute to public expenses. In the same age philosopher and saint Tommaso D' Aquino affirmed that fiscal duty was not a sort of payment of public services but a consequence of the existence of the State[57]. However the system that considered taxes as an

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55) The famous XIV century jurist *Bartolo di Sassoferrato* defined taxes as a load "*...necessario subimus lege vel mero imperio eius qui habet potestatem.*". From G.FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri, Editoriale Scientifica, Napoli, 2006, 92 See, also, L.CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 6, See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 21.

56) From *G.FALSITTA, in AA.VV., Diritto tributario e Corte Costituzionale,* a cura di *Perrone e Berliri*, 93.

57) See R.AMBERG, *Die Steuer in der Rechtsphilosophie der Scholastiker,* Berlin und Leipzig, 1909, 17 ss.

oppressive instrument of sovereign power changed only with French Revolution.[58] At that time the law became an expression of general will, of citizen's will. So from that started the idea of levies that support the expenses of a Constitutional Right State.[59]

An Italian author, Lorenzo Meucci, gave moral and juridical nature to this obligation[60]. As said Italian Republic president and famous economist *Luigi Einaudi* said that "with taxes State creates new values[...] Through the tax the State creates the juridical and political framework when men could work, organize, invent and produce".[61]

From this concept spreads the idea that a fair distribution of public expenses is necessary[62]

Article 25 of *Statuto Albertino* says"[All the subjects] contribute indiscriminately, in proportion of their owns to public expenditure"[63]. In that definition is excluded the concept of progressivity according to formal equality concept: in fact all the citizens[64] must be subjected to a proportional level of taxation (totally ignoring

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58) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 139.

59) Italian Constitutionalist Aldo Moro defined the State as the highest form of human solidarity.

60) From L.MEUCCI, *Istituzioni di diritto amministrativo*, Torino, 1905, 443.

61) L. EINAUDI, *Miti e paradossi della giustizia tributaria*, Torino, 1940, 199 in citation of From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 88.

The author, also, reported a passage of *Nicol vs Arnes, 173 U.S.* 509,515 (1899) US Supreme court sentence: "Tax power is the only grat founding power on that is founded all the State. It is necessary for the life of the nation as the air is necessary for man' s life. It is not only a destruction power, but also a life preservation power.".

62) From G. FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale*, a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 97.

63) I report here Italian text: "*Essi contribuiscono indistintamente, nella proporzione dei loro averi, ai carichi dello Stato*." *Ibidem*, 102. It is a rule similar to rules present in English 1688 Bill of Rights and French 1789 *Declaration de droits de l' homme et du citoyen*. A similar expression was also contained in Spanish Constitution that established: "Taxes will be subdivided between all Spanish citizens in proportion of their wealth, without exceptions nor privileges. From L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 24.

64) Without any kind of subjective exclusion like *Ancien Regime*. In fact that rule established fiscal equality, See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 23.

solidarity influenced conception of taxes).[65]

One hundred years later, Republican Constitutional legislator confirmed the duty for all citizen (without class or rank distinctions[66]) to participate to the public expenses, but the parameter changed, even due the introduction of other constitutional principles (Art. 2 and Art. 3 of our constitution) that influenced Art. 53 paragraph 1 rule.

The new rule expressed the evolution, in solidarity direction, of the principle.[67]

As noted Milone the rule is put by Italian Constitutional legislators in Title IV of first part of Constitutional Chart that defines "Politic Relations": for example article 54 establish for citizen Republic fidelity duty and article 52 Fatherland protection against attacks duty.[68] So the contribution to public expense is considered as one of the fundamental duties of every citizen or person that have economic links to Italian State (in that case is even possible real basis taxation.

2) Ability to pay principle in Italian 1948 Constitution.

The first paragraph of Article 53 of Italian 1948 Constitution says: "Every person shall contribute to public expenditure in accordance with their ability to pay."

Contained in that expression, ability to pay principle means the appropriateness in

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65) According to Milone "that rule gave to legislator the possibility only of a restrictive interpretation", From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 92. See, also, M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali*, CEDAM, Padova, 2012, 82.

66) From FEDELE, in AA.VV., *Diritto tributario e Corte Costituzionale*, a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 3. See, also, on the same volume, G. GAFFURI, 25.

67) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 94.

68) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 89.

a specific moment[69] (potentially economical) of every member of the community[70] to satisfy fiscal obligation, deducible from the circumstance to which the tax is linked.[71]

The article makes explicit the principles contained in Articles 2[72] and 3[73] of the Constitutional Chart:[74] in fact is affirmed[75] that ability to pay principle is a specification of Solidarity (Art. 2) and Equality (Art. 3) constitutional principles.

The principle is addressed to the legislator and to the taxpayer.[76]

For the first one it is both a limit (because levies must finance public expenses) and a parameter for Italian taxation system.[77] For the second one it expresses the duty to payment of fiscal burdens on the basis of his ability to pay.[78]

This obligation is not the consequence of a specific service, got from the State, but only of the fact that citizen belongs to a democratically and politically organized

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69) As affirmed by article 3, line 1 of Taxpayer Rights Statute (law 212/2000) tax law never have a backdated effect. Therefore, Taxpayer Rights Statute hasn't the same value of Constitutional provisions, so it could be waived by ordinary legislation. However the most part of the doctrine asserts that it is a juridical civilization principle.

However backdated taxation is not possible if his object is not still present when tax law is enacted.

70) S. La Rosa wrote that it means that participation to public expenditure concern people that belong to all social classes. From S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,* Giuffré, Milano, 1965, 10.

71) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 84.

72) "The Republic expects that the fundamental duties of political, economical and social solidarity be fulfilled".

This translation is published on Italian Senate internet website (www.senato.it).

73) Principle of formal and even substantive equality are projected in 53 par. 1 rule.

74) G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 58. See, also F.MOSCHETTI, A.FEDELE, P.BORIA and G.FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 2, 40, 57, 100. We can also find impotrant considerations in F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 96. See, also, M.PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 126-127.

75) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 129 See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 41-42.

76) G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 49.

77) *ibidem,* 50.

78) *ibidem,* 50.

community.[79]

Nevertheless, the ability to pay is even influenced by article 2 Constitutional provisions (the duty to pay the levies is included in political, economical and social solidarity[80]), and this fact involves the minimum vital exemption[81], so the people, differently from the letter of 53 par. 1 rule, mustn't participate to public expenditure.[82]

The rule doesn't mean that all the units of income have the same fiscal treatment[83]: in fact the juridical system permits discriminations between different situations. So it was affirmed that this Constitutional principle guarantees an equal treatment to people that are in the same *de facto* situation specifying, in that way, equality principle.[84]

These discriminations could be quantitative or qualitative.

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79) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 79.

80) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 79.

81) As noted Carpentieri Minimum Vital exemption was theorised for the first time by Bentham.

From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 19.

82) As say Melis not every economic capacity could be considered as ability to pay. G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 53.

Moschetti defined the same concept as minimum for personal and familiar necessary expenses. From FEDELE, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri, Editoriale Scientifica, Napoli, 2006, 49. Fedele says that minimum vital is related to human dignity. The article was written on the same volume, 2. Even Procopio agrees with that thesis affirming also that exclusions must respect Equality principle, expressed in article 3 Italian Constitution provisions. From M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 82 and 85 and 108. The author also, asserts that minimum vital exemption is necessarily based on solidarity principle. F. GALLO affirms that minimum vital exemption protect free and respectable subsistence in *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 9., See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 48-49. In Constitutional Court Sentence 97/1968 is expressed the same concept: “Is not exact that Article 53 of the Constitution exige from every income, independently from his entity a tax burden. Substantive equality principle, expressed in article 3, line 2 of Italian Constitution, that must inspire fiscal legislator, presuppose that taxes mustn' t deprivate anyone of goods that seems indispensable to fundamental human necessities.

83) M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 85.

84) S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 10.

Quantitative discriminations operate between different amount incomes.[85]In qualitative discrimination the reason of the different treatment is founded on the origin of the income.[86]

As affirmed Italian Constitutional Court Sentence 155/1963 “[Article 53], constituting the specific development of Equality Principle, expressed in article 3 of Constitution represent the necessity , for income taxes of equal taxation for equal incomes and different taxation for different incomes”[87].

In fact that principle has a double function: a solidarity function (every people should contribute to public expenditure) and a guarantee function that is a limit for legislator to tax only citizens that are effectively “able to pay”.[88]

This is the basis of so called tax justice.

In the firsts years after the introduction of Constitution, the doctrine defined the rule as a programmatic provision not binding for the legislator.[89]Also Italian Court of Cassation sentence 844/1954 affirmed “Article 53 of Italian Constitution

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85) For example corrections of regressive effects determined by indirect taxes like VAT or with a progressive personal income tax.

The main reason for that is an economic concept: marginal utility is decreasing.

From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 126-127

It is also the main reason for minimum vital exemption.I can explain the concept with that example: if a person is in the desert he surely need water, an other person arrive and bring him a glass of water, the thirsty person enjoys it a lot, than he give him an other and others. I think that when the water taker will give the 50 th glass the other person could even refuse it. In that example the satisfaction for the glasses of water is decreasing.

86) An example of qualitative discriminatione is surely patrimonial tax that hit two times capital income revenues. A more recent example is represented by the diversificated rate of Added Value Production Tax for Banks and Insurance companies and also additional taxes on pornographic material. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 129 and 133. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 127.

87) The same concept is also well affirmed in Italian Constitutional Court Sentence 120/1972.

88) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 81.

89) Giannini defined it as an “ideological statement”. See A.D.GIANNINI, *I rapporti tributari, in Commentario Sistematico alla Costituzione Italiana,* I, Firenze, 1950, 273; G.INGROSSO, *I tributi nella nuova costituzione Italiana,* in Archivio Finanziario, 160-161; F. MAFFEZZONI, *Valore positivo dei principi costituzionali in materia tributaria,* in Jus, 1956, 326.

contains a merely directive rule...”.

The expression was defined as unclear, ambiguous, a sort of “empty box”[90]Other authors thought that ability to pay was the expression of benefit theory; so it must be equal to the economic value of services received from the State, as Maffezzoni said.[91]

Constitutional Court affirmed that there aren't not binding constitutional rules in our juridical system[92] and that 53 par. 1 is related to indivisible services.[93]

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90) See G.INGROSSO, *I tributi nella nuova costituzione italiana,* in Archivio Finanziario, 1950, I, 163; A.D.GIANNINI, *I rapporti tributari,*Firenze, 1950, 281; A.BERLIRI, *Principi di diritto tributario,*Milano, 1952, I, 255; L.EINAUDI- F.REPACI, *Il sistema tributario italiano,* Torino,1958,11See M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 83-84. The author didn' t agree with that understimating theory of that constitutional principle and affirms, according with Paladin that ability to pay principle must necessarily be an “elastic concept”. See also, L.PALADIN, *Esiste un “principio di ragionevolezza” nella giurisprudenza costituzionale?,*in *Il principio di ragionevolezza nella giurisprudenza della Corte Costituzionale,* Atti del Seminario di studi, Roma, 13-14 ottobre 1992, Milano, 1994, 164.

That doctrine that would give more discretional power to the legislator, is recently developed by part of the doctrine with different arguments.

See, with regards to these new theories, L. ANTONINI, *Dovere tributario, interesse fiscale e diritti costituzionali,* Milano, 1996; S.F.COCIANI, *Attualità o declino del principio di capacità contributiva?,* in Rivista di diritto tributario, 2004, 823 ss; F.GALLO, *Etica e giustizia nella nuova riforma tributaria,* in Diritto e pratica tributaria, 2004, I, 17, *Le ragioni del fisco,* Il Mulino, Bologna,2011, P. BORIA, *La dialettica costituzionale del fenomeno tributario,* in Diritto e pratica tributaria, 2005, I, 1031 ss; A.FEDELE, *La funzione fiscale e la capacità contributiva nella Costituzione italiana, in AA.VV., Diritto tributario e Corte Costituzionale,* a cura di *Perrone e Berliri* , Editoriale Scientifica, Napoli, 2006, 1 ss.

91) G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 50, see, also, From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 93 and 99 ss

92) It was affirmed in Judgment 1/1956.

93) G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 51.See also *Diritto tributario e Corte Costituzionale,* Perrone and Berliri, From GAFFURI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 26.

3- Objective limits to fiscal overdraft: when does taxation become expropriation?

Article 42 paragraph 3 of our Constitution says “Private property could be, in cases established by laws, and always with economic compensation, expropriated for general interest reasons”.

As affirmed by the Human Rights European Court, compensation mustn't be considerably lower than the commercial value of the good.[94]

In the Italian juridical system, expropriation is authorized only for specific reasons and the cases are predetermined by law, so if a tax acquire confiscatory nature these constitutional rules are certainly violated by legislator.[95] Italian constitutional jurisprudence affirms that the fiscal legislator decides the maximum level of taxation, but taxation never can be arbitrary or unreasonable.[96]

An important case is well represented by so called “*Contribution exceptionelle de solidarité sur les très hauts revenus d'activité”*[97] that would increase to 75% income taxations for the part exceeding 1 million euros. In some cases, for example taxation for stock options and free shares, the taxation could reach 79,5%[98] and in case of real estate capital gains could reach 90,5%.[99] Most part of

94) Case *Pisacane and Others,* Sentence 27/05/2008.

95) See G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,55 and 61 and, also Fedele and Gaffuri, in A.A.V.V.,*Diritto tributario e Corte Costituzionale*, Editoriale Scientifica, Napoli, 2006, 19-20, 35.

96) From G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 23. See, also, Italian Constitutional Court provisions 62/1977, 336/1992, 475/1994, 352/1995,111/1997, 449/1998, 3/2001 and 23/2005. In particular sentence in 336/1992 it asserted “...is not entitled to Constitutional Court to judge the entity or proportionality of fiscal burdens but only to control arbitrariness or irrationality of fiscal measures”.

97) From art. 12 of *Projet de loi de finances pour 2013.*This rule was a main issue in french president François Hollande in 2012 electoral programm.

98) *From* G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 13.

99) *ibidem*, 17.

the doctrine considered the tax as an excessive or confiscatory measure[100] and also criticized the subjection to tax only for incomes deriving from professional activity and the excessive taxation for stock options and free shares.[101]

French *Conseil Constitutionnel* in Sentence 662 of 29/12/2012 stated that the new levy increases fiscal revenue and progressivity of the whole French tax system[102] but it defined the tax an excessive[103] measure that violates equality principle.[104]

It is not the first time that *Conseil Constitutionel* declared unconstitutional a tax: in 1986 it happened with a 50% tax defined "confiscatory".[105] In the 2014 budget law, the French legislator introduced a 75% levy on salaries paid by the enterprises of more than one million Euro.[106]In Decision 685/2013 the highest French jurisdictional authority affirmed that "the rule, considering the ability to pay of these enterprises, respects equality principle."[107] With that decision a different version of the rule that is relevant for less subjects than the previous one is considered valid, but a fiscal overdraft considered by many authors as confiscatory and, therefore, illegitimate, is authorized.

The question was also analysed by German *Bundesverfassungsgericht.* It affirmed

100) UMP and UDI deputy groups affirmed that the measure, leaving to the owner only 25% of the revenue, is against property right protected by article 17 of so called *Declaration des droits de l' homme et du citoyen* . *Ibidem*, 11.

101) *ibidem*, 12- 13. In case of stock options and free shares we find disparity of treatment between these income and labour income and it cause a violation of equality principle and the excessive rate has confiscatory nature. This was affirmed by UMP and UDI deputies groups.

102) *ibidem*,8.

103) *ibidem*,18. I report here the French text: *"une charge excessive au regard de leurs facultès contributives".*

104) I report here the French text: *"contraire au principe d' égalité dans les charges publiques".*

M. PROCOPIO asserted that French *Conseil Constitutionnel* based his decision on the violation of equality principle in *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 116.

105) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I,19.

106) See article 15 of *loi financiaire 2014.*

107) From *Conseil Constitutionnel, Comuniqué de Presse* 685/2013. I report here the french text:

"Compte tenu de ces éléments et au regard des capacités contributives desdites entreprises, l'article 15 ne porte pas atteinte à l'égalité devant les charges publiques. ".

that the sum of income tax and property tax mustn't ever exceed 100% of total income[108] leaving the citizen without the so called vital minimum.[109]

A relatively recent sentence[110] asserts that constitutional limits to taxation could be found in private property and in proportionality principle and that levies mustn't substantially jeopardize economic result.[111] In the specific case, a 57% levy was considered unreasonably excessive.

Spanish jurisprudence is based on the constitutional prohibition of confiscatory tax[112] and affirms that the sum of levies mustn't overtake the 100% of the citizen income.[113]

Brazil Constitutional Court considered confiscatory and therefore unconstitutional a 52,5 % income tax, defining it unreasonable.[114]

Argentina Constitutional Court in the '40s stated that real estate rent tax, inheritance tax and donation tax mustn't exceed 33%.[115] In this country is also present a Constitutional rule that put a ban to confiscatory taxes.[116]The position

108) See G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 20 and, also, G.FALSITTA, *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l' intero reddito del contribuente,*148-149, See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 39.

109) See BOZZA-BODEN, *L' imposta confiscatoria nella giurisprudenza e nella dottrina tedesca dopo la sentenza 18 gennaio 2006 della Corte costituzionale germanica,* 99.

110) Sentence of *Bundesverfassungsgericht 18-1-2006.*

111) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 20,see also, BOZZA-BODEN, *L' imposta confiscatoria nella giurisprudenza e nella dottrina tedesca dopo la sentenza 18 gennaio 2006 della Corte costituzionale germanica, 107.* See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 39.

112) Article 31, paragraph 1 says "..in no case [the fiscal system] will apply confiscatory measures". I report here also the spanish text: "*en nignùn caso [el sistema tributario] tendrá alcance confiscatorio.*". As noted Carpentieri the same ban is even present in Brazilian Constitution, article 150, line 4. From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 39.

113) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 22.

114 *) ibidem,* 24.

115) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 24.

116) I report here the expression: " Tax couldn't be indirectly used as a sort of instrument to

changed recently when the same *Corte Suprema de Justicia de la Nacion* asserted the non existence of a precise percentage limit of tax, but affirmed that the State fiscal power is not unlimited; so it is impossible that taxes could take a substantial part of the citizen income.[117] On the basis of these arguments, 62% and 55% levies were considered unconstitutional.[118]

Italian juridical system lacks of an express ban to confiscatory taxes and a confiscatory tax present in this fiscal system wasn't declared unconstitutional by the Constitutional Court. The case was treated in Sentence 68 of 20 march 1985 and was related to Italian Inheritance Tax Law that established Passive Equal Solidarity of heirs. In that case if an heir fail to exercise his Payback Right the tax that he pays could be higher than his succession rights determining in that way a confiscatory fiscal burden.[119]

However many experts[120] asserts that is present in Italian set of rules an implicit ban to confiscatory taxes inferable from articles 3, 42[121] and 53 of Constitutional Chart.

We clearly see that the confiscatory French notion is more restrictive[122] than the

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reach the same scope of confiscation of goods". From L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 40.

117) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 25.

118) *ibidem*, 26.

119)See L.CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 40. In that case Italian Constitutional Court affirms that guarantees for the heir are the possibility to refuse inheritance or to accept it with Inventory Advantage.

120) See L.CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 41.

121) Article 42 of our Constitution affirms:

"The ownership is public or private. Economic goods belong to the State, to Authorities or to privates.

Private property is recognized and guaranteed by law, that determine the modality of purchasing, of enjoyment, and limits in order to guarantee his social function and make it accessible for all.

Private property could be expropriated for public utility reason only in cases determined by law and with economic compensation.

The law establishes the rules and the limits of legal succession and Last Will Inheritance and State Rights over Inheritance goods.".

122) It means that tax must absorb the quasi entirety of citizen income, not only a substantial part. G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di

German or Argentine notion. As the Italian author Moschetti affirms[123], German and Italian constitutional fiscal principles are the same; so the same principle asserted by German *Bundesverfassungsgericht* should be valid even in Italy and it could have for consequence that a levy of more than 50-55% could be unconstitutional.[124]

Procopio affirms that fiscal overdraft would be confiscatory and so unconstitutional if it request the whole income citing Italian Cassation Court of 8 January 1951.[125]The thesis of absence of limits to ability to pay principle is endorsed by professor Franco Gallo: he affirms that this limit would break correlation between solidarity public expenses contribution duty and public expenses financing, and so between fiscal and social justice.[126]

The first thesis is confirmed by the rules present in article 17[127] of Nice 2001 Fundamental EU Rights Chart and article 1 of Additional Protocol of European Human Rights Convention of 1950 that sanction the respect for every physical or juridical person goods and that "anyone could be deprived of his property but for public utility causes and in conditions established by the law and the principles of International Law"[128]

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diritto tributario, 2013, 28.

123) Even G. FALSITTA , *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l' intero reddito del contribuente*, in Rivista di diritto tributario, 2010, I, 139 agrees saying that in our juridical system is immanent a maximum limit to taxation in.

124)From MOSCHETTI, in AA.VV., *Diritto tributario e Corte Costituzionale*, a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 52.

125) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 111 and 112. M.S. GIANNINI don't agree with this thesis in *I concetti fondamentali del diritto tributario,* Torino, 1956, 61 ss.

126) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 105.

127) Article 17 text says: "every person has the right to enjoy the property of goods that he has legally purchased, to use these goods, to have these goods available, to let these goods in inheritance. Anyone could be deprived of the property but for public interest cause".

128) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 115. Also G.FALSITTA agrees with this thesis in *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l`intero reddito del contribuente,* in Rivista di diritto tributario, 2010,Giuffré,Torino, I, 139.

4- Relevant indicators for the determination of ability to pay in Italy: the position of jurisprudence and doctrine expressed by Absolute theory and Relative Theory.

The ability to pay is shown by a situation or an index of economic force ascribable to a citizen.[129] Constitutional rule (Article 53 par. 1) doesn't specify what are the indicators that are fundamental to affirm the existence of ability to pay.

This situation causes an intense debate, mainly in doctrine, where some authors have a restricted conception of the principle and consider only traditionally known indicators like income, property and consumption, whereas others propose an extensive interpretation of the expression that includes all facts or situation that could modify the position of taxpayer in the juridical system[130]; in other words is considered satisfactory a mere economic potentiality[131]

In particular, the first one sees in the ability to pay principle an absolute or external[132] limit for the legislator, and this has as a consequence that ability to pay could be identified only in situations where tax object contains directly the economic resources necessary to pay the levy.[133] In other words the first and most

129) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 134 F. TESAURO add that it refers to the whole economic position of taxpayer, see F. TESAURO, *Istituzioni di diritto tributario, Vol. I, parte generale,* Torino, 1991, 55.

130) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 54. See, also, MOSCHETTI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 43. P. BORIA, also, affirmed in *Il sistema tributario,* Torino, 2008, 112 affirmed that flexibility and volatility are main characteristics of Fiscal System.

131) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 98.

132) From F. MOSCHETTI, *La capacità contributiva,* CEDAM, Padova, 1993, 9.

133) See F. MOSCHETTI, *Il principio di capacità contributiva,*Padova, CEDAM, 1973, 258;I. MANZONI, *Il principio della capacità contributiva nell' ordinamento costituzionale italiano,*Giappichelli, Torino, 1965, 13-14; G. GAFFURI, *L' attitudine alla contribuzione,* Giuffré, Milano, 1969, 106 ss, G. TINELLI, *Istituzioni di diritto tributario,* Padova, 2004 and G. FALSITTA, *L' imposta confiscatoria,* in Rivista di diritto tributario, 2008, I, 93 The theory is described by F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 54. and, also, M.

important limit for legislator is ability to pay principle that produces substantial guarantees[134] for every citizen and rationality principle is subordinate to ability to pay principle[135].

In addiction Absolute limit advocates theory assert that ability to pay principle is an autonomous principle and not a mere specification of Equality principle expressed in Article 3 provisions.[136]

In fact, Falsitta asserts that only facts expressive of economic capacity to pay the levy can be expression of ability to pay, and so facts that consist in money or goods easily transformable in money.[137] He, also, adds that the indicator can be allocated only to his effective possessor.[138] According to that thesis ability to pay could be identified with economic force certain and effective suitable to satisfy fiscal obligation.[139] That idea of ability to pay as a guarantee for " the person" consider the principle as an objective, patrimonial limit that forbid the participation to public expenditure to all subjects that hold vantage positions economically valuable when they lack of patrimonial means.[140]

PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 88.

134) See I. MANZONI, *Il principio della capacità contributiva nell' ordinamento costituzionale italiano,*Giappichelli, Torino, 1965, 50.

135) A. MILONE, *Sovraimposizione nell' imposta sul reddito della società,* Hoepli, 2012, 109 See also A. FANTOZZI that defined rationality as the "last limit" in *Il diritto tributario,* Torino, 2003, 28 and F.MOSCHETTI, *La capacità contributiva,* CEDAM, Padova, 1993, 9.

136) He says that if we consider 53 c. 1 of Italian constitution as a specification of Equality principle we have a *de facto* cancellation of ability to pay principle in Italian juridical system. From F. MOSCHETTI, *La capacità contributiva,* CEDAM, Padova, 1993, 7.

G.FALSITTA agrees with that thesis in *Storia veridica, in base ai "lavori preparatori" della inclusione del principio di capacità contributiva nella Costituzione,* in Rivista di Diritto tributario, 2009, II, 126-127, See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 12.

137) From FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone and Berliri, , Editoriale Scientifica, Napoli, 2006, 100-101, see, also, F.GALLO that describes this theory in *L'evoluzione del sistema tributario e il principio di capacità contributiva,* Rassegna Tributaria, 2013, I, 3.

138) *ibidem,* 101. See also G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 56-57.

139) A. MILONE, *Sovraimposizione nell' imposta sul reddito della società,* Hoepli, 2012, 110, see, also, G. FALSITTA, *Manuale di diritto tributario,* CEDAM, Padova, 2012, 151 ss.

140)See F.GALLO, *L'evoluzione del sistema tributario e il principio di capacità contributiva,*

As Fedele says, if that theory was accepted by Constitutional Court, many levies present in our fiscal system, Added Value Production Factors Regional Tax *in primis,* would be considered unconstitutional.[141]

Also environmental taxes[142] wouldn't be consistent with Art. 53 par. 1 Constitutional provision (they couldn't surely be part of fiscal area[143]).[144]

The other position sees in the principle of ability to pay a relative limit to the legislator decisions.[145] In other words tax distribution is a political problem whose solution is founded on requirements constituted by the economic and political situation of a country.[146] So the Constitutional judgement is a rationality,[147]

Rassegna Tributaria, 2013, I, 7.

141) From FEDELE , in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri, Editoriale Scientifica, Napoli, 2006, 12. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 98.

142) European Commission defined "environmental tax" a tax whose taxable income is a physical unity of something of that is scientifically demonstrated of negative effects for natural environment when it is used or released". So the basis could be polluting emissions or natural resources consumption. The condition is the presence of a causality nexus between the physical unit and taxable income.

Differently, it is not an environmental tax a levy that has an environmental scope but not contain it in fiscal requirement.

In that case it is an environmental function tax, for example very common so called "refuse tax". From F.GALLO and MARCHETTI, *I presupposti della tassazione ambientale,*Rassegna Tributaria, I, 1999,117 and 119. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 98.

143) F.GALLO and MARCHETTI report that they consider environmental tax as an extrafiscal goal levy in *I presupposti della tassazione ambientale,*Rassegna Tributaria, I, 1999,134.

144) *ibidem,* 13. See, also, G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 56. See, also, Gallo and Marchetti' s thesis that criticized that theory in *I presupposti della tassazione ambientale,*Rassegna Tributaria, I, 1999,138.

145) See G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 54.

146) From G. BORGATTA, *Appunti di scienza delle finanze e diritto finanziario,* Milano , 1935. It was part of citation of F. GALLO, *Le ragioni del fisco,* Bologna, 2011, 81(and also by the same author in *L'evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 1) and A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 85, see, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 13 that in 1965 spotted a similar position in part of Italian fiscal doctrine.

147) As says Constitutional Law professor Gino Scaccia it is a control of logic- juridic defects, see G.SCACCIA, *Gli strumenti della ragionevolezza nel diritto costituzionale,* Milano, 2000, see also A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 98 and 104-105. A. FEDELE affirms that ability to pay is a system total rationality criterion in *Appunti delle lezioni di diritto tributario,* Giappichelli, Torino, 2005, 32-33. Even M. PROCOPIO agrees with that thesis in *Il sistema tributario italiano.Principi istituzionali,* CEDAM,

coherence[148] judgement. In their vision not only an exchangeable good can constitute manifestation of ability to pay but even facts deriving from social relations[149] (even not patrimonial). This concept is also expressed by Nobel Prize Amartya Sen as “capacitation”, that is to say a vantage position in the society.[150]

In their opinion the basis of ability to pay could be found even in not necessarily economical indexes, is satisfactory that the index has an attitude to produce wealth.[151]

They think to Constitutional rule (Art. 53 par.1) as an open expression that has for consequence an elastic principle that gives a wide discretionary margin to legislator (that, however, mustn't establish irrational or arbitrary[152] taxes), according, also, with substantial and formal equality Constitutional principles (Art. 3).[153] On these basis, fiscal requirements must absolutely be objectively derivable as asserted Italian Constitutional Court.[154]

According to that thesis ability to pay become mainly based on distribution or

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Padova, 2012, 86 citing Italian Constitutional Court sentence 111 of 1997: “[Constitutionality judgment] must be a judgment on the rational use of legislator discretionary powers in fiscal legislation and must verify internal coherence of tax internal structure with his founding economic circumstance and also not arbitrary entity of the levy”. See, also, F.GALLO, *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 8.

148) A. MILONE specifies “non contradiction” in *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 114, See, also, F. GALLO, *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 8.

149) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 83.

150) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,55. See, also, F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 83. Amartya Sen affirms that, next to resources and primary goods, there are other condition that are important for definition of poverty.

151) From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 88. The author, also, affirmed his adhesion to relative limit theory. Even L.CARPENTIERI affirmed that she partially agrees with the thesis in , *L' illusione della progressività,* Dike Giuridica, 2013, 37.

152) From MOSCHETTI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 45.

153) See F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 88-89 and an other more recent work written by the same author, *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 9.

154) *ibidem,* 83.

mere subdivision criterion[155]. On the basis of this principle tax limits freedom, ownership and economic potentiality of the individual in order to increase positive freedoms, that is freedom associated with equality purposes.[156] Many authors[157] considered that position as a flattening of the art. 53 principle on art. 3 principle that could give no limits to legislator leaving the citizens in a fiscal oppression situation[158]. Italian Constitutional Court Sentence 16/1965 affirms: "...when the object of taxation is a productive thing the basis of taxation is given by the good's aptitude to produce an economic income, not by the income effectively received by his possessor."[159] Sentence 373/1988 confirms that principle:" It is certainly legitimate and not in contrast with the ability to pay principle custom fee when there is a fiscal requirement - not unreasonably defined by legislator - represented by the entry of goods in national market; and successive events or circumstance that taxpayer doesn't get any utility from these goods are not suitable to exclude fiscal requirement and relationship." Ability to pay is considered to be based on every wealth indicator in 1992 Constitutional Court sentence.[160]

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155) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 96-98. In these pages the author affirmed the passage of concept of ability to pay from an economic dimension to a distribution criterion based dimension. See, also, F. GALLO, *L'evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 1.

156) See F.GALLO, *L'evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 5-6.

157) See From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 104. Interesting also La Rosa's thesis that affirmed the distinction of ability to pay from equality principle saying that equality principle integrates equal treatment principle and article 53 line 1 principle establish a fair distribution of fiscal burdens. From S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,* Giuffré, Milano, 1965, 120.

158) A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 111-112. See, also, G. FALSITTA, *Giustizia tributaria e tirannia fiscale,* Giuffré, torino, 2008, 242.

The author says that in many States parliaments introduces confiscatory effect taxes.

159) See also Italian Constitutional Court Sentence 21/1996. According to Procopio' s thesis in that sentence is given relevance even to the aptitude of a good to the production of wealth. From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 100-101. That important Constitutional Court Sentence is even cited by S. LA ROSA in , *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 43.

160) See Italian Constitutional Court Sentence 42/1992.

These affirmations *consider* economic force in itself and not necessarily patrimonial elements referable to taxpayer creating an “objective profile” to the ability to pay principle.[161]

The statements of the sentence 156/2001 of the Constitutional Court are very important: “In the IRAP case, not irrationally, legislator identified as new index of ability to pay , different from these used for other levies, the value added produced by autonomously organized activities.”Apropos Professor Franco Gallo defined this interpretation as an evolution oriented interpretation.[162]

Doctrine also gives some examples of goods that are not patrimonial but are manifestation of wealth like goods with destination different from enterprise activity or fringe benefits.[163]

Reading Italian Constitutional Court reported statements it is clear that there was, in its position, a shift from Absolute Limit theory to Relative Limit theory[164], especially due an evolution oriented interpretation of constitutional provisions and considering also the influence of Art. 2 and 3 Constitutional principles.

Returning to environmental taxes, considering this, second theory, there is no doubt about their accordance to constitutional provision because the pollution or the use of natural resources are considered as the utilization of a luxury good.[165]

This is possible even if fiscal requirements (as prof. Gallo suggests, they have to be commensurate to damages that it could cause to natural environment comparing with other less polluting emissions[166]) haven't any direct patrimonial

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161) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,56-57. See, also, From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 144 ss; See, also Italian Constitutional Court sentences 164/1993, 143/1995,21/1996, 111/1997 and 21/2005 and 223/2012.

162)F. GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 92.

163) *ibidem*, 83.

164) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,56. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 100-101

165) F.GALLO and MARCHETTI, *I presupposti della tassazione ambientale,* Rassegna Tributaria, I, 1999,134 and 144.

166) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 94-95.

value and couldn't be exchangeable in the market as asserted by Relative Limit theory advocates.[167]

5- Do environmental taxes respect ability to pay principle?

As explained before, environmental taxes are taxes whose taxable income is a physical unity of something of that is scientifically demonstrated of negative effects for natural environment when it is used or released.

The logic on the basis of this fiscal burden could be found in an economic compensation from the polluter to the community that receives damages from the polluting activity in order to finance public services to prevent environmental deterioration[168] or in Negative Externalities Pigouvian Economic Theory that see environmental taxes as a balance of negative externalities caused by polluting activity.

In that kind of tax the economic circumstance on which it is based is directly linked to the environment: in fact are environmental taxes Carbon Tax, on CO_2 emissions and also taxation on environmental not friendly goods consumption.

Ficari don't think that this duty is an ability to pay principle based tax but a scope tax with compensation function[169], differently, as wrote before Gallo and Marchetti thinks that they are based on ability to pay principle because they hit the consumption of a luxury good (because of the use of natural resources of or the

167) *ibidem*, 93.

168) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 101.

169) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 102-103. See, also, V.FICARI, *Prime note sull' autonomia tributaria delle regioni a statuto speciale (e della Sardegna in particolare)*, in Rassegna tributaria, 2001, 1307.

pollution)[170].

According to Fedele' s opinion environmental tax couldn't considered against article 53 line 1 constitutional principle if we considered it an extrafiscal tax[171], so a tax established for scopes different from the contribution to public expenditure.[172]

Moschetti and Falsitta consider these kind of taxes as extraneous to ability to pay principle and asserts that they are a sort of “exchange-taxes”.

Procopio asserts that, in this case ability to pay is identified in vantage position enjoyed by the subject who uses not environmental friendly goods or inputs polluting emissions.[173]

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170) F.GALLO and MARCHETTI, *I presupposti della tassazione ambientale,* Rassegna Tributaria, I, 1999,134 and 144.

171) According to the italian doctrine extrafiscal use of levys don' t contrast with ability to pay principle, See S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 30-35.

The author affirms that it must be compatible with uniform distribution of fiscal burdens.

172)See A. FEDELE, *Appunti delle lezioni di diritto tributario,* Giappichelli, Torino, 2005, 31 ss.

See, also, MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 238-240 that considered it an “ethic tax”, like Robin Hood Tax and Pornotax. The author defined this fiscal burden as a sor of compensation for negative externalities released in the environment.

173) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 106-107.

Chapter III

Progressivity principle.

Progressivity principle is expressed in Article 53 paragraph 2 of the Italian Republican Constitution, which says: "The fiscal system is informed by progressivity criteria". This Constitutional principle has a guideline value for Italian fiscal legislator.[174]

This principle started to spread between the revolutionary environment of XIX Century: in fact the project of a progressive tax was debated in Napoleonic 1797 *Repubblica Cisalpina*[175] and was also present in anonymous Project for a Constitution for a Free and Independent Italy of 1835.

The first[176], rejected project for a progressive tax was presented to the French Parliament after 1848 Third French Revolution[177] by socialist Proudhon and got only two favourable votes.[178]

The principle was for the first time justified by Holland' s fiscal doctrine: on the

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174) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 118, See, also, F.FORTE, *Il problema della progressività con particolare riguardo al sistema tributario italiano,* in Rivista di diritto finanziario e scienza delle finanze, 1952, 301 ss.

175) Article 12 of *Repubblica Cisalpina's* Constitutional project stated "They [All the Italians] partecipate indiscriminately to State expenses in progressive proportion of their wealth.".

From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 21-22.

176) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 19.

177) That revolution, promoted by socialists and Republicans, overthrew Louis- Philippe d'Orléan's liberal monarchy, established in 1830 after the overthrown of reactionary legitimacy principle advocate sovereign Charles X due to his contrast with French Parliament.

However the revolutionary period lasted for less than one year because General Cavignac became Prime Minister after a few months and Louis Napoleon, leader of Bonapartist party (*Parti de l' Ordre)* was elected Chief of the State. Few years after Louis Napoleon, with *a coup d' état,* proclaimed himself "Emperor of Second French Empire". Second French Empire lasted 18 years, until 1870, when Napoleon III resigned from his position due to Sedan defeat and began French Third Repubblic (1870-1940).

178) That reform will be realised in France only in 1914 when was approved Joseph Caillaux reform that introduced a progressive tax on phisical person income.

basis of economic concept of marginal utility (decreasing) they theorised that on different incomes we can produce the same sacrifice with duties that increases with the increasing of the income.[179]

An important author that affirmed the necessity of a progressive fiscal system was Wagner in the end of XIX century on the basis of fiscal equality principle; according to his thesis progressivity make citizens sacrifices really equal.[180]

In Italy Progressivity was for the first time considered with favour from doctrine in *Belle Époque* age[181], the firsts progressive tax rates were introduced after World War I and, after a few years *Regio Decreto* number 3602 of 30 December 1923 established for the first time a progressive personal income tax that will last until '70 s years.[182]

New Constitutional provision reflects the deep political and social change that took place in '40 s Italy: so fiscal law passed from an exceptional and limiting concept to the mean that consent to realise social policy expected in the new Italian Constitutional Chart.[183]

The principle is not referring to the single tax but to the whole fiscal system[184], so

179) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 20 and 25. A similar concept was expressed by 1862 famous Italian Finance Minister *Quintino Sella* that affirmed: “A tax of 10% on all will seem fair, because it asks to person that gain 10 £ 1 £ and to the person who gain 1£ 10 cents, but if poor 's only £ needs to save him from famine and the tenth £ to the rich is spent for the theatre the sacrifices are different because the thing that for both is called £ haven' t the same importance.”.

180) See S. LA ROSA, *Eguaglianza ed agevolazioni fiscali*, Giuffré, Milano, 1965, 26-27 and 37. The author also agrees with this thesis defining it as “tax equalization”.

181) See G.RICCA SALERNO, *L'imposta progressiva e le riforme tributarie di alcuni stati europei,* Roma, 1894, and, also, F.S.NITTI, *Principi di scienza delle finanze,* Napoli, 1905.

182) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 27-28 and 58 ss .

183) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 30-31.

184) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,76. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 119, R. LUPI, *Diritto tributario-Parte generale,* Milano, Giuffré, 2009. See also Italian Constitutional Court Sentences 12/1960 and 159/1987. I report here the statement of the first sentence “ Progressivity principle, sanctioned in article 53 line 2 of Italian Constitutional Chart, concerns the whole fiscal system, not the singular taxes.” Important, also, Constitutional Court Sentence 102/2008 that affirms that even a regressive tax as Sardinian Regional Yacht Tax doesn't contrast with progressivity principle because it refers to the whole fiscal system. According to

is not necessary that all taxes are progressive. In Constitutional Court sentence 23/1968 it is affirmed that “the principle has to be considered only in relation with the whole fiscal system and not in relation to single taxes”.

The principle is, also, confirmed in successive sentence 159/1985.

Progressivity is not only referred to fiscal rates but to progressivity criteria: a combination of elements and circumstances that characterise the behaviour of tax passive subjects.[185]

Function of the principle is not only to guarantee redistribution of the wealth[186] but also it has a political- social scope[187]: it reflects in fiscal subject Substantive equality principle, expressed in Article 3, line 2 Constitutional provisions.[188]

Carpentieri defined it as an explication of economic, social and political solidarity principles (affirmed in Article 2 of Italian Constitution) and also of Substantive Equality principle (Art. 3 of Italian Repubblican Constitution).[189]The same author,

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L.CARPENTIERI' s thesis expressed in See *L' illusione della progressività,* Dike Giuridica, 2013, 44- 45 it was determined by a precise choice of Constituent legislators that imagined that progressive taxation was more suitable for personal income taxes. See, also, Atti Parlamentari dell' Assemblea Costituente, Roma, Tipografia della Camera Dei Deputati, 1947, CXXX, 4204. That thesis find also the favour of Italian Constitutional Court, expressed in Sentences 128/1966, 159/1985, 263/1994, 143/1995. Clearly, consequence of this choice is a bigger discretionary power for Italian legislator.

185) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 119.

186) See I. MANZONI, *Il principio della capacità contributiva nell' ordinamento costituzionale italiano,* 185, Giappichelli, Torino, 1965. L. PALADIN affirms that this principle permits the attenuation of discrepancy existing between all classes of taxpayers in *Il principio di egualglianza tributaria nella giurisprudenza costituzionale,* in Rivista di diritto tributario, 1997, 305 ss. According with Procopio 's thesis it absolves a social function, founded on solidarity and an economic function, because social disparity cause the reduction of consumption that determine the reduction of Gross Domestic Product. From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 122. See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 32-33 and G.FALSITTA, *L' imposta confiscatoria,* Rivista di diritto tributario, 2008,II, 122.

187) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 120.

188) It reinforces Substantive Equality principle realizing Economic Solidarity principle, expressed in Article 2 Constitutional Provisions. See M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 120.

189) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 32. See, also, F.MOSCHETTI, *Il principio della capacità contributiva,* Padova, 1973, 200,

also, asserts that it represents the goal of ability to pay principle imposing fiscal equity in subdivision of public expenditure.[190]

As affirms Professor Franco Gallo progressivity balances property rights with citizenship rights.[191]This thesis isn't seen with favour[192] by part of the doctrine that consider it as a vacuous[193] or approximated [194] obligation for Italian legislator. In our fiscal system there are many proportional taxes[195] like IRAP[196], Corporate Income Tax (IRES)[197], Obligation profit taxation, VAT, etc. and one only important progressive levy: IRPEF.

It is a tax on physical person income, regulated in law 917/1986 (known as TUIR), that predicts a class taxation: the person is taxed for a determined percentage that increases with increasing income for every class[198].

As we easily see the presence of 5 classes[199] and the exemption of so called vital

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C.SACCHETTO, voce *Tassa*, in Encyclopedia del diritto, Padova, 1956, P. RUSSO, *Manuale di diritto tributario*, parte generale, Milano, 2002, 60 ss, P.BORIA, *L' interesse fiscale*, Torino, 2002, 115, See, also Italian Constitutional Court Sentence 155/2001.

190) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 43.

191)See F. GALLO, *Diseguaglianze, giustizia distributiva e principio di progressività*, in Rassegna Tributaria, 2012, II, 290 ss.

192) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 33.

193) See G. FALSITTA, *Manuale di diritto tributario, parte generale*, Padova, 2012,190.

194) See P.BORIA, *Sistema tributario*, UTET, Torino, 2008, 87.

195) For example Capital income taxes avoid progressive taxation because of a replacement tax. See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 144 .

196) Carpentieri affirms the regressivity of that tax for its structure and effects: the tax put work cost in taxable income advantaging more modern business activities that hold more knowhow and less workforce imposing more important fiscal burden to old enterprises that employ greater number of workers. See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 66; See, also, G.TREMONTI, *Una nota di politica fiscale: la crisi dell' IRPEF e la questione della progressività. Il caso dell' Italia, in Rivista di diritto finanziario*, 1999, 17 ss.

197) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 144.

198) If Caius has a net income of 100,000 Euro his income is covered by 5 classes: as says art. 11 of law 917/1986 on the firsts 15,000 Euro it has to pay (as gross tax) 23%, on the seconds 13,000 (15-28,000) the 28%, on the thirds 27,000 Euro (28-55,000) the 38%, on the fourth 20,000 (55-75,000) the 41% and on the last class it has to pay 43%. (the highest class)

199) In his first version personal income tax was more progressive: in fact in 1974 we have 34 classes of income, reduced to 9 in 1983, to 7 in 1989 that became 5 in 1998.

At the beginning (1974) the highest marginal rate was 82 %, then reduced to 65% in 1983, to 50% in 1993, to 39% in 2003, due to Berlusconi' s tax cuts. As I wrote before the rate was re-increased to 43% by 2006 financial law (law 296/2006). See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 61 and 144.

minimum[200] guarantees the progressivity of the whole Italian fiscal system.[201]

Progressivity is also represented by other factors like the expansion of taxable income (so called no tax area),ISEE(Equivalent Economic Situation Indicator)[202] also deductions.[203] As affirms former Finance Minister Vincenzo Visco this instrument must be used to organise horizontal equity problems[204].

The principle was mentioned for the first time by Italian Constitutional Court

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200) As article 11, paragraph 2 of law 917/1986 says, if a person receives only pension income for a maximum of 7500 Euro and land income inferior to 185,92 Euro and his house income, he is excluded from the payment of this tax.

As paragraph 3 of the same article says, if a person receives less than 500 Euro of land income, not receiving other kinds of income, they mustn't pay the levy. As we could easily see, the vital minimum principle is applied in marginal cases because its beneficiaries are almost only very low pension income receivers. For example, a worker that earns a 500 Euro monthly salary must give 23% of his very low salary to contribute to public expenditure (not counting subtractions and deductions).

See, also, G. MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013,76.

201) A progressive tax with many classes is characteristic of socialist systems, the opposite is characteristic of laissez faire systems. In 2001 Silvio Berlusconi's electoral programme there were only two classes (23% and 33% and a “no tax area” for very low incomes) This system, as affirms M.PROCOPIO in *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 124 would introduce in Italy a flat tax because only 0,4 % of Italian taxpayers gain more than 100,000 euro par year, so IRPEF would hit the same percentage of income for 99,6 % of taxpayers.The author asserts that it would have create a regressive tax system probably in contrast with Constitutional progressivity principle. This project wasn't completely realised with 2003 tax reform that created no tax area and lowered mainly the highest classes bringing the highest from 48% to 39%. However our system remained with many classes and the highest class was still higher than 2001 project prevision. This system was applied for only three years, until law 296/2006 that put all the five classes on higher level (but less than *ante 2003 reform* period) and abolished no tax area leaving only an exclusion for total personal income of less than 7500 Euro. Although very much criticized, Prodian tax reform has remained still unchanged, mainly due to Italian State financial situation. See, also, about failed attempt to introduce flat tax in Italy, L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 160-165.

202) It measures Economic conditions of families, on the base of their income, their estate and other characteristics of nuclear family.It determines the receiver of welfare services. From L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 150-153.

203) In Italy art. 10 of law 917/1986 contains a long list of deduction hypothesis, for example some medical expenses, alimonies, etc.. Art. 13 contains hypothesis of subtractions for family burdens (for the spouse and even for sons).

Art. 15 includes cases of subtraction for some expenses like passive interests, donations, rental rates, etc.

See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 46-47.

204) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 47 and 146. According to Visco' s theories equity is distinguished in vertical equity that determines the increasing of taxation with the increasing of the income and horizontal equity that change the level of taxation of two equal incomes on the strength of personal conditions.

jurisprudence[205] in sentence 129/1957[206] where is affirmed progressivity of taxation; in successive sentence 128/1966 is asserted " taxes consent to burden mainly the higher income receivers and, in this way, make contribution to public expenses appropriate to individual ability to pay."[207] In important Italian Constitutional Court Sentence 155/2001 progressivity is defined as "further progression, in specific fiscal subject, of Equality Constitutional principle, linked to the duty to remove economic- social barriers *de facto* existing to freedom and equality of persons-citizens according with the aim of political, economical and social solidarity (Article 2 and 3 of Italian Republican Constitution)." With this statement constitutional court show a partial adhesion to Relative Limit Theory of ability to pay principle.[208]

The importance of Article 53, line 2 principle is, also reaffirmed by United Sections of Cassation Court Sentences 30055, 30056 and 30057 of 23 December 2008 that asserted the existence of a general principle against tax avoidance, based on Article 53 of Italian Constitution Principles. In particular Sentence 30555/2008 affirmed: " The principles of "ability to pay and progressivity of taxation are the basis of normal fiscal rules and also of rules that give advantages and benefits..."[209]

If there wasn't progressivity our fiscal system wouldn't be redistributive but only contributory and it wouldn't so be possible to consider the idea of substantial

205) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 48.

206) It was just the second year of activity Italian Constitutional Court.

207) See, also, Italian Constitutional Court Sentence 179/1976.

208) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 49-51. In this work the author criticized the position expressed by Constitutional Court in Sentence 155/2001.

209) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 51 ss,

See, also, G.FRANSONI, *Appunti su abuso del diritto e "valide ragioni economiche",* in Rassegna Tributaria, 2010, IV, 932 ss; V. FICARI, *Clausola generale antielusiva, articolo 53 della Costituzione e regole giurisprudenziali,* in Rassegna Tributaria, II, 2009, 390 ss; A. GIOVANNINI, *Il divieto di abuso del dirittoin ambito tributario come principio generale dell' ordinaento,* in Rassegna Tributaria, 2010, IV, 982 ss; E. DE MITA, *L' anti-elusione trova una base in costituzione,* in Diritto e pratica tributaria, 2009, 393 ss.

equality, expressed in Article 3, paragraph 2 Constitutional principle.[210] It is, in fact, a fundamental basis of what in Europe is well known as welfare state.[211]

210) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,76.

211) In modern history a first example of progressive tax are Revenue Act 1862 tax and UK income tax after 1909 Asquith's tax reform (so called People's Budget).

Chapter IV

Other rules related to the substantive equality principle.

1- Substantive equality principle as the basis of different treatment for different situations.

If different situations receive the same treatment equality principle is not really respected because people won't surely have the same opportunities; so Art. 3 Constitutional principle impose to legislator to regulate differently different situations[212] and to promote and improve citizen economic and social situation.[213]
The principle was, also, affirmed in the European Treaty where article 2 of TFUE affirms:”The Union is founded on the values of respect for human dignity, freedom, democracy, equality...”.
As we have seen before this principle is very much linked to the progressivity principle, because progressive taxation, making it possible the redistribution of wealth, gives more chances to low income receivers[214]; but there are also other measures that could increase fairness between high income and low income receivers: for example, particular sectors could be more heavily taxed, in reason of speculative nature of their activities, or, in other cases, it is possible to concede

212) The concept is clearly expressed in Italian Constitutional Court Sentence 155/1963 statement: “[Article 53], constituting the specific development of Equality Principle, expressed in article 3 of Constitution represent the necessity , for income taxes of equal taxation for equal incomes and different taxation for different incomes”. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 85.
213) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 58-59.
214) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 32. See, also, F.MOSCHETTI, *Il principio della capacità contributiva,* Padova, 1973, 200, C.SACCHETTO, voce *Tassa*, in Encyclopedia del diritto, Padova, 1956, P. RUSSO, *Manuale di diritto tributario,* parte generale, Milano, 2002, 60 ss, P.BORIA, *L' interesse fiscale,* Torino, 2002, 115, See, also Italian Constitutional Court Sentence 155/2001.

favourable tax regimes, in reason of the activity nature.[215]

About favourable tax regimes, doctrine and jurisprudence assert their accordance with constitution if they are directed to Article 3 par. 2 principle that justifies a different treatment to promote the improvement of citizen conditions or involve other constitutional values like family, education[216], assistance, cooperation, etc.[217]

In the following paragraphs it is possible to see what are the other measures adopted by the Italian legislator and some proposals that favour the idea of a fairer fiscal system.

2- Substantive equality and discouragement of speculative activity.

Before 2008, every year, the importance of the financial sector of the market increased together with US Gross Domestic product. In that situation, managers got retributions (composed mainly by bonuses and stock options) 200-300 times higher than normal workers[218], for operations that, in many cases, had only speculative scope. It was also the period when high speed transactions were developed, which consisted in buying or selling a financial instrument several times in a single day. In 1990, the average finance operator salary was 18% higher than that of a normal worker, in 2007 it was 52% higher, and in 2006 Wall Street

215) As I wrote before this phenomenon is called “qualitative discrimination”. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 129 and 133.

216) See Sentence 108/1983.

217) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 61-62.

218) From FREEMAN, *Ricerche: il lavoro in tempo di crisi tra riforme legislative ed evoluzione della contrattazione collettiva. Nuovi ruoli per i sindacati e per la contrattazione collettiva dopo l' implosione del capitalismo di Wall Street,* Diritto delle relazioni industriali, 2012, II, 268.

paid 62 billion as bonuses.[219]

Professor Franco Gallo noted that even in 2007 Italy the level of financial transactions reached the 73,5% of Gross Domestic Product, so he affirmed that financial products prices were wrong and that the gigantic growth of circulation of these things produced a planetary dimension market failure.[220]

When the financial crisis spread, the Americans discovered that the average family debt was more than 200% their annual income per capita and that many important banks and firms were near to financial collapse.

It was the beginning of a very long financial crisis like the '30s Great Depression, which is still ongoing today.

These facts persuaded many people that compensation with bonuses and stock options incentivizes dangerous decisions of managers and directors.[221]

Two remedies to these important problems could be the introduction of a tax on financial transactions and an additional tax on stock options and bonuses.

Tobin Tax[222] was elaborated more than forty years ago by the economist James Tobin that proposed to tax financial transactions[223] in order to make our financial system more stable.[224] In that case fiscal requirement is shares and similar products ownership transfer.[225]

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219) *ibidem,* 268.

220) See F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 44-45.

221) From FREEMAN, *Ricerche: il lavoro in tempo di crisi tra riforme legislative ed evoluzione della contrattazione collettiva. Nuovi ruoli per i sindacati e per la contrattazione collettiva dopo l' implosione del capitalismo di Wall Street,* Diritto delle relazioni industriali, 2012, II, 268.

222) Professor Franco Gallo defined it as “tassa parapatrimoniale”. The greek origin prefix “para” could be translated in english with “similar to”. So it means “ taxes similar to real estate taxes.” From F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 44.

223) The Bank of Italy defined this tax as an “ownership transfert tax” in 11 march 2014 Communication “ Budgetary and Surveillance Advisories” (Bilancio e segnalazioni di vigilanza).

224) From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 475.

225)From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 476-477. According to the author even conferiments are interested by the tax. See, also, F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 47.

Important principles are[226]:

-territoriality principle that affirms that tax is paid where the enterprise has his fiscal residence

- the proportionality of the levy

- the calculation of the tax is based on transaction value

- it is an indirect tax and *de facto taxpayer* is shares purchaser

After the financial crisis, many, also, said that it could also redistribute crisis costs (paid by governments and definitively by families and enterprises) and eliminate transactions that are not efficient (especially transactions with only speculative scope, mainly high-frequency transactions) creating, in that way a sort of financial carbon tax.[227]

The best solution would be that every transaction in the world should pay that levy but this isn't easily possible, so some countries made isolated attempts in that direction.

Probably, to realise the idea is necessary a combined effort of many countries because if a Financial Transactions Tax is established in only one country it could provoke a strong decline of financial transactions and, in consequence a little revenue for the State and also negative effects for the economy as it happened in '80 s in Sweden when was introduced that kind of tax.[228]

The detractors of that kind of tax affirms that it could cause a financial transactions reduction and some of them[229] propose the introduction of FAT or bank levy on the possession of risky financial activities, assuming, as taxable income, profits that overtake a pre-fixed threshold. Professor Franco Gallo, in contrast with their opinion state that the effect of FAT could be too limited

226) *Ibidem*,478, 479 and 480.

227) See F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 44, 46

228) As wrote M.PROCOPIO the revenue was the fourth part of expected revenue and the number of financial transactions dropped significantly. From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2013, 475.

229) Even IMF proposed the introduction, of this, alternative tax.

because the tax don't hit financial profits gained by an enterprise in deficit and that transactions reduction wouldn't have really negative effects because it consists, *de facto*, in elimination of transactions that are not efficient for the Market.[230]

For example France and Italy[231] put on financial transactions a sort of Tobin Tax in 2012; Italian rule, that establishes taxation over shares, similar instruments and relative derived transfers[232] was heavily criticized[233], mainly because it did not tax intra-day transactions, in fact that levy brought only 280 million Euro revenues[234].

In European the question was discussed since 2001, European Parliament adopted three resolutions in favour of the introduction of this tax[235] and, after may years, in 2012 ECOFIN council approved a Directive proposition. After the UK reject of the project EU presented a Directive Project for a Strengthened Cooperation in order to introduce the levy.[236]

European Commission estimated the revenue that could generate this kind of taxation to the sum of 60 billion Euros (three times more than an an Italian State annual financial budget).[237] As the project says, the tax would be paid by financial entities for every transaction, on the basis of the financial instrument value if the instrument is not a derived, and, in the other case, on the basis of his notional.[238]

In Italy, the taxation system for Stock Options and Bonuses changed many times in almost 10 years: in 1999 a favourable taxation regime was introduced, that if

230) See F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 46-47.

231) The tax was introduced in Italian fiscal system by Article 1, line 491 of Financial Law number 228 of 2012 that was applied to financial transactions since the 1st March 2013.

232) These operations are only part of transactions that would be taxed in Communitarian Project of Tobin Tax.

233) F. GALLO affirmed that the tax introduced in Italy was a very reduced version of communitarian model that consists, *de facto,* in a reintroduction of abrogated Stock Exchanges Stamp Duty in *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 45, 49.

234) See E. BENETAZZO, *Investimenti e tassazione,* Trend-online, 13-03-2014

235) Gallo noted favourable resolutions of 10 and 25 march 2010 and of 8 march 2011.See From F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 45

236) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 480

237) See F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 45

238) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 481-483

some conditions (holding period etc.) were respected, the capital gain received was taxed with only 12,5 % withholding tax.

A 2008 reform[239] suppressed that rule, so the capital gain was subject to ordinary physical persons income taxation that, as previously explained, is a progressive levy for classes. Due to this modifications, it is probable that taxpayer that before 2008 paid 12,5% in 2009 paid 43% (I refer to a manager, for example).

Less than two years later, a new rule[240] introduced an additional taxation[241] of 10% for Bonuses and Stock Options (taxable income is in that case represented by the portion of income distributed in form of stock options, considering their normal value[242]) if these benefits overtake the triple of the worker fixed payment[243].

The rule is implemented for financial sector managers[244]. These not precise definitions create interpretation doubts: there is not an Italian rule that defines financial sector and also, not all managers have an activity linked with financial speculations.[245] About the first question, Agenzia Delle Entrate gave to the rule an extensive, and probably contra legem interpretation in Circular 4/E of 2011.

So it includes banks, management trusts, brokerage film, exchange dealers,

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239) Law Decree 112/2008

240) art. 33 of Law Decree 78/2010

241) Petrucci affirms that are applicable normal income tax rule and that tax is mainly conditioned by cash basis. The opposite thesis is affirmed by Trettel that cited Agenzia Delle Entrate Circular 4/E of 2011. The same author, also, asserted that settlement and payment of the tax should be performed by the payer. See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2749. See, also, S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle "Stock options" dei manager,* from Corriere Tributario, 2011, XIII, 1028-1029.

242) See Article 9, line 4 of TUIR.

243) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2747, 2750, See, also, S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle "Stock options" dei manager,* from Corriere Tributario, 2011, XIII, 1027.

244) As precised by Agenzia Delle Entrate Circular 4/E of 2011 for the identification of passive subject of passive subject we have to see the category indicated in work contract.

245) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2749.

entities that manage electronic money emission activity, finance companies[246] and holdings that underwrite and/or manage participations in financial, credit or industrial companies.[247]

The insertion of industrial holding in the list, in Trettel' s, opinion is a “stretching of legislative text” because industrial holdings are surely not part of financial sector.[248] So Italian financial administration mustn't comply with the proposed interpretation for industrial holdings point because in Italian juridical system doesn't permit the existence of *contra-leges* interpretations.[249]

In technical note of Law 122/2010 (Law Decree 78/2010 conversion law) is contained a forecast of 10 million revenues par year from this additional tax. In legislator opinion the taxpayers interested by the new rule were 5200 people, therefore some experts criticized this prevision asserting that stock options payment is typical of Anglo-saxon investment banks and that many managers, based in Italy hold their registered address in London.[250]

After a few months the rule was modified by Law Decree 98/2011 that changed taxation threshold: in consequence of the reform from July 2011 the additional hit the portion of payment exceeding manager fixed payment.[251] The outcome was

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246) See Article 59, line 1, letter b) of TUB (Legislative Decree n. 385/1993), Testo Unico Bancario. We could translate it with the expression “Unique Bank Act”.

247) See S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle “Stock options” dei manager,* from Corriere Tributario, 2011, XIII, 1030.

248) See S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle “Stock options” dei manager,* from Corriere Tributario, 2011, XIII, 1030.

249) See Article 12, line 1 of Prelaws of Italian Civil Code that affirms: “In the application of the law is impossible to give it other meaning different from meaning make clear by the typical sense of the words [that compose legislative text] according to their connection and, also, to legislator intention.”. That provision was surely influenced by Article 4 of Napoleonic 1804 *Code Civil* that affirmed “*le juge ne doit être que la bouche de la loi...”*, expression that could be translated in “ the judge must be the call of the law...”.

Also important is article 101 of Italian Repubblican Constitution that state: “The judges are conditional only upon the law.”.

250) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2751, See, also, L.SERAFIN, “*Giro di vite soft sulle stock options”*, in Il Sole 24 Ore, 27-V-2010, 11.

251) From A. ANTONELLI and A.MENGOZZI, *Nuova stretta sulle stock options,* from Il Sole 24 Ore, 19 luglio, 2011.

that the same taxpayer that 5 years before paid 12,5% on his stock options income, had to pay in 2012 the 47,3%.

That decision was based on decisions taken on Pittsburgh 2009 G20[252] and the intention on the strength of was made this important choice was to increase taxation for managers that realised important profits with dangerous operations; (because stock options payment encourage exclusively speculative risky because the immediate profit for the company correspond with an immediate profit for the manager) operations that were one of the main causes of 2008 financial collapse.

As affirmed in G20 the taxation must interest people whose activity is linked to financial subjects risks. This guideline was not respected by the Italian government, which put the additional tax on every financial sector operator without any type of selection of dangerous activities creating, so, a sort of "objective responsibility" for every worker paid with stock options.[253]

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252) I report here the part of Pittsburgh G 20 document that concern stock options taxation (lines 15 and 16:

" The G-20 must fulfil the commitment subscribed to in London on pay and compensation to encourage sound risk management and a strong link between compensation and long-term performance, while ensuring a level playing-field.

In particular, the G-20 should commit to agreeing to binding rules for financial institutions on variable remunerations backed up by the threat of sanctions at the national level, covering the following principles:

a) enhanced governance to ensure appropriate board oversight of compensation and risk; b) strengthened transparency and disclosure requirements;

c) variable remunerations including bonuses to be set at an appropriate level in relation to fixed remuneration and made dependent on the performances of the bank, the business unit and the individuals; taking due account of negative developments, so as to avoid guaranteed bonuses; the payment of a major part of significant variable compensations must be deferred over time for an appropriate period and could be cancelled in case of a negative development in the bank's performance;

d) prevent stock options from being exercised, and stocks received from being sold, for an appropriate period of time;

e) prevent directors and officers from being completely sheltered from risk;

f) give supervisory boards the means to reduce compensations in case of deterioration of the performance of the bank;

g) explore ways to limit total variable remuneration in a bank to a certain proportion either of total compensation or of the bank's revenues and/or profits.

253) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2747-2748. See, also,S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle "Stock options" dei manager,* from Corriere

As many experts think, a favourable tax regime to this kind of income like the prior 2008 situation is not fair and also encourages dangerous decisions of market operators and operations with speculative scope only, which don't improve the real economy.
Due to this rule a few number of taxpayers would have a worse fiscal treatment; that discrimination could be considered a qualitative discrimination based on the nature of that kind of income, usually generated by speculative scope activities.
In my opinion the rule respects, according with the concept of "ethic tax"[254], articles 3 and 53 of Italian 1948 Constitutions only if bonuses are directly connected to dangerous operations, in other cases we are in presence of an irrational discrimination, so the examined rule should be declared partially unconstitutional.
Hollande's loi financiaire 2013 rules are also not fair because they established for the part exceeding 1 million Euro a taxation that could reach 79,5%, which is clearly confiscatory[255], according to French[256], German[257], Brazilian[258] and Argentinean[259] constitutional jurisprudence. So it isn't in compliance with art. 53 par.1 ability to pay constitutional principle.
The right decision seems to be the Italian government decision that abolished withholding favourable flat tax and introduced progressive income taxation.
Even 10% additional, for his amount and considering the situation, could be considered as progressive taxation, fair and reasonable.

Tributario, 2011, XIII, 1028.
254) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 231- 237.
255) See *Conseil d' état* decision 662/2012.
256) See Chapeter II, page 11 and 12.
257) See Chapeter II, page 11 and 12.
258) See Chapeter II, page 11 and 12.
259) See Chapeter II, page 11 and 12.

3- Discouraging scope taxes: extrafiscal utilization of taxation.

There are some taxes put by the legislator that want to discourage the utilization of some products: for example in Northern Europe alcoholic products are heavily taxed by governments as a mean to fight alcoholism, notoriously a social plague in these countries.

Even in Italy, for example, tobacco products are heavily taxed by the government for the same reason.

The strange fact is that the goal of the law is reached if these taxes don' t produce any income.[260]

These levies condition consumer and producer choices.[261]

As asserts part of the doctrine (mainly absolute limit theory advocates) even environmental taxes enter in that kind of taxation because they discourage some conducts.

Defined by *Agenzia delle Entrate* communicate 103895 as an “ethic” tax[262], Pornotax[263] is an ordinary autonomous special[264] additional 25%[265] tax applied to

260) See G. MELIS , *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 62.

261) *ibidem,* 62.

262) Ethic taxes can be explained with this reasoning: in modern Constitutional systems the man is different from *homo oeconomicus* (mainly as described by Amartya Sen), he is a beeing with politic , social and moral relations, so he is part of a community that forms a juridical system.

So, in Italian juridical system economic freedom and property rights are values protected by the Constitution but are not the fundamental basis of our juridical system: in fact other values also are part of our constitutional system like equality (formal and substantive, art. 3), solidarity (art. 2), protection of community material and spiritual progress (art. 4), promotion of cultural development (art. 9) , protection of mores (art. 21), protection of the family (art. 29), protection of Youth and Childhood (art. 31), Health protection (art. 32), free and fair existence (art. 36).

So economic values should be necessarily counterbalanced with these other values.

In consequence of that is admissible a qualitative discrimination founded on ethic basis (like Pornotax case) when an other constitutional rule prevail in counterbalance with ability to pay principle. See MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 231-238.

263) Introduced by art. 1 par. 466 of of law 266/2005.

enterprises that distribute items that are pornographic or inciting to violence, or encourage the popular credulity.

The generating circumstance is represented by the possession of enterprise incomes deriving from activities of production, distribution, selling and representation of pornographic[266], violence inciting[267] or costly soliciting of popular credulity[268] objects.[269]

The tax could be considered not in contrast with ability to pay principle considering it an extrafiscal tax use in order to protect a Constitutional value

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264) The author of this definition is A.MILONE in *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 309.

265) Law Decree 112/2008. As Fantozzi said "In additional tax an other tax rate is applied on the tax amount and not on the taxable income. From A. FANTOZZI, *Diritto tributario,* UTET, Torino, 1991, 51. Examples of additional taxes in Italian juridical system are Extraordinary IRPEG Additional Tax established by article 4 of law Decree number 787 of 22 December 1981, Regional IRPEF Additional Tax established by art. 3 , line 143, letter a), of law number 662 of law 23 December 1996 and art. 50 of Legislative Decree number 446 of 1997 and Local Council Additional Tax, established by Legislative Decree number 360 of 28 September 1998. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 40-41.

266) The word "pornographic" means concerning erotic subjects that offend modesty. Distribution of pornographic objects could be punished, if the rules are literally interpreted, with criminal sanctions (see Italian Penal Code Article 528 "Obscene Exhibition or publication" and 725 " Selling of writens, drawings and other objects against modesty"). Therefore diffusion of these objects is *de facto* tolerated due to an "adjusting evolution oriented jurisprudence interpretation" (see I.CARACCIOLI, *Addizionale sul materiale pornografico e di incitamento alla violenza. Aspetti penali,* in Il Fisco, 2006, VIII, 1226 ss. From A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 276.

267) The notion could be derived from World Health Organization definition "the wilful use of phisic force or power, menaced or real, against themselves, an other person, or against a group or a community, that determines or has elevated degree of probabilities to cause lesions, death, psychological damage or deprivation" and also from Art. 392 of Italian Penal Code "We have violence over things when it is transformed, damaged or its destination changes", art. 582 "[is punished] anybody causes to one person a personal lesion, causing a disease", art. 610 "Commits private violence the subject who force someone to make, do not make or omit something".

So we could define items as violence incitating when they encourage to create damages to people or things." See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 280-281.

268) The definition is contained in Article 661 of Italian Penal Code "Anyone that, publicly, pretends, with any kind of charlatanism, even gratuitously, to abuse of popular credulity is punished...". In fiscal rule is described a solicitation of popular credulity that don't digress in Abuse, hypotesis sanctioned by criminal law. A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 283-284.

269) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 299.

(mores, art. 21)[270] or, also, considering that the diffusion of pornographic objects (a specific activity that justifies a discriminatory treatment[271]) generates in the community negative externalities (I think, especially, to instruction, security, justice and health costs).[272]

This tax was introduced for two reasons: to provide money for the State and to discourage both selling and purchase of these items.

Well known for its evocative name, the Robin Hood Tax, introduced with Law Decree 112/2008, increases by 5,5% the enterprise income tax for producers and sellers of energy coming from fossil fuels[273], for enterprises that have a minimum sale volume of 25 million Euro, in order also to fight their speculative conducts. The levy was increased to 6,5% in 2009[274] and to 10,5% temporarily for 3 years (this temporary rise could be defined as “extraordinary tax”[275]) in 2011[276] bringing the total enterprise income taxation to 38%.

DL 138/2011, also, increased the number of taxpayers reducing the minimum sales volume to 10 million and including even renewable energy sector operators.

In the rules is, also, present a ban on economic translation of the additional on consumer.

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270) See note 262.

271) Respecting, in that way, article 3 of Italian Republican Constitution. See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 305.

272) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 300-303.

273) See G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 62. See, also, A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 401

274) See art. 54 par. 3 law 99/2009.

275) Extraordinarity alludes to a particular historical- political circumstance or economic trend when the tax is established. So the levy is necessarily related to exceptional State revenue requirements. Clearly, the levy must be a transient, an *una tantum* fiscal burden.

In addition even his generating circumstance have to be strongly related to the special economic trend. These three conditions must be respected if we want to define a tax “Extraordinary tax”.

A typical example of Extraordinary tax was Windfall Profit Tax, established during Wordl War II by warring countries governments that, in some cases, had a quasi-confiscatory effect. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 190-203.

276) Law Decree 138/2011.

Robin Hood Tax is a surtax[277]: in that case the juridical system use a basis tax or "mother tax" as circumstance for the configuration of an other tax.[278]

Additional taxes and surtaxes are different from double taxation phenomenon: in fact in double taxation we have one only circumstance and two different overdrafts, in case of additional taxes and surtaxes we have two circumstances (basis circumstance and additional circumstance).[279]

As affirmed by Falsitta surtax mustn't be a manner that consent to avoid ability to pay principle, creating, in that way a confiscatory taxes.[280]

Many authors affirmed that Robin Hood Tax violates many constitutional principles: Art.3, Art.53, Art.77, Art.23 and, also, Art. 117 of Italian Constitution.

In particular is alleged violation of Equality and ability to pay principles on many profiles[281]:

- The rule is discriminatory because it hits one only productive sector

-Inwards this sectors are hit producing and distributor enterprises (distributors of hydrocarbon products are assimilated with crude oil producers). The first could influence price formation mechanism, the others no. So part of the taxed subjects have an obligation of non translation of this tax on consumer.

- In this tax legislator put, in order to identify taxpayers, a 25, then lowered to10 million turnover threshold: in this way an enterprise with a lower turnover but higher profits than enterprise whose turnover surpasses threshold could not be subjected to payment of the levy. So we are in presence of a clear irrational incongruity of treatment.

Reggio Emilia Taxation Committee, also, asserted the violation of art. 117, letter

277) Surtax was mainly used for land income from '30 s in Italian fiscal system and even for ILOR, established by President Republic Decree number 599 of 1973 and then abrogated with Legislative Decree number 446 of 1997. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 34-40.

278) A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 28.

279) A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 33.

280) G. FALSITTA, *Giustizia tributaria e tirannia fiscale,* Giuffré, torino, 2008, 217.

281) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 471-474

e) of Italian Constitution because the ban to taxation costs translation constitute an authoritative price fixing that doesn't respect free competition principle.[282]

Art. 77 of Italian Republic Constitution affirms: “When, in extraordinary cases of necessity and urgency, the government opt, under his responsibility, for short-term measures with force of law must present...[283]”. It is Constitutional rule for Law Decrees, measures that, as affirms the provision could be used only in particular hypotesis, like an earthquake or an other case that don' t give the satisfactory time to legislator to promulgate an ordinary law.

Therefore, this idea, doesn't represent, mainly in the last thirty, thirty-five years the approach of Italian governments that, in order to avoid parliamentary debate, usually adopt, even for not urgent measures, Law Decree procedure.

Milone affirms that Robin Hood Tax introduction and modification (always with Law Decree) is one of these cases[284] because it is an ordinary nature fiscal measure. In addition art. 4 of Statuto del Contribuente bans the introduction of new taxes with Law Decree instrument. (however it is not a Constitutional rule, so it could be derogated even by ordinary law according to principle *lex posterior derogat priori*).[285]

As asserts Marongiu this defect involve the not compliance to our Constitution not only for Law Decrees, but even for conversion laws, so the whole measure would be, consequently, unconstitutional.[286]

Furthermore not even article 23 Constitutional Provision “None personal patrimonial performance can be dictated unless on the strength of a law”[287] is

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282) The violation of that principle was denied by Sentence of *Consiglio di Stato* (the highest administrative justice organ) in sentence 4388/2011. See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 474-477.

283) From Article 77, line 2 of Italian 1948 Republican Constitution.

284)See Constitutional Court Ordinance 9/2011.

285) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 451-456.

286)G.MARONGIU, *Robin Hood Tax: taxation without constitutional principles”?,* Rassegna Tributaria, 2008, 1345.

287) See Article 23 of Italian Republican Constitution.

respected: Constituents used word “law” because only law is promulgated after a specific procedure (see articles 70-74 of Italian Constitution) that requests parliamentary debate.[288]

The controversial tax has, also, backdated effects[289]. The doctrine classifies this hypothesis of retrospectivity as not authentic retrospectivity[290] because it explains his effects to the current tax period. However even that kind of retrospectivity is not compliant with article 3, line 1 of *Statuto dei Diritti del Contribuente* (due the violation of just confidence principle[291]). Therefore, as affirmed by Italian Cassation Court[292] and then confirmed by Italian Constitutional Court[293] *Statuto* principles don't have a superior hierarchical position compared with ordinary laws.[294]

In 2012 Italian Constitutional Court stated[295] that law retrospectivity ban (fundamental juridical civilization principle) doesn't receive a favoured protection, so legislator could promulgate retrospective effects rules if they defend

288) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 457-458.

289) Law Decree 112/2008 of July 2008 establishes the application of the tax to taxation period accruing from 1 January 2008, Law Decree 138/2011 establishes the extension and the increasing for three tax period from 1 January 2011. In addition article 56, line 3 of law 99 of 2009 that increased the additional tax of one point could have a not declared retrospective effect, starting from 2009. See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 458-459.

290) The doctrine make a distinction between authentic and not authentic retrospectivity. The first is present when the tax is related to a past fiscal period, in the other it is related to the current fiscal period. The first could more easily generate conflict with juridical certainty principle and even with ability to pay principle because it could be more easily related to an inexistent thing at the present time. See A. FANTOZZI and A. FEDELE, *I limiti della retroattività nel diritto tributario,*Milano, 2005, 68ss; F. AMATUCCI, *L'efficacia nel tempo della norma tributaria,* Milano, 2005, 39 ss; K. TIPKE, *La retroattività nel diritto tributario,* in A.AMATUCCI, *Trattato di diritto tributario. Annuario,* Padova, 2001, 103 ss.

291) See A.CONTRINO, *Modifiche fiscali in corso di periodo e divieto di retroattività “non autentica” nello Statuto del Contribuente,* in Rassegna Tributaria, 2012, III, 590.

He affirms that, in this way, legislator “deceives” taxpayer confiance.

292) See Italian Cassation Court Sentence 2221/2011.

293) See Italian Constitutional Court Sentence 247/2011.

294) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 458-467.

295) See Italian Constitutional Court Sentence 78/2012.

constitutional principles and rights that constitute imperative general interests reasons, as established by ECHR.[296]

So the compliance to Constitution of controversial rule would be the result of a value balancing: if is considered prevailing law certainty on State fiscal interest the rule is not compliant with our Constitutional Chart, otherwise yes on this point.[297]

In conclusion there is also a possibility[298] of contrast with EU State Aids discipline contained in art. 107 of TFUE[299].

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296) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 468

297) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 469-471.

298) See E.COVINO and D.MAJORANA, *É costituzionalmente legittimo l' aggravio di aliquota per un settore economico?*, in Dialoghi Tributari, 2011, IV, 393.

299) I report here the text of Article 107 of Treaty on the Functioning of the EU "aids granted by state"(ex Article 87 TEC):

"1. Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

2. The following shall be compatible with the internal market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

3. The following may be considered to be compatible with the internal market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;

(e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission."

As we see the literally meaning of the rules it indicates subsidies but we have to reflect in term of a more extended concept where are included even negative content State intervention acts like taxation of only one productive sector.

In other words a rule that hit only a kind of economic operators could, consequently and indirectly, advantage the others. This thesis is not embraced by *Consiglio di Stato* that, in Sentence 4388/2011 denied the nature of the tax of State Aid.[300]

This tax, considered by Aldo Milone as an “Ethic tax”[301] because it hits short-term or speculative gains,[302] could be considered for some aspects, according with Massimo Procopio's thesis, as an exceptional instrument[303] used by legislator during financial crisis period (exceptional economic present-day situation) and so, for that reasons it respects ability to pay principle, constituting, also an expression of solidarity duty that justifies discriminations.[304]

Nevertheless the identification taxpayer threshold creates an irrational discrimination that is not compliant with our Constitutional system, so the part of the measure that determines it could be declared unconstitutional.

If the rule has to be considered unconstitutional for his retrospective effects it couldn't be applicable to part of some past fiscal years.

However, all the measure is clearly unconstitutional due the violation of legislative procedure (a mere procedural defect that involves all institutive fiscal

300) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 477-481.

301) However, as affirmed in 2008 Bengasi Italia-Libia cooperation and friendship International Treaty, art.8 part of the revenues coming from this additional tax must be used to build infrastructures in Libya for a total value of 5 billion Euro for twenty years in order to indemnify Libia for damages caused during colonial period.

302)See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 240-244. The Author compare Robin Hood Tax with Windfall Profit Tax saying that both are inspired by the same principle: to establish more important taxation rate on “not ethic gains” (they are considered in that sense because they are the consequences of a not ordinary situation).

303) See M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 87.

304) See S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 42. See, also, A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 190-194.

law) established in art.77 Constitutional rule (and also of art. 23 of Italian Constitutional Chart.).

I make this reasoning because if it is true and the rule is declared unconstitutional for this reason is, then, possible to introduce exactly the same rule respecting normal legislative procedure (if the rule is compliance even with art. 107 of TFEU).

We have also to remember that for IRAP (Added Value Production Tax) not all passive subjects, always the same rate: banks and insurance companies paid for some years a more important transitory rate. This caused the proposal of a constitutional compliance question related to Article 2, 3 and 53 of Italian Constitution. Constitutional Court in Sentence 21/2005 denied these allegations, affirming, also, an important principle: "The prevision of tax rates enters in legislative discretionary powers, it only mustn't be based on irrational reason of economic and distribution policy". This statement, so, seems an, at least partial, acceptance of relative limit theory of ability to pay.[305]

Very important are, also, the rules against so called "dummy companies" or "dummy corporations".

A dummy company is an entity created to serve as a front or cover for one or more companies. It can have the appearance of being real (logo, internet website, and sometimes employing actual staff such as for public relations), but it lacks the capability of functioning independently. The goal of a dummy corporation can be to conceal true ownership and/or avoid taxes.

To contrast this phenomenon, the Italian legislator introduced[306] rules that impose to corporation that doesn't reach presumed minimum earning[307] to declare not less

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305) A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 433 ss.

306) Law 724/1994.

307) The basis for calculations are a percentage of current assets, real estate owned by corporation and capital assets.

There is a confrontation between the three previous years earnings and presumed than the presumed minimum income calculated on the basis of assets[308] owned in the financial cycle. This patrimonial nature tax is a sort of sanction for a corporation form abuse[309]: in that case corporation rules are used for a scope not protected by our juridical system. In that case legislator doesn't use a radical solution like corporation nullity but discourage the abusive conduct using a sort of estate tax.[310]

That rule effectively changes the ability to pay index from income to endowment[311]; if it was the income the rule would not be constitutional because it could tax even a non existent income.

Italian legislator respected equality principle because these entities are not like normal corporation (they are an abuse of that juridical form).

Many criticisms to the legislation arrived for the link of income inadequacy and dummy corporation provision but unconstitutionality is avoided due the *Interpello*[312] procedure that allows the taxpayer to give to the financial administration a countercheck[313].

4- Tax favourable regimes in the Italian fiscal system.

Article 47, paragraph 1, of the Italian Republican Constitution affirms: “The Republic encourages and protects savings in all its forms; it regulates coordinates

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minimum earnings that are calculated on the basis of cited factors.

308) The basis for calculations are a percentage of current assets, real estate owned by corporation and capital assets.

309) From PEVERINI, *Società di comodo e imposta patrimoniale: il contrasto tributario all' utilizzo distorto della forma societaria.* Giurisprudenza commerciale, 2013, II, 260.

310) *ibidem.*

311) *ibidem.*

312) Paragraph 4 bis, article 30, law 724/1994.

313) ibidem, See also G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 62-63.

and controls the exercise of credit." This rule, that is also linked to the substantive equality principle, is the basis of a favourable taxation system for savings. European Union also supports the introduction of this special regime.

It is important to remember that in Italy capital income is subjected to a separate favourable taxation system[314]. Before 2011 they were taxed with a 12,5% withholding tax that was raised to 20% with 2011 summer financial measure[315] but remained to 12,5% for Italian government securities and for investments in real estate mortgage funds. The protection of savings is an important issue but Italian system excessively favoured that sector, especially during the period *ante* 2011 reform: if you think that the lowest physical person income tax rate is 23%, that measure appears as not fair.[316] It could advantage many very high income receivers; however is also true that the State must encourage investments, especially in a crisis period.

The right solution could be to hold withholding tax system and raise the rates for government securities and investments in real estate mortgage funds to 18 % and the other tax rates to 25%. This solution could advantage State finances, guarantees a better redistribution of wealth and also not discourage the investments in this important sector.

Even capital gains realized by physical persons who are not entrepreneurs are also subjected to separate taxation if the conditions of Article 67 Income Tax Act are respected. This favours operations of private citizen over corporations operations.

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314) Until 1988 Capital income were connected with produced income notion including only profits deriving from the conclusion of speculative acts (so the notion of Capital income was restricted comparing with French tax-law notion, linked to Revenue- income concept). The notion of Revenue- income, in this subject, was introduced by TUIR and successive Legislative Decree n. 461 of 1997. See F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 21, 22.

315) Law Decree 138/2011.

316) For example, if a person has 10,000,000 Euro and buys CCT government securities, he receives a 3% annual interest rate, so he has a 300,000 Euro annual income, and has to pay only 37,500 Euros to the State, whereas a person that exercise a professional activity that receives a 105,000 Euro income has to pay, according to art. 11 of law 917/1986, has to pay a more important amount of taxes.

In order to avoid double economic taxation, Participation Exemption is adopted in our fiscal system: according to Article 87 of Income Tax Act capital gains realised[317] concerning shares or corporation or other entities participation quotes, respecting determined conditions[318] could be deducted from taxable income. If the receiver is a corporation the exemption is for 95% and is also possible to deduct from the few taxes participation management costs, if he is a physical person the exemption is for 49,72% so the person will be subject to double taxation for half of the income deriving from participation. That system was encouraged by European Court of Justice that with *Sentence Manninen (C-319/2002)* suggested to Finland the introduction of this system instead of tax credit system that was applied, at that time, also in Italy. Both systems prevent double taxation that could have as a consequence a worse and consequently unfair treatment to this kind of income receivers.[319]

However that rule don' t establish a properly a tax favour regime but a method to avoid double economic taxation in Italian juridical system.

5- Gender-based taxation: a special tax regime for a special situation.

As affirmed by optimal taxation theory (Ramsey principle), goods and services

317) The system is applied mainly to capital gains on shares, financial instruments similar to shares and titles.

318) One year Minimum Holding period, classification in budget as financial assets, the participated corporation mustn't be resident in a privileged tax system country and it must exercise a financial activity.

319) A person could have an income of 100 as first taxed for 27,5 % as IRES. The remaining 72,5% could be taxed to 43% rate, leaving them only 41,4. Carpentieri asserts that that fiscal regime creates discrimination between resident partners: between IRPEF taxation partners and IRES taxation partners. (here we have a complete elimination of taxation). See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 84.

that have a more elastic supply should enjoy a better treatment from the fiscal system, paying less taxes than the others.[320]

As demonstrated by many researchers, woman labour supply is more elastic than men's, so women labour income taxes should be lower than men income taxes.[321].

It is also asserted that GBT provides substantial welfare and minimizes the aggregate social loss deriving from labour market distortions.

The consequence would be more bargaining power for women, and as other additional effect, the reallocation towards more equality of household duties.[322]

This proposal respects also the European Union Law principles, in fact Article 23 paragraph 2 of Charter of fundamental rights of the EU- that became legally binding after 2009 Lisbon Treaty -affirms that "*the principle of equality shall not prevent the maintenance or adoption of measures providing for specific advantages in favour of the under-represented sex*".

An exemple of Gender Based Tax operating in Italy is art. 3 of law 238 of 30 December 2010 that concedes, with the respect of some conditions[323], a temporary[324] reduction of taxable income for Italian people working abroad[325] that decide to return in their home State. This reduction is more important for women (80%) than for men (70%) making it, effectively, a kind of Gender Based Taxation.[326]

We could, also give the same consideration for article 1, line 95 of law 228/2012 that established a more important IRAP deduction for entrepreneur that hire a

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320) From A.ICHINO, A.ALESINA, Loukas working paper *Gender based taxation and the divisions of family chores,* Leibniz Information Center of Economics, 2007, 2.

321) *ibidem* .

322) *ibidem,* 27.

323) The beneficiary must be born after 1-1-1969, he must own a graduation title, he must be employed as dependent worker in Italy, he must transfer his residence to Italy in three months from his hiring time

324) Until the end of 2015.

325) He must, also, reside at least 24 months abroad before his return in Italy.

326) From Circolare CNR - Consiglio Nazionale delle Ricerche,19/12/2012, n.40/2012 "Incentivi fiscali per il rientro dei lavoratori in Italia".

woman with an open ended contract: in fact if he employs a man he got 10,600 Euro of deduction, if he hires a woman 13,500.[327]

It is possible to conclude that a different situation requests such a different treatment; for that reason an equal treatment of both sexes results as substantially unequal and this proposal is moving towards direction of Art. 3 par. 2 Substantive Equality Constitutional principle.

6- Family taxation proposals

In Italy, a long political discussion started over the introduction of familiar income division principle present, for example, in French tax system.

According to this principle, taxable amount should be divided for the number of people that compose family and should be paid according to tax class rate[328]. In our fiscal system the situation forty years ago was the exact opposite: the wife income had to be accumulated to the husband's and then taxed[329].

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327) From L.BERTOLOZZI, R.BELLOTTI, *Lavoro autonomo e professionale nell' IRAP e nelle imposte dirette,* Giuffré, Milano, 2013, 307

328) For example, if we have a family of 5 and a 100,000 Euro income, it has to be divided and they have to pay for each part 23%. So they could pay 23,000 instead of 36,000 (with the actual fiscal system).

329) As established by article 4 of President of Republic Decree 29 September 1973, n. 597 three kinds of income have to be ascribed to passive subject income: wife's income (with the exception of incomes that are available for legally and effectively separated wife, incomes produced by non emancipated cohabiting sons and other incomes *de facto* available for passive subject.

The provision was founded on an extended concept of income possession that overrides formal ownership.

Obviously that rule generated Constitution compliance problems in reason of contrast with Articles 3, 24, 29, 31, and 53 of Italian Constitutional Chart.

The most evident, but not the only, violation was that spouses weren't considered morally and juridically equal by the rule. In addition married couples were effectively discriminated compared with *de facto* couples (these couples enjoyed a surely better taxation level if they received the same income of a married couple). From A. TURCHI, *La famiglia nell' ordinamento tributario,* Giappichelli, Torino, 2012, 102, 105, 110, 111.

That regime was declared unconstitutional[330] for the violation of equality principle as affirms Italian Constitutional Court Sentence 179/1976 because " ability to pay has to be recognized to every physical person"[331].

That system didn't favour family because two separated persons got a better treatment than a family. In contrast,The French system would aid family in our country and would also be another step in the direction of substantive equality because the fair treatment involve also children and if the family is economically well treated also the children will be economically well treated.

Neverthless there are, probably, also Constitution compliance problems about this measure because, in that case, single people could have a different fiscal treatement than people that constitute a family. In addition it is, at least partially, also against GBT idea that wants lowered taxes for women in order to realise a substantive equality scope.

However, these observation could be overcame with this reasoning: on the strength of equality principle we could say not that we mustn't have any discrimination but that discrimination have to be based on rational criteria.

In the specific case the criterion of encourage family is a constitutional based criterion (Article 31, line 1 of Italian 1948 Republic Constitution affirms "The Republic supports with economic measures and other actions the formation of the family and the fulfilllment of relative tasks, with special attention to numerous families. It protects Maternity, Childhood and Youth, favoring institutes necessaries to this goal.") that, in value balancing must prevail over other

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330) Italian Constitutional Court recognized the violation of articles 3, 29, 31, and 53 of Italian Republican Constitutional Chart. So this taxation form was a discriminatory taxation form for married based families and it also violated ability to pay principle because it establishes that ability to pay must be, necessarily, personal.

Twenty year before a similar rule in Germany was declared unconstitutional by *Bunderverfassungsgericht* in reason of its discriminatory effects for families. Due to this sentence familiar accumulation became an optional taxation regime in that country. From A. TURCHI, *La famiglia nell' ordinamento tributario,* Giappichelli, Torino, 2012, 118-121 and 135-137. See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 43.

331) From Constitutional Court Sentence 179 of 15 July 1976.

principles.

We could, so easily affirm, that due the presence of very low deductions for families the principle expressed by Article 31 Constitutional rule wasn't really realized and that a financial reform introducing Income splitting realizing a situation similar to France would, finally give fulfillment to Constituents intentions.

However, in this economic and financial situation[332] is very difficult to find funding satisfactory for the realization of a similar reform.

7- Other measures to increase the fiscal system progressivity.

The *Buffett Rule* is named after American investor Warren Buffet, who publicly stated in early 2011 that he believed it was wrong that rich people, like himself, could pay less in federal taxes, as a portion of their income, than the middle class, and voiced support for increased income taxes on the wealthy people.

Proposed in 2011 by Obama administration, *Buffet rule* would limit deductions available for high income taxpayer imposing a 30% minimum tax to taxpayer with income equal or superior to 1 million dollars per year, that progressive reform wasn't ever realized due the opposition of the US Congress. Certainly that reform respects the principles of fairness, equality, ability to pay and progressivity.

I think in Italy there is probably a very low number people that pay less than 30% for an income higher than 750,000 Euro. It could happen only due to special capital income rules.

Italian taxation system would be surely more progressive, and so more fair with low income receiver if we had a no tax area for the first 5,500 Euro of income as

332) Italy is also well known for his very huge public debt that reached in 2012 the amount of 2,000 billion Euro.

in France. It could be a better vital minimum guarantee than the exclusion that we have only for people that receive a pension income of less than 7,500 Euro.

The system could also be fairer if we had lower personal income tax rates, especially for medium income receivers[333].

333) I think it would be best to have a reduction of the first class (0-15000) from 23% to 22%, of the second (15,000-28,000) from 28% to 26%, of the third (28,000-55,000) from 38% to 29%, of the fourth from 41% to 32% bringing also this class (55,000-75,000) to 55,000-100,000 Euro, while over 100,000 Euro we would have the last class with a 38% rate.

Chapter V

General Conclusions

Fairness between low income and high income receivers is based on the equality principle expressed in Article 3 of Italian Republican Constitutional Chart that contain a formal equality principle (characteristic of all XIX century liberal constitutions) and a substantive equality principle that creates an obligation for the State to the promotion of the socio-economic condition of citizens, on ability to pay, and on progressivity system taxation principles, both expressed in Article 53 of Italian 1948 Constitution.

After the analysis of the previous pages it is possible to conclude that flat tax income rate like East European Countries wouldn't be fair for low income receivers, that environmental tax, higher taxations over stock options, familiar income division and gender based taxations respect ability to pay principle and fairness idea, that so called “ethic taxes” contribute to realize substantial equality and discourage some dangerous or unfair activities.

Also, after the analysis of confiscatory taxes, the solution proposed by German, Argentinean and Brazilian constitutional courts can be accepted, concluding that an income taxation of more than 50-55% wouldn't respect Constitutional ability to pay principle and would also be absolutely unfair.

In Italian fiscal system is possible to find rules against fairness between low income and high income receivers in the very low important exclusions present in art.11 of Income Tax Act that didn't really and totally guarantee the vital minimum exemption principle, and in the capital income taxation that is taxed less than any professional activity or dependent job income.

In any case the realization of every proposal must be compatible to Italian financial situation that has not been good since 1991, when our GDP growth, which had been strong in the previous three decades, start slowing down, leaving to Italy one of the highest public debts in the world.

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Chapter IV

Chapter V

Chapter I

1- Historical background of the equality principle: from the French Revolution to the 1948 Italian *Republican* Constitutional Chart

“The men come in to the world and remain free and equal in rights. Social distinctions can be based only on the common utility”.

The meaning of the beginning of *Declaration des droits de l' homme et du citoyen* (1789) is that all man hold the same rights.[1]

It's the concept of general juridical capacity that represent the most important difference between the modern state and the *Ancién Régime* state.

In the *Ancien Règime*, only people that hold a determined status in reason of their birth could be holders of some rights. The laws weren't equal for all, also the tribunals were different, because, for example, a nobleman had to be judged by other noblemen, a clergyman had to be judged by other clergymen.[2] Breaking with that longtime tradition, Article 6 of *Declaration des droits de l' homme et du citoyen* affirms that ”law must be expression of general will... and must be the same for all, in case of protection as in case of sanction.”

Revolutionary France *Declaration,* US Constitution, *Octroi*-Charts[3] and Liberal

1) F. SORRENTINO, *Lezioni,* Giappichelli, Torino, 2011, 3.

2) It seems a tale from medieval ages but, for example, in the Piedmont Kingdom this kind of judgement was possible until the '50s of XIX century when it was prohibited by a law promoted by Italian statesman *Camillo Benso Count of Cavour.*

3) *Octroi* Charts were constitutions that people got as a concession from the king that autonomously decided to limit his powers. The first Octroi-Chart was the 1814 France kingdom Constitution. It was a concession of King Louis XVIII, Louis XVI 's brother, that didn't want to restore *Ancién Régime.* This chart was a model even for the Piedmont Kingdom, where king Charles Albert I gave to his people a constitution, *Statuto Albertino,* in 1848. The text was the Italian constitution from 1861 to 1947.

Democratic Constitutions introduced in many juridical systems the equality principle that concerned civil and political rights.[4] These rights could be summarized in the famous expression “liberty-property”.[5] In other words they concern freedom from the State. To respect these principles the State has an obligation to *non facere*; it means that never the State has to do something as a positive conduct to respect these rights.

It was an age when the importance of public expenditure was very low; for example, in 1861 the Italian State spent 13.5% of Gross Domestic Product: *de facto* XIX century State spent money mostly for military purposes and infrastructures (very little developed at that time), while social expenditure was quasi-non existent.

In that situation we can't imagine a juridical system in which the State has obligations to a positive conduct *(facere)* with citizens.

In that State the equality principle was expressed in Art. 24 of *Statuto Albertino*: “All the subjects, independently of their degree or title, are equal in front of the law. They equally enjoy civil and political rights. They are admissible to all civil and military offices unless exceptions defined by laws.” Obviously, it affirms the principle of formal equality as others XIX centuries constitutions.

The conditions changed gradually from the end of XIX century: the State started to use more money for public expenditure[6], and also for social expenditure.[7] The rise of socialist and catholic[8] parties also radically changed the political situation.[9] These conditions and the consequences of World War I were the causes of Liberal State collapse.

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4) F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 6.

5) ibidem, 6.

6) When Giolitti came to power, public expenditure was about 20-25% of the Italian Gross National Product.

7) The first country that introduced pensions was Bismarckian German Empire, twenty years after Giolittian Italy (1903-1913) started with a first form of welfare state .

8) I refer to german *Zentrumspartei*, to the Italian People Party, etc.

9) For example, in Germany, SPD got more than 20% of votes from the 90's of XIX century, Italian Socialist Party became the first party in the 1919 Italian general elections...

In an American state, liberal state collapsed some years before the Great War. This state was the Mexican Republic, where, in the '10s, due to a radical socialist revolution[10], the first constitution that established social rights was written and promulgated in 1917.

In that Constitution, the Mexican State had an obligation to hold positive conducts, in some cases regulated by constitutional provisions: Art. 27 established an obligation to promulgate an agrarian reform that would make property accessible to all the citizens, and Art.123 established many obligations for the state, towards the workers.[11]

In November 1918 the military defeat of the German Empire caused the collapse of its institutions; three months later, after the elections for the Constituent Assembly, the largest party was the German Social democratic Party and the second the catholic Center Party. The coalition led by these two forces wrote the Weimar Constitution: the first European constitution in which even social rights were expressed.

It is important to see the preamble that says “The German People [...] to promote social progress, has adopted this Constitution.”. This passage is very interesting because it gives, with the verb promote, the idea that State couldn't only “*non facere*”, but it had to intervene to guarantee substantial equality to citizens.[12]

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10) An uprising, started in 1910, forced one year later president General *Porfirio Diaz* to resign after more than 25 years of presidency. Then radical liberal politician *Francisco Madero* was elected Chief of the State, but in a few months extremist revolutionary groups started a revolt against him. Exploiting the weakness of new president, General *Victoriano Huerta* carried a reactionary bloody *coup d' état* in february 1913. Nerverthless *Huerta* 's initiative resulted in a disaster: radical socialist revolutionaries defeated him and in one and a half year they were able to control the whole Country.

11) For example the State had to guarantee an 8 hr working day, the maternity, a salary satistificatory for the normal necessities of the worker, responsibility of entrepreneurs for work accidents, strike as a right, etc.

12) I report here the rules of articles 142-145 of 1919 German Constitution. In these articles the intention of preamble is confirmed:

“**Article 142**

The arts, science and instruction are free. The State provides protection and participates in its cultivation.

After the dramatic epilogue of World War II these principles became part of most European constitutions, including the 1948 Italian Republican Constitution.

2- Legal basis of the equality principle in the Italian Republic Constitutional System

The principle is expressed in Article 3 of our Constitution, which says:

"All citizens have an equal social dignity and are equal before the law without any discrimination of sex, race, language, religion, political opinion, personal and social conditions. It is the duty of the Republic to remove those obstacles of economic or social nature which, constraining the freedom and the equality of citizens, thereby impede the full development of the human person and the effective participation of all workers to the political, economic and social organization of the country."[13]

Article 143

The education of the youth **has to be provided** by public institutions. In their establishment, Reich, states and communities cooperate. The training of teachers has to be regulated uniform by the Reich, according to principles applying generally for higher education. Teachers at public schools enjoy the rights and share the duties of state Beamte.

Article 144

Schooling is entirely **placed under state supervision**; the state can give a share of that supervision to the communities. School supervision is taken charge of by full-time, professionally qualified Beamte.

Article 145

Schooling is obligatory. This obligation is served by the Volksschule (20) with at least 8 school years and the school for further instruction, following on the former, until the completed 18th year. Instruction and learning aids are, at Volksschule and at schools for further instruction, **free of charge.** "

We could observe the repetition of the verb "provide", which indicates the clear intention of an obligation of a positive conduct for the State towards citizens.

13) The translation is published on Italian Senate internet website (www.senato.it). I report here the Italian text:

"Tutti i cittadini hanno pari dignità sociale e sono eguali davanti alla legge, senza

This very important rule is the legal basis of the equality principle in Republican Italy.

Italian Constitutional Court also affirmed in the historical sentence 1146/1988 that this is one of the founding principles of our democracy that couldn't be changed even with the Constitutional amendment procedure[14] ruled by Article 138 of our Constitutional Chart[15].

In particular, the judgement of the Court said that in our Constitutional System we find expressed limits to Constitutional amendment and unexpressed limits: the supreme founding values of our Constitution.[16]

As also doctrine says, the equality principle is included in these values because it is the main basis of the constitutional system, and without it we would not have the principle of legality.[17]

The Greek philosopher Aristotle said that "In good constitutions the men are under the law, in bad constitution one or some men are above the law". It also

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distinzione di sesso, di razza, di lingua, di religione, di opinioni politiche, di condizioni personali e sociali. È compito della Repubblica rimuovere gli ostacoli di ordine economico e sociale, che, limitando di fatto la libertà e l'eguaglianza dei cittadini, impediscono il pieno sviluppo della persona umana e l'effettiva partecipazione di tutti i lavoratori all'organizzazione politica, economica e sociale del Paese.".

14) Constitutional amendament procedure procedure requires double exam of *Camera dei Deputati* and *Senato della Repubblica* and vote of more than the 66% of members of the two legislatures (is also possible with the vote of more than 50% of MP and a successive popular referendum that should confirm the parliamentary vote).

15) It is a passage of very important Italian Constitutional Court Sentence 1146/1988 :

"La Costituzione italiana contiene alcuni principi supremi che non possono essere sovvertiti o modificati nel loro contenuto essenziale neppure da leggi di revisione costituzionale o da altre leggi costituzionali. Tali sono tanto i principi che la stessa Costituzione esplicitamente prevede come limiti assoluti al potere di revisione costituzionale, quale la forma repubblicana (art. 139 Cost.), quanto i principi che, pur non essendo espressamente menzionati fra quelli non assoggettabili al procedimento di revisione costituzionale, appartengono all'essenza dei valori supremi sui quali si fonda la Costituzione italiana.".

16) Professor Franco Gallo agrees with this thesis in his speech to University *Ca' Foscari* of Venice of 14/06/2013.

17) A. CERRI, *Eguaglianza, (principio costituzionale)* Treccani Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 8;See, also, F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 35. Also A.CELOTTO in *Declinazioni dell' eguaglianza,* Editoriale scientifica, Napoli, 2011,17-18 agrees with the others and remember the words of italian constitutionalist C. MORTATI, who said "the equality rule is a sort of super rule, a closing principle of the juridical system" in *Istituzioni di diritto pubblico*, II, ninth edition, Padova, 1976, 1023.

means that both the citizens and the powers of the State must obey the law.
All laws voted by the parliament must respect this principle, because our Constitution has more importance than a normal law in our law system, according to Hans Kelsen thesis, expressed in his work *The Pure Doctrine of law*[18]

3- The influence of International law in the Equality principle in the Italian juridical system.

The first paragraph of Article 117 of our constitution says: ”The legislative power is exercised by the State and the Regions respecting the Constitution and EU and International law obligations.”[19]
The rule has, as a consequence, that an Italian law can be valid only if is not in contrast with the European Convention of Human Rights.[20] In the other case it violates Article 117 paragraph 1 of our constitutional text. Therefore, an italian rule that violates equality principle is against the provisions of both Articles 3 and 117.[21]
As supporters of Multilevel Constitutionalist Theory say, our constitutional system is becoming “open”[22] to the international and EU dimension. It means that international rules become, in equality constitutional critics, as *tertia comparationis* or indirect parameters.[23]

18) H. KELSEN, *La Dottrina pura del Diritto,* Torino, Einaudi 1966.
19) I add here the original text: ”La potestà legislativa è esercitata dallo Stato e dalle Regioni nel rispetto della Costituzione, nonché dei vincoli derivanti dall'ordinamento comunitario e dagli obblighi internazionali.”.
20) See F. SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 49.
21) *ibidem*, 2011, 49.
22) *ibidem*, 50.
23) *ibidem*, 50.

4-The wording of provisions that affirm the equality principle.

As we have seen before, Article 3 is divided in two paragraphs: in the first, it is affirmed that all citizens have the same social dignity.

Analysing the word citizens, we could think that in Italy the provision is not applied to stateless and foreigners (and our constitution would be very different from the German one, or other constitution that don't use in the equality rule the word citizen), and also some experts at the beginning of Italian Republic history thought the same.[24]

Therefore, a judgement of Italian Constitutional Court in 1967, on the basis of Art. 2[25] and 10, paragraph 2[26], interpreted in connection[27] with Article 3, extended the principle even to these two categories saying that "equality for fundamental rights should concern even the foreigner"[28].

Doctrine[29] says that foreigner has a different treatment because the situation is different.

It is also important to add that in our system, even for corporations, bodies, association, juridical entities [well described in Article 2, paragraph 1), Art. 3 principle is recognized by the Constitutional jurisprudence[30] (sentence 40/1965; 2/1969; 15/1975 and others...)] that also affirms equality among Regions[31]

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24) A. CELOTTO, *Le declinazioni dell' eguaglianza,* Editoriale Scientifica, Napoli, 2011, 19.

25) Relating to the issue Art. 2 says "The Republic recognizes and guarantees the inviolable rights of the person ,...".

26) Art. 10 paragraph 2 says:"The juridical condition of foreigner is ruled by the law according to international rules and international treaties".

27) From the paragraph 2 of Constitutional Court Sentence 120 of 1967.

28) From the paragraph 2 of Constitutional Court Sentence 120 of 1967.

29) Sorrentino, *Lessons*, Giappichelli, Torino, 2011, 151.

30)A. CERRI, *Eguaglianza , (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 3 ss.

31) See Italian Constitutional Court Sentence 11/1969; 2/1972;243/1974; 64/1987; 21/1991;

(politic-administrative bodies that compose the Republic[32]) and among Commons[33] (they are the nearest to the citizen entities that are part of the Republic[34] and hold only administrative powers).[35] Recent Constitutional jurisprudence[36] affirms that recognition of the treated principle is also extended to the subjects nationals of other European Union States.[37]

The expression “same social dignity”, as says the most recent doctrine[38], means that all must be suitable to be holder of the same rights and that all are equal in front of the law.[39]

The second is an enlightment principle[40] and a founding principle of liberal democratic state of XIX century. According to that principle laws must be general and abstract, without any subjective distinction.[41] As US Supreme Court says, the law must be colour blind[42]. We have, first, to specify that the word “law” means

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277/1995, 303 and 338/2003.

32) From the first paragraph of article 114 of Italian Republic Constitution. I report here for a more clear analysis the Italian text:”La Repubblica è costituita dai Comuni, dalle Province, dalle Città metropolitane, dalle Regioni e dallo Stato.”.

33) See Italian Constitutional Court Sentence 61/1958; 113/1970.

34) From the first paragraph of article 114 of Italian Republic Constitution.

35) A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 3 ss.

36) See Italian Constitutional Court Sentences 443/1997 and 86/2004.

37) See A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 36

38) F.MODUGNO, *Principi generali dell' ordinamento,*in Enciclopedia Giuridica, XXIV, Roma,1991, 20.

The expression was considered in the '50s a repetition of the equality in front of the law principle, and the doctrine didn't give to these words the great importance they have now. Differently, Sorrentino says that it means that every citizen merits the same consideration in the community., from F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 30-31.

39) See A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 20.

40) *Egalité devant la loi* is a french expression. A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 3, also C.PERELMAN, *Egalité et valeurs*, I, 323.

41) There is one only juridical system for all the citizens, as A. CERRI says in *Egualglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 4, according with Esposito's thesis, expressed in *Eguaglianza e giustizia nell' articolo3,* in *La Costituzione italiana,*Saggi, Padova,1954, 30 ss.

42)A. CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia

not only parliamentary acts but it includes our whole juridical system.[43] We also add that new doctrine and jurisprudence suggest a dynamic interpretation of the expression[44]: the law must treat equal situations equally and different situations differently.

In particular, Sorrentino defines equality as a relationship-wise principle, and many Constitutional Court sentences see the judgements on this principle even as a reason judgement.[45]

In the second part of the paragraph, it is excluded from our juridical system every ethnic, religious, political, language, national, gender, personal or social condition discrimination: never a person has to receive a worse treatment in reason of ethnics, faith, language, political opinions, social and personal[46] conditions.

It is the so called "Nucleus"[47], a sort of "inner core" of the principle (the description of the most unfair subjective discriminations).

In that case the critic of the constitutional judges is stricter and derogation is not possible even if it is founded on other constitutional principles.[48]

The second paragraph of Art. 3 is one of the most innovative parts of the constitutional text because it introduces for the first time the substantive "equality". It establishes the responsibility for the Republic to remove economic

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italiana, Roma, 1994,XXII, 3 ss.

43) See F. MODUGNO, *Legge in generale,* in Enciclopedia del diritto, XXIII, Milano, 1973, 875 and also A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 25.

44) See F.GHERA, Eguaglianza, CEDAM, 2003, 39ss and also A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 25.

45) F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 21.

46) That word could be interpreted as a general principle against subjective discrimination (like laws *in personam),* as says Cerri. See A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994,XXII, 5.

47) See A.CERRI, *Eguaglianza, (principio costituzionale)* Enciclopedia, Istituto Enciclopedia italiana, Roma, 1994, XXII, 3-4. See, also, A.CELOTTO, *Le declinazioni dell' eguaglianza* ,Editoriale Scientifica, Napoli, 2011, 20 and L.PALADIN, *La Corte Costituzionale e un principio generale di eguaglianza* , Padova 1985, 659.

48) *ibidem,* 4. See also Constitutional Court sentences 32/ 1971. In that case a rule of Italian 1929 State- Church Agreement covered by the article 7 of the Constitution was declared unconstitutional for the contrast with equality principle.

and social obstacles that prevent the full development of person or impede the effective exercise of political, economical or social rights.[49] On the basis of this principle, apparently similar situations could be considered really different.[50] It is a form of equality with a positive and dynamic content.[51] It could be realized with state performances but also with limitations of rights of some persons, for example, it is possible to limit property rights[52] or economic initiative[53] to guarantee their social function.[54]

49) *ibidem*, 6. See also Constitutional Court Sentences 43/1988, 497/1988 and 768/1988.

50) *ibidem*, 6. For example, if men and women have the same labour schedule, this could disadvantage women, especially for some kinds of work.

51) F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 10.

52) Articles 42 and 44 of Italian Republican Constitution.

53) Articles 41 and 43 of Italian Republican Constitution.

54) F.SORRENTINO, *Lezioni*, Giappichelli, Torino, 2011, 10.

Chapter II

The principle of ability to pay

1- Historical overview of the principle of ability to pay.

From the Roman age to the rise of constitutional states, levies were seen only as an unfair burden that the king or legislators dictate[55].

For example, in Pre-Revolutionary France, Noblemen and Clergy didn't pay any tax and Third State paid about 42% of their income in taxes, so the tax system was regressive because the richest part of population were beneficiaries of tax exclusion.

The only basis of levy, at that time, was the law,[56] declared by the Absolute Sovereign.

From the stipulation of *Magna Charta Libertatum* the powers of English king were restricted and levy started to become an obligation to contribute to public expenses. In the same age philosopher and saint Tommaso D' Aquino affirmed that fiscal duty was not a sort of payment of public services but a consequence of the existence of the State[57]. However the system that considered taxes as an

55) The famous XIV century jurist *Bartolo di Sassoferrato* defined taxes as a load "*...necessario subimus lege vel mero imperio eius qui habet potestatem.*". From G.FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri, Editoriale Scientifica, Napoli, 2006, 92 See, also, L.CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 6, See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 21.

56) From *G.FALSITTA, in AA.VV., Diritto tributario e Corte Costituzionale,* a cura di *Perrone e Berliri,* 93.

57) See R.AMBERG, *Die Steuer in der Rechtsphilosophie der Scholastiker,* Berlin und Leipzig, 1909, 17 ss.

oppressive instrument of sovereign power changed only with French Revolution.[58] At that time the law became an expression of general will, of citizen's will. So from that started the idea of levies that support the expenses of a Constitutional Right State.[59]

An Italian author, Lorenzo Meucci, gave moral and juridical nature to this obligation[60]. As said Italian Republic president and famous economist *Luigi Einaudi* said that "with taxes State creates new values[...] Through the tax the State creates the juridical and political framework when men could work, organize, invent and produce".[61]

From this concept spreads the idea that a fair distribution of public expenses is necessary[62]

Article 25 of *Statuto Albertino* says"[All the subjects] contribute indiscriminately, in proportion of their owns to public expenditure"[63]. In that definition is excluded the concept of progressivity according to formal equality concept: in fact all the citizens[64] must be subjected to a proportional level of taxation (totally ignoring

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58) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 139.

59) Italian Constitutionalist Aldo Moro defined the State as the highest form of human solidarity.

60) From L.MEUCCI, *Istituzioni di diritto amministrativo*, Torino, 1905, 443.

61) L. EINAUDI, *Miti e paradossi della giustizia tributaria,* Torino, 1940, 199 in citation of From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 88.

The author, also, reported a passage of *Nicol vs Arnes, 173 U.S.* 509,515 (1899) US Supreme court sentence: "Tax power is the only grat founding power on that is founded all the State. It is necessary for the life of the nation as the air is necessary for man' s life. It is not only a destruction power, but also a life preservation power.".

62) From G. FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 97.

63) I report here Italian text: "*Essi contribuiscono indistintamente, nella proporzione dei loro averi, ai carichi dello Stato*." *Ibidem,* 102. It is a rule similar to rules present in English 1688 Bill of Rights and French 1789 *Declaration de droits de l' homme et du citoyen.* A similar expression was also contained in Spanish Constitution that established: "Taxes will be subdivided between all Spanish citizens in proportion of their wealth, without exceptions nor privileges. From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 24.

64) Without any kind of subjective exclusion like *Ancien Regime.* In fact that rule established fiscal equality, See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 23.

solidarity influenced conception of taxes).[65]

One hundred years later, Republican Constitutional legislator confirmed the duty for all citizen (without class or rank distinctions[66]) to participate to the public expenses, but the parameter changed, even due the introduction of other constitutional principles (Art. 2 and Art. 3 of our constitution) that influenced Art. 53 paragraph 1 rule.

The new rule expressed the evolution, in solidarity direction, of the principle.[67]

As noted Milone the rule is put by Italian Constitutional legislators in Title IV of first part of Constitutional Chart that defines "Politic Relations": for example article 54 establish for citizen Republic fidelity duty and article 52 Fatherland protection against attacks duty.[68] So the contribution to public expense is considered as one of the fundamental duties of every citizen or person that have economic links to Italian State (in that case is even possible real basis taxation.

2) Ability to pay principle in Italian 1948 Constitution.

The first paragraph of Article 53 of Italian 1948 Constitution says: "Every person shall contribute to public expenditure in accordance with their ability to pay."

Contained in that expression, ability to pay principle means the appropriateness in

65) According to Milone "that rule gave to legislator the possibility only of a restrictive interpretation", From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 92. See, also, M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 82.

66) From FEDELE, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 3. See, also, on the same volume, G. GAFFURI, 25.

67) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 94.

68) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 89.

a specific moment[69] (potentially economical) of every member of the community[70] to satisfy fiscal obligation, deducible from the circumstance to which the tax is linked.[71]

The article makes explicit the principles contained in Articles 2[72] and 3[73] of the Constitutional Chart:[74] in fact is affirmed[75] that ability to pay principle is a specification of Solidarity (Art. 2) and Equality (Art. 3) constitutional principles.

The principle is addressed to the legislator and to the taxpayer.[76]

For the first one it is both a limit (because levies must finance public expenses) and a parameter for Italian taxation system.[77] For the second one it expresses the duty to payment of fiscal burdens on the basis of his ability to pay.[78]

This obligation is not the consequence of a specific service, got from the State, but only of the fact that citizen belongs to a democratically and politically organized

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69) As affirmed by article 3, line 1 of Taxpayer Rights Statute (law 212/2000) tax law never have a backdated effect. Therefore, Taxpayer Rights Statute hasn't the same value of Constitutional provisions, so it could be waived by ordinary legislation. However the most part of the doctrine asserts that it is a juridical civilization principle.

However backdated taxation is not possible if his object is not still present when tax law is enacted.

70) S. La Rosa wrote that it means that participation to public expenditure concern people that belong to all social classes. From S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,* Giuffré, Milano, 1965, 10.

71) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 84.

72) “The Republic expects that the fundamental duties of political, economical and social solidarity be fulfilled”.

This translation is published on Italian Senate internet website (www.senato.it).

73) Principle of formal and even substantive equality are projected in 53 par. 1 rule.

74) G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 58. See, also F.MOSCHETTI, A.FEDELE, P.BORIA and G.FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 2, 40, 57, 100. We can also find impotrant considerations in F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 96. See, also, M.PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 126-127.

75) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 129 See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 41-42.

76) G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 49.

77) *ibidem*, 50.

78) *ibidem*, 50.

community.[79]

Nevertheless, the ability to pay is even influenced by article 2 Constitutional provisions (the duty to pay the levies is included in political, economical and social solidarity[80]), and this fact involves the minimum vital exemption[81], so the people, differently from the letter of 53 par. 1 rule, mustn't participate to public expenditure.[82]

The rule doesn't mean that all the units of income have the same fiscal treatment[83]: in fact the juridical system permits discriminations between different situations. So it was affirmed that this Constitutional principle guarantees an equal treatment to people that are in the same *de facto* situation specifying, in that way, equality principle.[84]

These discriminations could be quantitative or qualitative.

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79) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 79.

80) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 79.

81) As noted Carpentieri Minimum Vital exemption was theorised for the first time by Bentham.

From L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 19.

82) As say Melis not every economic capacity could be considered as ability to pay. G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013*,* 53.

Moschetti defined the same concept as minimum for personal and familiar necessary expenses. From FEDELE, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri, Editoriale Scientifica, Napoli, 2006, 49. Fedele says that minimum vital is related to human dignity. The article was written on the same volume, 2. Even Procopio agrees with that thesis affirming also that exclusions must respect Equality principle, expressed in article 3 Italian Constitution provisions. From M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 82 and 85 and 108. The author also, asserts that minimum vital exemption is necessarily based on solidarity principle. F. GALLO affirms that minimum vital exemption protect free and respectable subsistence in *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 9., See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 48-49. In Constitutional Court Sentence 97/1968 is expressed the same concept: "Is not exact that Article 53 of the Constitution exige from every income, independently from his entity a tax burden. Substantive equality principle, expressed in article 3, line 2 of Italian Constitution, that must inspire fiscal legislator, presuppose that taxes mustn' t deprivate anyone of goods that seems indispensable to fundamental human necessities.

83) M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 85.

84) S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 10.

Quantitative discriminations operate between different amount incomes.[85]In qualitative discrimination the reason of the different treatment is founded on the origin of the income.[86]

As affirmed Italian Constitutional Court Sentence 155/1963 "[Article 53], constituting the specific development of Equality Principle, expressed in article 3 of Constitution represent the necessity , for income taxes of equal taxation for equal incomes and different taxation for different incomes"[87].

In fact that principle has a double function: a solidarity function (every people should contribute to public expenditure) and a guarantee function that is a limit for legislator to tax only citizens that are effectively "able to pay".[88]

This is the basis of so called tax justice.

In the firsts years after the introduction of Constitution, the doctrine defined the rule as a programmatic provision not binding for the legislator.[89]Also Italian Court of Cassation sentence 844/1954 affirmed "Article 53 of Italian Constitution

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85) For example corrections of regressive effects determined by indirect taxes like VAT or with a progressive personal income tax.

The main reason for that is an economic concept: marginal utility is decreasing.

From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 126-127

It is also the main reason for minimum vital exemption.I can explain the concept with that example: if a person is in the desert he surely need water, an other person arrive and bring him a glass of water, the thirsty person enjoys it a lot, than he give him an other and others. I think that when the water taker will give the 50 th glass the other person could even refuse it. In that example the satisfaction for the glasses of water is decreasing.

86) An example of qualitative discriminatione is surely patrimonial tax that hit two times capital income revenues. A more recent example is represented by the diversificated rate of Added Value Production Tax for Banks and Insurance companies and also additional taxes on pornographic material. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 129 and 133. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 127.

87) The same concept is also well affirmed in Italian Constitutional Court Sentence 120/1972.

88) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 81.

89) Giannini defined it as an "ideological statement". See A.D.GIANNINI, *I rapporti tributari, in Commentario Sistematico alla Costituzione Italiana*, I, Firenze, 1950, 273; G.INGROSSO, *I tributi nella nuova costituzione Italiana*, in Archivio Finanziario, 160-161; F. MAFFEZZONI, *Valore positivo dei principi costituzionali in materia tributaria*, in Jus, 1956, 326.

contains a merely directive rule...".

The expression was defined as unclear, ambiguous, a sort of "empty box"[90]Other authors thought that ability to pay was the expression of benefit theory; so it must be equal to the economic value of services received from the State, as Maffezzoni said.[91]

Constitutional Court affirmed that there aren't not binding constitutional rules in our juridical system[92] and that 53 par. 1 is related to indivisible services.[93]

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90) See G.INGROSSO, *I tributi nella nuova costituzione italiana,* in Archivio Finanziario, 1950, I, 163; A.D.GIANNINI, *I rapporti tributari,*Firenze, 1950, 281; A.BERLIRI, *Principi di diritto tributario,*Milano, 1952, I, 255; L.EINAUDI- F.REPACI, *Il sistema tributario italiano,* Torino,1958,11See M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 83-84. The author didn' t agree with that understimating theory of that constitutional principle and affirms, according with Paladin that ability to pay principle must necessarily be an "elastic concept". See also, L.PALADIN, *Esiste un "principio di ragionevolezza" nella giurisprudenza costituzionale?,*in *Il principio di ragionevolezza nella giurisprudenza della Corte Costituzionale,* Atti del Seminario di studi, Roma, 13-14 ottobre 1992, Milano, 1994, 164.

That doctrine that would give more discretional power to the legislator, is recently developed by part of the doctrine with different arguments.

See, with regards to these new theories, L. ANTONINI, *Dovere tributario, interesse fiscale e diritti costituzionali,* Milano, 1996; S.F.COCIANI, *Attualità o declino del principio di capacità contributiva?,* in Rivista di diritto tributario, 2004, 823 ss; F.GALLO, *Etica e giustizia nella nuova riforma tributaria,* in Diritto e pratica tributaria, 2004, I, 17, *Le ragioni del fisco,* Il Mulino, Bologna,2011, P. BORIA, *La dialettica costituzionale del fenomeno tributario,* in Diritto e pratica tributaria, 2005, I, 1031 ss; A.FEDELE, *La funzione fiscale e la capacità contributiva nella Costituzione italiana, in AA.VV., Diritto tributario e Corte Costituzionale,* a cura di *Perrone e Berliri ,* Editoriale Scientifica, Napoli, 2006, 1 ss.

91) G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 50, see, also, From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 93 and 99 ss

92) It was affirmed in Judgment 1/1956.

93) G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 51.See also *Diritto tributario e Corte Costituzionale,* Perrone and Berliri, From GAFFURI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 26.

3- Objective limits to fiscal overdraft: when does taxation become expropriation?

Article 42 paragraph 3 of our Constitution says “Private property could be, in cases established by laws, and always with economic compensation, expropriated for general interest reasons”.

As affirmed by the Human Rights European Court, compensation mustn't be considerably lower than the commercial value of the good.[94]

In the Italian juridical system, expropriation is authorized only for specific reasons and the cases are predetermined by law, so if a tax acquire confiscatory nature these constitutional rules are certainly violated by legislator.[95] Italian constitutional jurisprudence affirms that the fiscal legislator decides the maximum level of taxation, but taxation never can be arbitrary or unreasonable.[96]

An important case is well represented by so called “*Contribution exceptionelle de solidarité sur les très hauts revenus d'activité”*[97] that would increase to 75% income taxations for the part exceeding 1 million euros. In some cases, for example taxation for stock options and free shares, the taxation could reach 79,5%[98] and in case of real estate capital gains could reach 90,5%.[99] Most part of

94) Case *Pisacane and Others*, Sentence 27/05/2008.

95) See G. MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013,55 and 61 and, also Fedele and Gaffuri, in A.A.V.V.,*Diritto tributario e Corte Costituzionale*, Editoriale Scientifica, Napoli, 2006, 19-20, 35.

96) From G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale*, Rivista di diritto tributario, 2013, I, 23. See, also, Italian Constitutional Court provisions 62/1977, 336/1992, 475/1994, 352/1995,111/1997, 449/1998, 3/2001 and 23/2005. In particular sentence in 336/1992 it asserted “...is not entitled to Constitutional Court to judge the entity or proportionality of fiscal burdens but only to control arbitrariness or irrationality of fiscal measures”.

97) From art. 12 of *Projet de loi de finances pour 2013.*This rule was a main issue in french president François Hollande in 2012 electoral programm.

98) *From* G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale*, Rivista di diritto tributario, 2013, I, 13.

99) *ibidem*, 17.

the doctrine considered the tax as an excessive or confiscatory measure[100] and also criticized the subjection to tax only for incomes deriving from professional activity and the excessive taxation for stock options and free shares.[101]
French *Conseil Constitutionnel* in Sentence 662 of 29/12/2012 stated that the new levy increases fiscal revenue and progressivity of the whole French tax system[102] but it defined the tax an excessive[103] measure that violates equality principle.[104]
It is not the first time that *Conseil Constitutionel* declared unconstitutional a tax: in 1986 it happened with a 50% tax defined "confiscatory".[105] In the 2014 budget law, the French legislator introduced a 75% levy on salaries paid by the enterprises of more than one million Euro.[106]In Decision 685/2013 the highest French jurisdictional authority affirmed that "the rule, considering the ability to pay of these enterprises, respects equality principle."[107] With that decision a different version of the rule that is relevant for less subjects than the previous one is considered valid, but a fiscal overdraft considered by many authors as confiscatory and, therefore, illegitimate, is authorized.
The question was also analysed by German *Bundesverfassungsgericht.* It affirmed

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100) UMP and UDI deputy groups affirmed that the measure, leaving to the owner only 25% of the revenue, is against property right protected by article 17 of so called *Declaration des droits de l' homme et du citoyen* . *Ibidem,* 11.

101) *ibidem*, 12- 13. In case of stock options and free shares we find disparity of treatment between these income and labour income and it cause a violation of equality principle and the excessive rate has confiscatory nature. This was affirmed by UMP and UDI deputies groups.

102) *ibidem*,8.

103) *ibidem*,18. I report here the French text: "*une charge excessive au regard de leurs facultès contributives".*

104) I report here the French text: "*contraire au principe d' égalité dans les charges publiques".*

M. PROCOPIO asserted that French *Conseil Constitutionnel* based his decision on the violation of equality principle in *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 116.

105) G.BERGONZINI*, I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I,19.

106) See article 15 of *loi financiaire 2014.*

107) From *Conseil Constitutionnel, Comuniqué de Presse* 685/2013. I report here the french text:

"Compte tenu de ces éléments et au regard des capacités contributives desdites entreprises, l'article 15 ne porte pas atteinte à l'égalité devant les charges publiques. ".

that the sum of income tax and property tax mustn't ever exceed 100% of total income[108] leaving the citizen without the so called vital minimum.[109]

A relatively recent sentence[110] asserts that constitutional limits to taxation could be found in private property and in proportionality principle and that levies mustn't substantially jeopardize economic result.[111] In the specific case, a 57% levy was considered unreasonably excessive.

Spanish jurisprudence is based on the constitutional prohibition of confiscatory tax[112] and affirms that the sum of levies mustn't overtake the 100% of the citizen income.[113]

Brazil Constitutional Court considered confiscatory and therefore unconstitutional a 52,5 % income tax, defining it unreasonable.[114]

Argentina Constitutional Court in the '40s stated that real estate rent tax, inheritance tax and donation tax mustn't exceed 33%.[115] In this country is also present a Constitutional rule that put a ban to confiscatory taxes.[116]The position

108) See G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 20 and, also, G.FALSITTA, *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l' intero reddito del contribuente,*148-149, See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 39.

109) See BOZZA-BODEN, *L' imposta confiscatoria nella giurisprudenza e nella dottrina tedesca dopo la sentenza 18 gennaio 2006 della Corte costituzionale germanica,* 99.

110) Sentence of *Bundesverfassungsgericht 18-1-2006.*

111) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 20,see also, BOZZA-BODEN, *L' imposta confiscatoria nella giurisprudenza e nella dottrina tedesca dopo la sentenza 18 gennaio 2006 della Corte costituzionale germanica, 107.* See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 39.

112) Article 31, paragraph 1 says "..in no case [the fiscal system] will apply confiscatory measures". I report here also the spanish text: "*en nignùn caso [el sistema tributario] tendrá alcance confiscatorio.".* As noted Carpentieri the same ban is even present in Brazilian Constitution, article 150, line 4. From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 39.

113) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 22.

114 *) ibidem*, 24.

115) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 24.

116) I report here the expression: " Tax couldn't be indirectly used as a sort of instrument to

changed recently when the same *Corte Suprema de Justicia de la Nacion* asserted the non existence of a precise percentage limit of tax, but affirmed that the State fiscal power is not unlimited; so it is impossible that taxes could take a substantial part of the citizen income.[117] On the basis of these arguments, 62% and 55% levies were considered unconstitutional.[118]

Italian juridical system lacks of an express ban to confiscatory taxes and a confiscatory tax present in this fiscal system wasn't declared unconstitutional by the Constitutional Court. The case was treated in Sentence 68 of 20 march 1985 and was related to Italian Inheritance Tax Law that established Passive Equal Solidarity of heirs. In that case if an heir fail to exercise his Payback Right the tax that he pays could be higher than his succession rights determining in that way a confiscatory fiscal burden.[119]

However many experts[120] asserts that is present in Italian set of rules an implicit ban to confiscatory taxes inferable from articles 3, 42[121] and 53 of Constitutional Chart.

We clearly see that the confiscatory French notion is more restrictive[122] than the

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reach the same scope of confiscation of goods". From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 40.

117) G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di diritto tributario, 2013, I, 25.

118) *ibidem*, 26.

119)See L.CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 40. In that case Italian Constitutional Court affirms that guarantees for the heir are the possibility to refuse inheritance or to accept it with Inventory Advantage.

120) See L.CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 41.

121) Article 42 of our Constitution affirms:

"The ownership is public or private. Economic goods belong to the State, to Authorities or to privates.

Private property is recognized and guaranteed by law, that determine the modality of purchasing, of enjoyment, and limits in order to guarantee his social function and make it accessible for all.

Private property could be expropriated for public utility reason only in cases determined by law and with economic compensation.

The law establishes the rules and the limits of legal succession and Last Will Inheritance and State Rights over Inheritance goods.".

122) It means that tax must absorb the quasi entirety of citizen income, not only a substantial part. G.BERGONZINI, *I limiti massimi o confiscatori della imposizione reddituale,* Rivista di

German or Argentine notion. As the Italian author Moschetti affirms[123], German and Italian constitutional fiscal principles are the same; so the same principle asserted by German *Bundesverfassungsgericht* should be valid even in Italy and it could have for consequence that a levy of more than 50-55% could be unconstitutional.[124]

Procopio affirms that fiscal overdraft would be confiscatory and so unconstitutional if it request the whole income citing Italian Cassation Court of 8 January 1951.[125]The thesis of absence of limits to ability to pay principle is endorsed by professor Franco Gallo: he affirms that this limit would break correlation between solidarity public expenses contribution duty and public expenses financing, and so between fiscal and social justice.[126]

The first thesis is confirmed by the rules present in article 17[127] of Nice 2001 Fundamental EU Rights Chart and article 1 of Additional Protocol of European Human Rights Convention of 1950 that sanction the respect for every physical or juridical person goods and that "anyone could be deprived of his property but for public utility causes and in conditions established by the law and the principles of International Law"[128]

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diritto tributario, 2013, 28.

123) Even G. FALSITTA , *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l' intero reddito del contribuente*, in Rivista di diritto tributario, 2010, I, 139 agrees saying that in our juridical system is immanent a maximum limit to taxation in.

124)From MOSCHETTI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 52.

125) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 111 and 112. M.S. GIANNINI don't agree with this thesis in *I concetti fondamentali del diritto tributario,* Torino, 1956, 61 ss.

126) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 105.

127) Article 17 text says: "every person has the right to enjoy the property of goods that he has legally purchased, to use these goods, to have these goods available, to let these goods in inheritance. Anyone could be deprived of the property but for public interest cause".

128) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 115. Also G.FALSITTA agrees with this thesis in *I divergenti orientamenti giurisprudenziali in Italia e in Germania sulla incostituzionalità delle imposte dirette che espropriano l`intero reddito del contribuente,* in Rivista di diritto tributario, 2010,Giuffré,Torino, I, 139.

4- Relevant indicators for the determination of ability to pay in Italy: the position of jurisprudence and doctrine expressed by Absolute theory and Relative Theory.

The ability to pay is shown by a situation or an index of economic force ascribable to a citizen.[129] Constitutional rule (Article 53 par. 1) doesn't specify what are the indicators that are fundamental to affirm the existence of ability to pay.

This situation causes an intense debate, mainly in doctrine, where some authors have a restricted conception of the principle and consider only traditionally known indicators like income, property and consumption, whereas others propose an extensive interpretation of the expression that includes all facts or situation that could modify the position of taxpayer in the juridical system[130]; in other words is considered satisfactory a mere economic potentiality[131]

In particular, the first one sees in the ability to pay principle an absolute or external[132] limit for the legislator, and this has as a consequence that ability to pay could be identified only in situations where tax object contains directly the economic resources necessary to pay the levy.[133] In other words the first and most

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129) From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 134 F. TESAURO add that it refers to the whole economic position of taxpayer, see F. TESAURO, *Istituzioni di diritto tributario, Vol. I, parte generale,* Torino, 1991, 55.

130) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 54. See, also, MOSCHETTI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 43. P. BORIA, also, affirmed in *Il sistema tributario,* Torino, 2008, 112 affirmed that flexibility and volatility are main characteristics of Fiscal System.

131) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 98.

132) From F. MOSCHETTI, *La capacità contributiva,* CEDAM, Padova, 1993, 9.

133) See F. MOSCHETTI, *Il principio di capacità contributiva,*Padova, CEDAM, 1973, 258;I. MANZONI, *Il principio della capacità contributiva nell' ordinamento costituzionale italiano,*Giappichelli, Torino, 1965, 13-14; G. GAFFURI, *L' attitudine alla contribuzione,* Giuffré, Milano, 1969, 106 ss, G. TINELLI, *Istituzioni di diritto tributario,* Padova, 2004 and G. FALSITTA, *L' imposta confiscatoria,* in Rivista di diritto tributario, 2008, I, 93 The theory is described by F.GALLO*, Le ragioni del fisco,* Il Mulino, Bologna, 2011, 54. and, also, M.

important limit for legislator is ability to pay principle that produces substantial guarantees[134] for every citizen and rationality principle is subordinate to ability to pay principle[135].

In addiction Absolute limit advocates theory assert that ability to pay principle is an autonomous principle and not a mere specification of Equality principle expressed in Article 3 provisions.[136]

In fact, Falsitta asserts that only facts expressive of economic capacity to pay the levy can be expression of ability to pay, and so facts that consist in money or goods easily transformable in money.[137] He, also, adds that the indicator can be allocated only to his effective possessor.[138] According to that thesis ability to pay could be identified with economic force certain and effective suitable to satisfy fiscal obligation.[139] That idea of ability to pay as a guarantee for " the person" consider the principle as an objective, patrimonial limit that forbid the participation to public expenditure to all subjects that hold vantage positions economically valuable when they lack of patrimonial means.[140]

PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 88.

134) See I. MANZONI, *Il principio della capacità contributiva nell' ordinamento costituzionale italiano,*Giappichelli, Torino, 1965, 50.

135) A. MILONE, *Sovraimposizione nell' imposta sul reddito della società,* Hoepli, 2012, 109 See also A. FANTOZZI that defined rationality as the "last limit" in *Il diritto tributario,* Torino, 2003, 28 and F.MOSCHETTI, *La capacità contributiva,* CEDAM, Padova, 1993, 9.

136) He says that if we consider 53 c. 1 of Italian constitution as a specification of Equality principle we have a *de facto* cancellation of ability to pay principle in Italian juridical system. From F. MOSCHETTI, *La capacità contributiva,* CEDAM, Padova, 1993, 7.

G.FALSITTA agrees with that thesis in *Storia veridica, in base ai "lavori preparatori" della inclusione del principio di capacità contributiva nella Costituzione,* in Rivista di Diritto tributario, 2009, II, 126-127, See, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 12.

137) From FALSITTA, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone and Berliri, , Editoriale Scientifica, Napoli, 2006, 100-101, see, also, F.GALLO that describes this theory in *L'evoluzione del sistema tributario e il principio di capacità contributiva,* Rassegna Tributaria, 2013, I, 3.

138) *ibidem,* 101. See also G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 56-57.

139) A. MILONE, *Sovraimposizione nell' imposta sul reddito della società,* Hoepli, 2012, 110, see, also, G. FALSITTA, *Manuale di diritto tributario,* CEDAM, Padova, 2012, 151 ss.

140)See F.GALLO, *L'evoluzione del sistema tributario e il principio di capacità contributiva,*

As Fedele says, if that theory was accepted by Constitutional Court, many levies present in our fiscal system, Added Value Production Factors Regional Tax *in primis,* would be considered unconstitutional.[141]

Also environmental taxes[142] wouldn't be consistent with Art. 53 par. 1 Constitutional provision (they couldn't surely be part of fiscal area[143]).[144]

The other position sees in the principle of ability to pay a relative limit to the legislator decisions.[145] In other words tax distribution is a political problem whose solution is founded on requirements constituted by the economic and political situation of a country.[146] So the Constitutional judgement is a rationality,[147]

Rassegna Tributaria, 2013, I, 7.

141) From FEDELE , in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri, Editoriale Scientifica, Napoli, 2006, 12. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 98.

142) European Commission defined "environmental tax" a tax whose taxable income is a physical unity of something of that is scientifically demonstrated of negative effects for natural environment when it is used or released". So the basis could be polluting emissions or natural resources consumption. The condition is the presence of a causality nexus between the physical unit and taxable income.

Differently, it is not an environmental tax a levy that has an environmental scope but not contain it in fiscal requirement.

In that case it is an environmental function tax, for example very common so called "refuse tax". From F.GALLO and MARCHETTI, *I presupposti della tassazione ambientale,*Rassegna Tributaria, I, 1999,117 and 119. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 98.

143) F.GALLO and MARCHETTI report that they consider environmental tax as an extrafiscal goal levy in *I presupposti della tassazione ambientale,*Rassegna Tributaria, I, 1999,134.

144) *ibidem,* 13. See, also, G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 56. See, also, Gallo and Marchetti' s thesis that criticized that theory in *I presupposti della tassazione ambientale,*Rassegna Tributaria, I, 1999,138.

145) See G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 54.

146) From G. BORGATTA, *Appunti di scienza delle finanze e diritto finanziario,* Milano , 1935. It was part of citation of F. GALLO, *Le ragioni del fisco,* Bologna, 2011, 81(and also by the same author in *L'evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 1) and A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 85, see, also, S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 13 that in 1965 spotted a similar position in part of Italian fiscal doctrine.

147) As says Constitutional Law professor Gino Scaccia it is a control of logic- juridic defects, see G.SCACCIA, *Gli strumenti della ragionevolezza nel diritto costituzionale,* Milano, 2000, see also A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 98 and 104-105. A. FEDELE affirms that ability to pay is a system total rationality criterion in *Appunti delle lezioni di diritto tributario,* Giappichelli, Torino, 2005, 32-33. Even M. PROCOPIO agrees with that thesis in *Il sistema tributario italiano.Principi istituzionali,* CEDAM,

coherence[148] judgement. In their vision not only an exchangeable good can constitute manifestation of ability to pay but even facts deriving from social relations[149] (even not patrimonial). This concept is also expressed by Nobel Prize Amartya Sen as “capacitation”, that is to say a vantage position in the society.[150]

In their opinion the basis of ability to pay could be found even in not necessarily economical indexes, is satisfactory that the index has an attitude to produce wealth.[151]

They think to Constitutional rule (Art. 53 par.1) as an open expression that has for consequence an elastic principle that gives a wide discretionary margin to legislator (that, however, mustn't establish irrational or arbitrary[152] taxes), according, also, with substantial and formal equality Constitutional principles (Art. 3).[153] On these basis, fiscal requirements must absolutely be objectively derivable as asserted Italian Constitutional Court.[154]

According to that thesis ability to pay become mainly based on distribution or

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Padova, 2012, 86 citing Italian Constitutional Court sentence 111 of 1997: “[Constitutionality judgment] must be a judgment on the rational use of legislator discretionary powers in fiscal legislation and must verify internal coherence of tax internal structure with his founding economic circumstance and also not arbitrary entity of the levy”. See, also, F.GALLO, *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 8.

148) A. MILONE specifies “non contradiction” in *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 114, See, also, F. GALLO, *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 8.

149) F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 83.

150) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,55. See, also, F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 83. Amartya Sen affirms that, next to resources and primary goods, there are other condition that are important for definition of poverty.

151) From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 88. The author, also, affirmed his adhesion to relative limit theory. Even L.CARPENTIERI affirmed that she partially agrees with the thesis in , *L' illusione della progressività,* Dike Giuridica, 2013, 37.

152) From MOSCHETTI, in AA.VV., *Diritto tributario e Corte Costituzionale,* a cura di Perrone e Berliri , Editoriale Scientifica, Napoli, 2006, 45.

153) See F.GALLO, *Le ragioni del fisco,* Il Mulino, Bologna, 2011, 88-89 and an other more recent work written by the same author, *L' evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 9.

154) *ibidem*, 83.

mere subdivision criterion[155]. On the basis of this principle tax limits freedom, ownership and economic potentiality of the individual in order to increase positive freedoms, that is freedom associated with equality purposes.[156] Many authors[157] considered that position as a flattening of the art. 53 principle on art. 3 principle that could give no limits to legislator leaving the citizens in a fiscal oppression situation[158]. Italian Constitutional Court Sentence 16/1965 affirms: "...when the object of taxation is a productive thing the basis of taxation is given by the good's aptitude to produce an economic income, not by the income effectively received by his possessor."[159] Sentence 373/1988 confirms that principle:" It is certainly legitimate and not in contrast with the ability to pay principle custom fee when there is a fiscal requirement - not unreasonably defined by legislator - represented by the entry of goods in national market; and successive events or circumstance that taxpayer doesn't get any utility from these goods are not suitable to exclude fiscal requirement and relationship." Ability to pay is considered to be based on every wealth indicator in 1992 Constitutional Court sentence.[160]

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155) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 96-98. In these pages the author affirmed the passage of concept of ability to pay from an economic dimension to a distribution criterion based dimension. See, also, F. GALLO, *L'evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 1.

156) See F.GALLO, *L'evoluzione del sistema tributario e il principio di capacità contributiva,*Rassegna Tributaria, 2013, I, 5-6.

157) See From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 104. Interesting also La Rosa's thesis that affirmed the distinction of ability to pay from equality principle saying that equality principle integrates equal treatment principle and article 53 line 1 principle establish a fair distribution of fiscal burdens. From S. LA ROSA, *Eguaglianza ed agevolazioni fiscali*, Giuffré, Milano, 1965, 120.

158) A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 111-112. See, also, G. FALSITTA, *Giustizia tributaria e tirannia fiscale,* Giuffré, torino, 2008, 242.

The author says that in many States parliaments introduces confiscatory effect taxes.

159) See also Italian Constitutional Court Sentence 21/1996. According to Procopio' s thesis in that sentence is given relevance even to the aptitude of a good to the production of wealth. From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 100-101. That important Constitutional Court Sentence is even cited by S. LA ROSA in , *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 43.

160) See Italian Constitutional Court Sentence 42/1992.

These affirmations *consider* economic force in itself and not necessarily patrimonial elements referable to taxpayer creating an "objective profile" to the ability to pay principle.[161]

The statements of the sentence 156/2001 of the Constitutional Court are very important: "In the IRAP case, not irrationally, legislator identified as new index of ability to pay , different from these used for other levies, the value added produced by autonomously organized activities."Apropos Professor Franco Gallo defined this interpretation as an evolution oriented interpretation.[162]

Doctrine also gives some examples of goods that are not patrimonial but are manifestation of wealth like goods with destination different from enterprise activity or fringe benefits.[163]

Reading Italian Constitutional Court reported statements it is clear that there was, in its position, a shift from Absolute Limit theory to Relative Limit theory[164], especially due an evolution oriented interpretation of constitutional provisions and considering also the influence of Art. 2 and 3 Constitutional principles.

Returning to environmental taxes, considering this, second theory, there is no doubt about their accordance to constitutional provision because the pollution or the use of natural resources are considered as the utilization of a luxury good.[165]

This is possible even if fiscal requirements (as prof. Gallo suggests, they have to be commensurate to damages that it could cause to natural environment comparing with other less polluting emissions[166]) haven't any direct patrimonial

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161) See G.MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013,56-57. See, also, From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 144 ss; See, also Italian Constitutional Court sentences 164/1993, 143/1995,21/1996, 111/1997 and 21/2005 and 223/2012.

162)F. GALLO, *Le ragioni del fisco*, Il Mulino, Bologna, 2011, 92.

163) *ibidem*, 83.

164) See G.MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013,56. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 100-101

165) F.GALLO and MARCHETTI, *I presupposti della tassazione ambientale*, Rassegna Tributaria, I, 1999,134 and 144.

166) F.GALLO, *Le ragioni del fisco*, Il Mulino, Bologna, 2011, 94-95.

value and couldn't be exchangeable in the market as asserted by Relative Limit theory advocates.[167]

5- Do environmental taxes respect ability to pay principle?

As explained before, environmental taxes are taxes whose taxable income is a physical unity of something of that is scientifically demonstrated of negative effects for natural environment when it is used or released.

The logic on the basis of this fiscal burden could be found in an economic compensation from the polluter to the community that receives damages from the polluting activity in order to finance public services to prevent environmental deterioration[168] or in Negative Externalities Pigouvian Economic Theory that see environmental taxes as a balance of negative externalities caused by polluting activity.

In that kind of tax the economic circumstance on which it is based is directly linked to the environment: in fact are environmental taxes Carbon Tax, on CO_2 emissions and also taxation on environmental not friendly goods consumption.

Ficari don't think that this duty is an ability to pay principle based tax but a scope tax with compensation function[169], differently, as wrote before Gallo and Marchetti thinks that they are based on ability to pay principle because they hit the consumption of a luxury good (because of the use of natural resources of or the

167) *ibidem*, 93.

168) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 101.

169) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 102-103. See, also, V.FICARI, *Prime note sull' autonomia tributaria delle regioni a statuto speciale (e della Sardegna in particolare),* in Rassegna tributaria, 2001, 1307.

pollution)[170].

According to Fedele' s opinion environmental tax couldn't considered against article 53 line 1 constitutional principle if we considered it an extrafiscal tax[171], so a tax established for scopes different from the contribution to public expenditure.[172]

Moschetti and Falsitta consider these kind of taxes as extraneous to ability to pay principle and asserts that they are a sort of “exchange-taxes”.

Procopio asserts that, in this case ability to pay is identified in vantage position enjoyed by the subject who uses not environmental friendly goods or inputs polluting emissions.[173]

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170) F.GALLO and MARCHETTI, *I presupposti della tassazione ambientale,* Rassegna Tributaria, I, 1999,134 and 144.

171) According to the italian doctrine extrafiscal use of levys don' t contrast with ability to pay principle, See S. LA ROSA, *Eguaglianza ed agevolazioni fiscali*,Giuffré, Milano, 1965, 30-35.

The author affirms that it must be compatible with uniform distribution of fiscal burdens.

172)See A. FEDELE, *Appunti delle lezioni di diritto tributario,* Giappichelli, Torino, 2005, 31 ss.

See, also, MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 238-240 that considered it an “ethic tax”, like Robin Hood Tax and Pornotax. The author defined this fiscal burden as a sor of compensation for negative externalities released in the environment.

173) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 106-107.

Chapter III

Progressivity principle.

Progressivity principle is expressed in Article 53 paragraph 2 of the Italian Republican Constitution, which says: “The fiscal system is informed by progressivity criteria”. This Constitutional principle has a guideline value for Italian fiscal legislator.[174]

This principle started to spread between the revolutionary environment of XIX Century: in fact the project of a progressive tax was debated in Napoleonic 1797 *Repubblica Cisalpina*[175] and was also present in anonymous Project for a Constitution for a Free and Independent Italy of 1835.

The first[176], rejected project for a progressive tax was presented to the French Parliament after 1848 Third French Revolution[177] by socialist Proudhon and got only two favourable votes.[178]

The principle was for the first time justified by Holland' s fiscal doctrine: on the

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174) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 118, See, also, F.FORTE, *Il problema della progressività con particolare riguardo al sistema tributario italiano,* in Rivista di diritto finanziario e scienza delle finanze, 1952, 301 ss.

175) Article 12 of *Repubblica Cisalpina's* Constitutional project stated “They [All the Italians] partecipate indiscriminately to State expenses in progressive proportion of their wealth.”.

From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 21-22.

176) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 19.

177) That revolution, promoted by socialists and Republicans, overthrew Louis- Philippe d'Orléan's liberal monarchy, established in 1830 after the overthrown of reactionary legitimacy principle advocate sovereign Charles X due to his contrast with French Parliament.

However the revolutionary period lasted for less than one year because General Cavignac became Prime Minister after a few months and Louis Napoleon, leader of Bonapartist party (*Parti de l' Ordre)* was elected Chief of the State. Few years after Louis Napoleon, with *a coup d' état,* proclaimed himself “Emperor of Second French Empire”. Second French Empire lasted 18 years, until 1870, when Napoleon III resigned from his position due to Sedan defeat and began French Third Repubblic (1870-1940).

178) That reform will be realised in France only in 1914 when was approved Joseph Caillaux reform that introduced a progressive tax on phisical person income.

basis of economic concept of marginal utility (decreasing) they theorised that on different incomes we can produce the same sacrifice with duties that increases with the increasing of the income.[179]

An important author that affirmed the necessity of a progressive fiscal system was Wagner in the end of XIX century on the basis of fiscal equality principle; according to his thesis progressivity make citizens sacrifices really equal.[180]

In Italy Progressivity was for the first time considered with favour from doctrine in *Belle Époque* age[181], the firsts progressive tax rates were introduced after World War I and, after a few years *Regio Decreto* number 3602 of 30 December 1923 established for the first time a progressive personal income tax that will last until '70 s years.[182]

New Constitutional provision reflects the deep political and social change that took place in '40 s Italy: so fiscal law passed from an exceptional and limiting concept to the mean that consent to realise social policy expected in the new Italian Constitutional Chart.[183]

The principle is not referring to the single tax but to the whole fiscal system[184], so

179) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 20 and 25. A similar concept was expressed by 1862 famous Italian Finance Minister *Quintino Sella* that affirmed: “A tax of 10% on all will seem fair, because it asks to person that gain 10 £ 1 £ and to the person who gain 1£ 10 cents, but if poor 's only £ needs to save him from famine and the tenth £ to the rich is spent for the theatre the sacrifices are different because the thing that for both is called £ haven' t the same importance.”.

180) See S. LA ROSA, *Eguaglianza ed agevolazioni fiscali*, Giuffré, Milano, 1965, 26-27 and 37. The author also agrees with this thesis defining it as “tax equalization”.

181) See G.RICCA SALERNO, *L'imposta progressiva e le riforme tributarie di alcuni stati europei*, Roma, 1894, and, also, F.S.NITTI, *Principi di scienza delle finanze*, Napoli, 1905.

182) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 27-28 and 58 ss .

183) See L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 30-31.

184) See G.MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013,76. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 119, R. LUPI, *Diritto tributario-Parte generale*, Milano, Giuffré, 2009. See also Italian Constitutional Court Sentences 12/1960 and 159/1987. I report here the statement of the first sentence “ Progressivity principle, sanctioned in article 53 line 2 of Italian Constitutional Chart, concerns the whole fiscal system, not the singular taxes.” Important, also, Constitutional Court Sentence 102/2008 that affirms that even a regressive tax as Sardinian Regional Yacht Tax doesn't contrast with progressivity principle because it refers to the whole fiscal system. According to

is not necessary that all taxes are progressive. In Constitutional Court sentence 23/1968 it is affirmed that “the principle has to be considered only in relation with the whole fiscal system and not in relation to single taxes”.

The principle is, also, confirmed in successive sentence 159/1985.

Progressivity is not only referred to fiscal rates but to progressivity criteria: a combination of elements and circumstances that characterise the behaviour of tax passive subjects.[185]

Function of the principle is not only to guarantee redistribution of the wealth[186] but also it has a political- social scope[187]: it reflects in fiscal subject Substantive equality principle, expressed in Article 3, line 2 Constitutional provisions.[188]

Carpentieri defined it as an explication of economic, social and political solidarity principles (affirmed in Article 2 of Italian Constitution) and also of Substantive Equality principle (Art. 3 of Italian Repubblican Constitution).[189]The same author,

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L.CARPENTIERI' s thesis expressed in See *L' illusione della progressività*, Dike Giuridica, 2013, 44- 45 it was determined by a precise choice of Constituent legislators that imagined that progressive taxation was more suitable for personal income taxes. See, also, Atti Parlamentari dell' Assemblea Costituente, Roma, Tipografia della Camera Dei Deputati, 1947, CXXX, 4204. That thesis find also the favour of Italian Constitutional Court, expressed in Sentences 128/1966, 159/1985, 263/1994, 143/1995. Clearly, consequence of this choice is a bigger discretionary power for Italian legislator.

185) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 119.

186) See I. MANZONI, *Il principio della capacità contributiva nell' ordinamento costituzionale italiano,* 185, Giappichelli, Torino, 1965. L. PALADIN affirms that this principle permits the attenuation of discrepancy existing between all classes of taxpayers in *Il principio di egualglianza tributaria nella giurisprudenza costituzionale,* in Rivista di diritto tributario, 1997, 305 ss. According with Procopio 's thesis it absolves a social function, founded on solidarity and an economic function, because social disparity cause the reduction of consumption that determine the reduction of Gross Domestic Product. From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 122. See, also, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 32-33 and G.FALSITTA, *L' imposta confiscatoria,* Rivista di diritto tributario, 2008,II, 122.

187) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 120.

188) It reinforces Substantive Equality principle realizing Economic Solidarity principle, expressed in Article 2 Constitutional Provisions. See M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2012, 120.

189) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 32. See, also, F.MOSCHETTI, *Il principio della capacità contributiva,* Padova, 1973, 200,

also, asserts that it represents the goal of ability to pay principle imposing fiscal equity in subdivision of public expenditure.[190]

As affirms Professor Franco Gallo progressivity balances property rights with citizenship rights.[191]This thesis isn't seen with favour[192] by part of the doctrine that consider it as a vacuous[193] or approximated [194] obligation for Italian legislator. In our fiscal system there are many proportional taxes[195] like IRAP[196], Corporate Income Tax (IRES)[197], Obligation profit taxation, VAT, etc. and one only important progressive levy: IRPEF.

It is a tax on physical person income, regulated in law 917/1986 (known as TUIR), that predicts a class taxation: the person is taxed for a determined percentage that increases with increasing income for every class[198].

As we easily see the presence of 5 classes[199] and the exemption of so called vital

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C.SACCHETTO, voce *Tassa*, in Encyclopedia del diritto, Padova, 1956, P. RUSSO, *Manuale di diritto tributario,* parte generale, Milano, 2002, 60 ss, P.BORIA, *L' interesse fiscale,* Torino, 2002, 115, See, also Italian Constitutional Court Sentence 155/2001.

190) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 43.

191)See F. GALLO, *Diseguaglianze, giustizia distributiva e principio di progressività,* in Rassegna Tributaria, 2012, II, 290 ss.

192) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 33.

193) See G. FALSITTA, *Manuale di diritto tributario, parte generale,* Padova, 2012,190.

194) See P.BORIA, *Sistema tributario,* UTET, Torino, 2008, 87.

195) For example Capital income taxes avoid progressive taxation because of a replacement tax. See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 144 .

196) Carpentieri affirms the regressivity of that tax for its structure and effects: the tax put work cost in taxable income advantaging more modern business activities that hold more knowhow and less workforce imposing more important fiscal burden to old enterprises that employ greater number of workers. See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 66; See, also, G.TREMONTI, *Una nota di politica fiscale: la crisi dell' IRPEF e la questione della progressività. Il caso dell' Italia, in Rivista di diritto finanziario,* 1999, 17 ss.

197) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 144.

198) If Caius has a net income of 100,000 Euro his income is covered by 5 classes: as says art. 11 of law 917/1986 on the firsts 15,000 Euro it has to pay (as gross tax) 23%, on the seconds 13,000 (15-28,000) the 28%, on the thirds 27,000 Euro (28-55,000) the 38%, on the fourth 20,000 (55-75,000) the 41% and on the last class it has to pay 43%. (the highest class)

199) In his first version personal income tax was more progressive: in fact in 1974 we have 34 classes of income, reduced to 9 in 1983, to 7 in 1989 that became 5 in 1998.

At the beginning (1974) the highest marginal rate was 82 %, then reduced to 65% in 1983, to 50% in 1993, to 39% in 2003, due to Berlusconi' s tax cuts. As I wrote before the rate was re-increased to 43% by 2006 financial law (law 296/2006). See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 61 and 144.

minimum[200] guarantees the progressivity of the whole Italian fiscal system.[201]

Progressivity is also represented by other factors like the expansion of taxable income (so called no tax area),ISEE(Equivalent Economic Situation Indicator)[202] also deductions.[203] As affirms former Finance Minister Vincenzo Visco this instrument must be used to organise horizontal equity problems[204].

The principle was mentioned for the first time by Italian Constitutional Court

200) As article 11, paragraph 2 of law 917/1986 says, if a person receives only pension income for a maximum of 7500 Euro and land income inferior to 185,92 Euro and his house income, he is excluded from the payment of this tax.

As paragraph 3 of the same article says, if a person receives less than 500 Euro of land income, not receiving other kinds of income, they mustn't pay the levy. As we could easily see, the vital minimum principle is applied in marginal cases because its beneficiaries are almost only very low pension income receivers. For example, a worker that earns a 500 Euro monthly salary must give 23% of his very low salary to contribute to public expenditure (not counting subtractions and deductions).

See, also, G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013,76.

201) A progressive tax with many classes is characteristic of socialist systems, the opposite is characteristic of laissez faire systems. In 2001 Silvio Berlusconi's electoral programme there were only two classes (23% and 33% and a “no tax area” for very low incomes) This system, as affirms M.PROCOPIO in *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 124 would introduce in Italy a flat tax because only 0,4 % of Italian taxpayers gain more than 100,000 euro par year, so IRPEF would hit the same percentage of income for 99,6 % of taxpayers.The author asserts that it would have create a regressive tax system probably in contrast with Constitutional progressivity principle. This project wasn't completely realised with 2003 tax reform that created no tax area and lowered mainly the highest classes bringing the highest from 48% to 39%. However our system remained with many classes and the highest class was still higher than 2001 project prevision. This system was applied for only three years, until law 296/2006 that put all the five classes on higher level (but less than *ante 2003 reform* period) and abolished no tax area leaving only an exclusion for total personal income of less than 7500 Euro. Although very much criticized, Prodian tax reform has remained still unchanged, mainly due to Italian State financial situation. See, also, about failed attempt to introduce flat tax in Italy, L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 160-165.

202) It measures Economic conditions of families, on the base of their income, their estate and other characteristics of nuclear family.It determines the receiver of welfare services. From L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 150-153.

203) In Italy art. 10 of law 917/1986 contains a long list of deduction hypothesis, for example some medical expenses, alimonies, etc.. Art. 13 contains hypothesis of subtractions for family burdens (for the spouse and even for sons).

Art. 15 includes cases of subtraction for some expenses like passive interests, donations, rental rates, etc.

See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 46-47.

204) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 47 and 146. According to Visco' s theories equity is distinguished in vertical equity that determines the increasing of taxation with the increasing of the income and horizontal equity that change the level of taxation of two equal incomes on the strength of personal conditions.

jurisprudence[205] in sentence 129/1957[206] where is affirmed progressivity of taxation; in successive sentence 128/1966 is asserted " taxes consent to burden mainly the higher income receivers and, in this way, make contribution to public expenses appropriate to individual ability to pay."[207] In important Italian Constitutional Court Sentence 155/2001 progressivity is defined as "further progression, in specific fiscal subject, of Equality Constitutional principle, linked to the duty to remove economic- social barriers *de facto* existing to freedom and equality of persons-citizens according with the aim of political, economical and social solidarity (Article 2 and 3 of Italian Republican Constitution)." With this statement constitutional court show a partial adhesion to Relative Limit Theory of ability to pay principle.[208]

The importance of Article 53, line 2 principle is, also reaffirmed by United Sections of Cassation Court Sentences 30055, 30056 and 30057 of 23 December 2008 that asserted the existence of a general principle against tax avoidance, based on Article 53 of Italian Constitution Principles. In particular Sentence 30555/2008 affirmed: " The principles of "ability to pay and progressivity of taxation are the basis of normal fiscal rules and also of rules that give advantages and benefits..."[209]

If there wasn't progressivity our fiscal system wouldn't be redistributive but only contributory and it wouldn't so be possible to consider the idea of substantial

205) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 48.

206) It was just the second year of activity Italian Constitutional Court.

207) See, also, Italian Constitutional Court Sentence 179/1976.

208) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 49-51. In this work the author criticized the position expressed by Constitutional Court in Sentence 155/2001.

209) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 51 ss,

See, also, G.FRANSONI, *Appunti su abuso del diritto e "valide ragioni economiche",* in Rassegna Tributaria, 2010, IV, 932 ss; V. FICARI, *Clausola generale antielusiva, articolo 53 della Costituzione e regole giurisprudenziali*, in Rassegna Tributaria, II, 2009, 390 ss; A. GIOVANNINI, *Il divieto di abuso del dirittoin ambito tributario come principio generale dell' ordinaento,* in Rassegna Tributaria, 2010, IV, 982 ss; E. DE MITA, *L' anti-elusione trova una base in costituzione,* in Diritto e pratica tributaria, 2009, 393 ss.

equality, expressed in Article 3, paragraph 2 Constitutional principle.[210] It is, in fact, a fundamental basis of what in Europe is well known as welfare state.[211]

210) See G.MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013,76.

211) In modern history a first example of progressive tax are Revenue Act 1862 tax and UK income tax after 1909 Asquith's tax reform (so called People's Budget).

Chapter IV

Other rules related to the substantive equality principle.

1- Substantive equality principle as the basis of different treatment for different situations.

If different situations receive the same treatment equality principle is not really respected because people won't surely have the same opportunities; so Art. 3 Constitutional principle impose to legislator to regulate differently different situations[212] and to promote and improve citizen economic and social situation.[213]

The principle was, also, affirmed in the European Treaty where article 2 of TFUE affirms:”The Union is founded on the values of respect for human dignity, freedom, democracy, equality...”.

As we have seen before this principle is very much linked to the progressivity principle, because progressive taxation, making it possible the redistribution of wealth, gives more chances to low income receivers[214]; but there are also other measures that could increase fairness between high income and low income receivers: for example, particular sectors could be more heavily taxed, in reason of speculative nature of their activities, or, in other cases, it is possible to concede

212) The concept is clearly expressed in Italian Constitutional Court Sentence 155/1963 statement: “[Article 53], constituting the specific development of Equality Principle, expressed in article 3 of Constitution represent the necessity , for income taxes of equal taxation for equal incomes and different taxation for different incomes”. See, also, M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2012, 85.

213) See G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 58-59.

214) See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 32. See, also, F.MOSCHETTI, *Il principio della capacità contributiva,* Padova, 1973, 200, C.SACCHETTO, voce *Tassa*, in Encyclopedia del diritto, Padova, 1956, P. RUSSO, *Manuale di diritto tributario,* parte generale, Milano, 2002, 60 ss, P.BORIA, *L' interesse fiscale,* Torino, 2002, 115, See, also Italian Constitutional Court Sentence 155/2001.

favourable tax regimes, in reason of the activity nature.[215]

About favourable tax regimes, doctrine and jurisprudence assert their accordance with constitution if they are directed to Article 3 par. 2 principle that justifies a different treatment to promote the improvement of citizen conditions or involve other constitutional values like family, education[216], assistance, cooperation, etc.[217]

In the following paragraphs it is possible to see what are the other measures adopted by the Italian legislator and some proposals that favour the idea of a fairer fiscal system.

2- Substantive equality and discouragement of speculative activity.

Before 2008, every year, the importance of the financial sector of the market increased together with US Gross Domestic product. In that situation, managers got retributions (composed mainly by bonuses and stock options) 200-300 times higher than normal workers[218], for operations that, in many cases, had only speculative scope. It was also the period when high speed transactions were developed, which consisted in buying or selling a financial instrument several times in a single day. In 1990, the average finance operator salary was 18% higher than that of a normal worker, in 2007 it was 52% higher, and in 2006 Wall Street

215) As I wrote before this phenomenon is called “qualitative discrimination”. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 129 and 133.

216) See Sentence 108/1983.

217) See G.MELIS, *Lezioni di diritto tributario*, Giappichelli, Torino, 2013, 61-62.

218) From FREEMAN, *Ricerche: il lavoro in tempo di crisi tra riforme legislative ed evoluzione della contrattazione collettiva. Nuovi ruoli per i sindacati e per la contrattazione collettiva dopo l' implosione del capitalismo di Wall Street*, Diritto delle relazioni industriali, 2012, II, 268.

paid 62 billion as bonuses.[219]

Professor Franco Gallo noted that even in 2007 Italy the level of financial transactions reached the 73,5% of Gross Domestic Product, so he affirmed that financial products prices were wrong and that the gigantic growth of circulation of these things produced a planetary dimension market failure.[220]

When the financial crisis spread, the Americans discovered that the average family debt was more than 200% their annual income per capita and that many important banks and firms were near to financial collapse.

It was the beginning of a very long financial crisis like the '30s Great Depression, which is still ongoing today.

These facts persuaded many people that compensation with bonuses and stock options incentivizes dangerous decisions of managers and directors.[221]

Two remedies to these important problems could be the introduction of a tax on financial transactions and an additional tax on stock options and bonuses.

Tobin Tax[222] was elaborated more than forty years ago by the economist James Tobin that proposed to tax financial transactions[223] in order to make our financial system more stable.[224] In that case fiscal requirement is shares and similar products ownership transfer.[225]

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219) *ibidem*, 268.

220) See F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 44-45.

221) From FREEMAN, *Ricerche: il lavoro in tempo di crisi tra riforme legislative ed evoluzione della contrattazione collettiva. Nuovi ruoli per i sindacati e per la contrattazione collettiva dopo l' implosione del capitalismo di Wall Street*, Diritto delle relazioni industriali, 2012, II, 268.

222) Professor Franco Gallo defined it as “tassa parapatrimoniale”. The greek origin prefix “para” could be translated in english with “similar to”. So it means “ taxes similar to real estate taxes.” From F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 44.

223) The Bank of Italy defined this tax as an “ownership transfert tax” in 11 march 2014 Communication “ Budgetary and Surveillance Advisories” (Bilancio e segnalazioni di vigilanza).

224) From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2013, 475.

225)From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali*, CEDAM, Padova, 2013, 476-477. According to the author even conferiments are interested by the tax. See, also, F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 47.

Important principles are[226]:

-territoriality principle that affirms that tax is paid where the enterprise has his fiscal residence

- the proportionality of the levy

- the calculation of the tax is based on transaction value

- it is an indirect tax and *de facto taxpayer* is shares purchaser

After the financial crisis, many, also, said that it could also redistribute crisis costs (paid by governments and definitively by families and enterprises) and eliminate transactions that are not efficient (especially transactions with only speculative scope, mainly high-frequency transactions) creating, in that way a sort of financial carbon tax.[227]

The best solution would be that every transaction in the world should pay that levy but this isn't easily possible, so some countries made isolated attempts in that direction.

Probably, to realise the idea is necessary a combined effort of many countries because if a Financial Transactions Tax is established in only one country it could provoke a strong decline of financial transactions and, in consequence a little revenue for the State and also negative effects for the economy as it happened in '80 s in Sweden when was introduced that kind of tax.[228]

The detractors of that kind of tax affirms that it could cause a financial transactions reduction and some of them[229] propose the introduction of FAT or bank levy on the possession of risky financial activities, assuming, as taxable income, profits that overtake a pre-fixed threshold. Professor Franco Gallo, in contrast with their opinion state that the effect of FAT could be too limited

226) *Ibidem*,478, 479 and 480.

227) See F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 44, 46

228) As wrote M.PROCOPIO the revenue was the fourth part of expected revenue and the number of financial transactions dropped significantly. From M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 475.

229) Even IMF proposed the introduction, of this, alternative tax.

because the tax don't hit financial profits gained by an enterprise in deficit and that transactions reduction wouldn't have really negative effects because it consists, *de facto,* in elimination of transactions that are not efficient for the Market.[230]

For example France and Italy[231] put on financial transactions a sort of Tobin Tax in 2012; Italian rule, that establishes taxation over shares, similar instruments and relative derived transfers[232] was heavily criticized[233], mainly because it did not tax intra-day transactions, in fact that levy brought only 280 million Euro revenues[234].

In European the question was discussed since 2001, European Parliament adopted three resolutions in favour of the introduction of this tax[235] and, after may years, in 2012 ECOFIN council approved a Directive proposition. After the UK reject of the project EU presented a Directive Project for a Strengthened Cooperation in order to introduce the levy.[236]

European Commission estimated the revenue that could generate this kind of taxation to the sum of 60 billion Euros (three times more than an an Italian State annual financial budget).[237] As the project says, the tax would be paid by financial entities for every transaction, on the basis of the financial instrument value if the instrument is not a derived, and, in the other case, on the basis of his notional.[238]

In Italy, the taxation system for Stock Options and Bonuses changed many times in almost 10 years: in 1999 a favourable taxation regime was introduced, that if

230) See F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 46-47.

231) The tax was introduced in Italian fiscal system by Article 1, line 491 of Financial Law number 228 of 2012 that was applied to financial transactions since the 1st March 2013.

232) These operations are only part of transactions that would be taxed in Communitarian Project of Tobin Tax.

233) F. GALLO affirmed that the tax introduced in Italy was a very reduced version of communitarian model that consists, *de facto,* in a reintroduction of abrogated Stock Exchanges Stamp Duty in *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 45, 49.

234) See E. BENETAZZO, *Investimenti e tassazione*, Trend-online, 13-03-2014

235) Gallo noted favourable resolutions of 10 and 25 march 2010 and of 8 march 2011.See From F.GALLO, *Mercati finanziari e fiscalità,* Rassegna Tributaria, 2013, I, 45

236) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 480

237) See F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 45

238) M. PROCOPIO, *Il sistema tributario italiano. Principi istituzionali,* CEDAM, Padova, 2013, 481-483

some conditions (holding period etc.) were respected, the capital gain received was taxed with only 12,5 % withholding tax.

A 2008 reform[239] suppressed that rule, so the capital gain was subject to ordinary physical persons income taxation that, as previously explained, is a progressive levy for classes. Due to this modifications, it is probable that taxpayer that before 2008 paid 12,5% in 2009 paid 43% (I refer to a manager, for example).

Less than two years later, a new rule[240] introduced an additional taxation[241] of 10% for Bonuses and Stock Options (taxable income is in that case represented by the portion of income distributed in form of stock options, considering their normal value[242]) if these benefits overtake the triple of the worker fixed payment[243].

The rule is implemented for financial sector managers[244]. These not precise definitions create interpretation doubts: there is not an Italian rule that defines financial sector and also, not all managers have an activity linked with financial speculations.[245] About the first question, Agenzia Delle Entrate gave to the rule an extensive, and probably contra legem interpretation in Circular 4/E of 2011.

So it includes banks, management trusts, brokerage film, exchange dealers,

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239) Law Decree 112/2008

240) art. 33 of Law Decree 78/2010

241) Petrucci affirms that are applicable normal income tax rule and that tax is mainly conditioned by cash basis. The opposite thesis is affirmed by Trettel that cited Agenzia Delle Entrate Circular 4/E of 2011. The same author, also, asserted that settlement and payment of the tax should be performed by the payer. See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario*, from Corriere Tributario, 2010, XXXIII, 2749. See, also, S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle "Stock options" dei manager,* from Corriere Tributario, 2011, XIII, 1028-1029.

242) See Article 9, line 4 of TUIR.

243) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario*, from Corriere Tributario, 2010, XXXIII, 2747, 2750, See, also, S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle "Stock options" dei manager,* from Corriere Tributario, 2011, XIII, 1027.

244) As precised by Agenzia Delle Entrate Circular 4/E of 2011 for the identification of passive subject of passive subject we have to see the category indicated in work contract.

245) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2749.

entities that manage electronic money emission activity, finance companies[246] and holdings that underwrite and/or manage participations in financial, credit or industrial companies.[247]

The insertion of industrial holding in the list, in Trettel' s, opinion is a “stretching of legislative text” because industrial holdings are surely not part of financial sector.[248] So Italian financial administration mustn't comply with the proposed interpretation for industrial holdings point because in Italian juridical system doesn't permit the existence of *contra-leges* interpretations.[249]

In technical note of Law 122/2010 (Law Decree 78/2010 conversion law) is contained a forecast of 10 million revenues par year from this additional tax. In legislator opinion the taxpayers interested by the new rule were 5200 people, therefore some experts criticized this prevision asserting that stock options payment is typical of Anglo-saxon investment banks and that many managers, based in Italy hold their registered address in London.[250]

After a few months the rule was modified by Law Decree 98/2011 that changed taxation threshold: in consequence of the reform from July 2011 the additional hit the portion of payment exceeding manager fixed payment.[251] The outcome was

246) See Article 59, line 1, letter b) of TUB (Legislative Decree n. 385/1993), Testo Unico Bancario. We could translate it with the expression “Unique Bank Act”.

247) See S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle “Stock options” dei manager,* from Corriere Tributario, 2011, XIII, 1030.

248) See S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle “Stock options” dei manager,* from Corriere Tributario, 2011, XIII, 1030.

249) See Article 12, line 1 of Prelaws of Italian Civil Code that affirms: “In the application of the law is impossible to give it other meaning different from meaning make clear by the typical sense of the words [that compose legislative text] according to their connection and, also, to legislator intention.”. That provision was surely influenced by Article 4 of Napoleonic 1804 *Code Civil* that affirmed *“le juge ne doit être que la bouche de la loi...”*, expression that could be translated in “ the judge must be the call of the law...”.

Also important is article 101 of Italian Repubblican Constitution that state: “The judges are conditional only upon the law.”.

250) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario,* from Corriere Tributario, 2010, XXXIII, 2751, See, also, L.SERAFIN, “*Giro di vite soft sulle stock options”,* in Il Sole 24 Ore, 27-V-2010, 11.

251) From A. ANTONELLI and A.MENGOZZI, *Nuova stretta sulle stock options,* from Il Sole 24 Ore, 19 luglio, 2011.

that the same taxpayer that 5 years before paid 12,5% on his stock options income, had to pay in 2012 the 47,3%.

That decision was based on decisions taken on Pittsburgh 2009 G20[252] and the intention on the strength of was made this important choice was to increase taxation for managers that realised important profits with dangerous operations; (because stock options payment encourage exclusively speculative risky because the immediate profit for the company correspond with an immediate profit for the manager) operations that were one of the main causes of 2008 financial collapse.

As affirmed in G20 the taxation must interest people whose activity is linked to financial subjects risks. This guideline was not respected by the Italian government, which put the additional tax on every financial sector operator without any type of selection of dangerous activities creating, so, a sort of "objective responsibility" for every worker paid with stock options.[253]

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252) I report here the part of Pittsburgh G 20 document that concern stock options taxation (lines 15 and 16:

" The G-20 must fulfil the commitment subscribed to in London on pay and compensation to encourage sound risk management and a strong link between compensation and long-term performance, while ensuring a level playing-field.

In particular, the G-20 should commit to agreeing to binding rules for financial institutions on variable remunerations backed up by the threat of sanctions at the national level, covering the following principles:

a) enhanced governance to ensure appropriate board oversight of compensation and risk; b) strengthened transparency and disclosure requirements;

c) variable remunerations including bonuses to be set at an appropriate level in relation to fixed remuneration and made dependent on the performances of the bank, the business unit and the individuals; taking due account of negative developments, so as to avoid guaranteed bonuses; the payment of a major part of significant variable compensations must be deferred over time for an appropriate period and could be cancelled in case of a negative development in the bank's performance;

d) prevent stock options from being exercised, and stocks received from being sold, for an appropriate period of time;

e) prevent directors and officers from being completely sheltered from risk;

f) give supervisory boards the means to reduce compensations in case of deterioration of the performance of the bank;

g) explore ways to limit total variable remuneration in a bank to a certain proportion either of total compensation or of the bank's revenues and/or profits.

253) See F.PETRUCCI, *L' Imposta addizionale sui bonus per i manager del settore finanziario*, from Corriere Tributario, 2010, XXXIII, 2747-2748. See, also,S.TRETTEL, *Dubbi interpretativi per l' addizionale IRPEF sulle "Stock options" dei manager,* from Corriere

As many experts think, a favourable tax regime to this kind of income like the prior 2008 situation is not fair and also encourages dangerous decisions of market operators and operations with speculative scope only, which don’t improve the real economy.
Due to this rule a few number of taxpayers would have a worse fiscal treatment; that discrimination could be considered a qualitative discrimination based on the nature of that kind of income, usually generated by speculative scope activities.
In my opinion the rule respects, according with the concept of “ethic tax”[254], articles 3 and 53 of Italian 1948 Constitutions only if bonuses are directly connected to dangerous operations, in other cases we are in presence of an irrational discrimination, so the examined rule should be declared partially unconstitutional.
Hollande's loi financiaire 2013 rules are also not fair because they established for the part exceeding 1 million Euro a taxation that could reach 79,5%, which is clearly confiscatory[255], according to French[256], German[257], Brazilian[258] and Argentinean[259] constitutional jurisprudence. So it isn't in compliance with art. 53 par.1 ability to pay constitutional principle.
The right decision seems to be the Italian government decision that abolished withholding favourable flat tax and introduced progressive income taxation.
Even 10% additional, for his amount and considering the situation, could be considered as progressive taxation, fair and reasonable.

Tributario, 2011, XIII, 1028.
254) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 231- 237.
255) See *Conseil d' état* decision 662/2012.
256) See Chapeter II, page 11 and 12.
257) See Chapeter II, page 11 and 12.
258) See Chapeter II, page 11 and 12.
259) See Chapeter II, page 11 and 12.

3- Discouraging scope taxes: extrafiscal utilization of taxation.

There are some taxes put by the legislator that want to discourage the utilization of some products: for example in Northern Europe alcoholic products are heavily taxed by governments as a mean to fight alcoholism, notoriously a social plague in these countries.

Even in Italy, for example, tobacco products are heavily taxed by the government for the same reason.

The strange fact is that the goal of the law is reached if these taxes don' t produce any income.[260]

These levies condition consumer and producer choices.[261]

As asserts part of the doctrine (mainly absolute limit theory advocates) even environmental taxes enter in that kind of taxation because they discourage some conducts.

Defined by *Agenzia delle Entrate* communicate 103895 as an “ethic” tax[262], Pornotax[263] is an ordinary autonomous special[264] additional 25%[265] tax applied to

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260) See G. MELIS , *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 62.

261) *ibidem*, 62.

262) Ethic taxes can be explained with this reasoning: in modern Constitutional systems the man is different from *homo oeconomicus* (mainly as described by Amartya Sen), he is a beeing with politic , social and moral relations, so he is part of a community that forms a juridical system.

So, in Italian juridical system economic freedom and property rights are values protected by the Constitution but are not the fundamental basis of our juridical system: in fact other values also are part of our constitutional system like equality (formal and substantive, art. 3), solidarity (art. 2), protection of community material and spiritual progress (art. 4), promotion of cultural development (art. 9) , protection of mores (art. 21), protection of the family (art. 29), protection of Youth and Childhood (art. 31), Health protection (art. 32), free and fair existence (art. 36).

So economic values should be necessarily counterbalanced with these other values.

In consequence of that is admissible a qualitative discrimination founded on ethic basis (like Pornotax case) when an other constitutional rule prevail in counterbalance with ability to pay principle. See MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 231-238.

263) Introduced by art. 1 par. 466 of of law 266/2005.

enterprises that distribute items that are pornographic or inciting to violence, or encourage the popular credulity.

The generating circumstance is represented by the possession of enterprise incomes deriving from activities of production, distribution, selling and representation of pornographic[266], violence inciting[267] or costly soliciting of popular credulity[268] objects.[269]

The tax could be considered not in contrast with ability to pay principle considering it an extrafiscal tax use in order to protect a Constitutional value

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264) The author of this definition is A.MILONE in *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 309.

265) Law Decree 112/2008. As Fantozzi said "In additional tax an other tax rate is applied on the tax amount and not on the taxable income. From A. FANTOZZI, *Diritto tributario,* UTET, Torino, 1991, 51. Examples of additional taxes in Italian juridical system are Extraordinary IRPEG Additional Tax established by article 4 of law Decree number 787 of 22 December 1981, Regional IRPEF Additional Tax established by art. 3 , line 143, letter a), of law number 662 of law 23 December 1996 and art. 50 of Legislative Decree number 446 of 1997 and Local Council Additional Tax, established by Legislative Decree number 360 of 28 September 1998. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 40-41.

266) The word "pornographic" means concerning erotic subjects that offend modesty. Distribution of pornographic objects could be punished, if the rules are literally interpreted, with criminal sanctions (see Italian Penal Code Article 528 "Obscene Exhibition or publication" and 725 " Selling of writens, drawings and other objects against modesty"). Therefore diffusion of these objects is *de facto* tolerated due to an "adjusting evolution oriented jurisprudence interpretation" (see I.CARACCIOLI, *Addizionale sul materiale pornografico e di incitamento alla violenza. Aspetti penali,* in Il Fisco, 2006, VIII, 1226 ss. From A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 276.

267) The notion could be derived from World Health Organization definition "the wilful use of phisic force or power, menaced or real, against themselves, an other person, or against a group or a community, that determines or has elevated degree of probabilities to cause lesions, death, psychological damage or deprivation" and also from Art. 392 of Italian Penal Code "We have violence over things when it is transformed, damaged or its destination changes", art. 582 "[is punished] anybody causes to one person a personal lesion, causing a disease", art. 610 "Commits private violence the subject who force someone to make, do not make or omit something".

So we could define items as violence incitating when they encourage to create damages to people or things." See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 280-281.

268) The definition is contained in Article 661 of Italian Penal Code "Anyone that, publicly, pretends, with any kind of charlatanism, even gratuitously, to abuse of popular credulity is punished...". In fiscal rule is described a solicitation of popular credulity that don't digress in Abuse, hypotesis sanctioned by criminal law. A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 283-284.

269) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 299.

(mores, art. 21)[270] or, also, considering that the diffusion of pornographic objects (a specific activity that justifies a discriminatory treatment[271]) generates in the community negative externalities (I think, especially, to instruction, security, justice and health costs).[272]

This tax was introduced for two reasons: to provide money for the State and to discourage both selling and purchase of these items.

Well known for its evocative name, the Robin Hood Tax, introduced with Law Decree 112/2008, increases by 5,5% the enterprise income tax for producers and sellers of energy coming from fossil fuels[273], for enterprises that have a minimum sale volume of 25 million Euro, in order also to fight their speculative conducts. The levy was increased to 6,5% in 2009[274] and to 10,5% temporarily for 3 years (this temporary rise could be defined as "extraordinary tax"[275]) in 2011[276] bringing the total enterprise income taxation to 38%.

DL 138/2011, also, increased the number of taxpayers reducing the minimum sales volume to 10 million and including even renewable energy sector operators.

In the rules is, also, present a ban on economic translation of the additional on consumer.

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270) See note 262.

271) Respecting, in that way, article 3 of Italian Republican Constitution. See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 305.

272) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 300-303.

273) See G. MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 62. See, also, A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 401

274) See art. 54 par. 3 law 99/2009.

275) Extraordinarity alludes to a particular historical- political circumstance or economic trend when the tax is established. So the levy is necessarily related to exceptional State revenue requirements. Clearly, the levy must be a transient, an *una tantum* fiscal burden.

In addition even his generating circumstance have to be strongly related to the special economic trend. These three conditions must be respected if we want to define a tax "Extraordinary tax".

A typical example of Extraordinary tax was Windfall Profit Tax, established during Wordl War II by warring countries governments that, in some cases, had a quasi-confiscatory effect. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 190-203.

276) Law Decree 138/2011.

Robin Hood Tax is a surtax[277]: in that case the juridical system use a basis tax or "mother tax" as circumstance for the configuration of an other tax.[278]

Additional taxes and surtaxes are different from double taxation phenomenon: in fact in double taxation we have one only circumstance and two different overdrafts, in case of additional taxes and surtaxes we have two circumstances (basis circumstance and additional circumstance).[279]

As affirmed by Falsitta surtax mustn't be a manner that consent to avoid ability to pay principle, creating, in that way a confiscatory taxes.[280]

Many authors affirmed that Robin Hood Tax violates many constitutional principles: Art.3, Art.53, Art.77, Art.23 and, also, Art. 117 of Italian Constitution.

In particular is alleged violation of Equality and ability to pay principles on many profiles[281]:

- The rule is discriminatory because it hits one only productive sector

-Inwards this sectors are hit producing and distributor enterprises (distributors of hydrocarbon products are assimilated with crude oil producers). The first could influence price formation mechanism, the others no. So part of the taxed subjects have an obligation of non translation of this tax on consumer.

- In this tax legislator put, in order to identify taxpayers, a 25, then lowered to10 million turnover threshold: in this way an enterprise with a lower turnover but higher profits than enterprise whose turnover surpasses threshold could not be subjected to payment of the levy. So we are in presence of a clear irrational incongruity of treatment.

Reggio Emilia Taxation Committee, also, asserted the violation of art. 117, letter

277) Surtax was mainly used for land income from '30 s in Italian fiscal system and even for ILOR, established by President Republic Decree number 599 of 1973 and then abrogated with Legislative Decree number 446 of 1997. From A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 34-40.

278) A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 28.

279) A. MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 33.

280) G. FALSITTA, *Giustizia tributaria e tirannia fiscale,* Giuffré, torino, 2008, 217.

281) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 471-474

e) of Italian Constitution because the ban to taxation costs translation constitute an authoritative price fixing that doesn't respect free competition principle.[282]

Art. 77 of Italian Republic Constitution affirms: “When, in extraordinary cases of necessity and urgency, the government opt, under his responsibility, for short-term measures with force of law must present...[283]”. It is Constitutional rule for Law Decrees, measures that, as affirms the provision could be used only in particular hypotesis, like an earthquake or an other case that don' t give the satisfactory time to legislator to promulgate an ordinary law.

Therefore, this idea, doesn't represent, mainly in the last thirty, thirty-five years the approach of Italian governments that, in order to avoid parliamentary debate, usually adopt, even for not urgent measures, Law Decree procedure.

Milone affirms that Robin Hood Tax introduction and modification (always with Law Decree) is one of these cases[284] because it is an ordinary nature fiscal measure. In addition art. 4 of Statuto del Contribuente bans the introduction of new taxes with Law Decree instrument. (however it is not a Constitutional rule, so it could be derogated even by ordinary law according to principle *lex posterior derogat priori*).[285]

As asserts Marongiu this defect involve the not compliance to our Constitution not only for Law Decrees, but even for conversion laws, so the whole measure would be, consequently, unconstitutional.[286]

Furthermore not even article 23 Constitutional Provision “None personal patrimonial performance can be dictated unless on the strength of a law”[287] is

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282) The violation of that principle was denied by Sentence of *Consiglio di Stato* (the highest administrative justice organ) in sentence 4388/2011. See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 474-477.

283) From Article 77, line 2 of Italian 1948 Republican Constitution.

284)See Constitutional Court Ordinance 9/2011.

285) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società*, Hoepli, 2012, 451-456.

286)G.MARONGIU, *Robin Hood Tax: taxation without constitutional principles”?*, Rassegna Tributaria, 2008, 1345.

287) See Article 23 of Italian Republican Constitution.

respected: Constituents used word “law” because only law is promulgated after a specific procedure (see articles 70-74 of Italian Constitution) that requests parliamentary debate.[288]

The controversial tax has, also, backdated effects[289]. The doctrine classifies this hypothesis of retrospectivity as not authentic retrospectivity[290] because it explains his effects to the current tax period. However even that kind of retrospectivity is not compliant with article 3, line 1 of *Statuto dei Diritti del Contribuente* (due the violation of just confidence principle[291]). Therefore, as affirmed by Italian Cassation Court[292] and then confirmed by Italian Constitutional Court[293] *Statuto* principles don't have a superior hierarchical position compared with ordinary laws.[294]

In 2012 Italian Constitutional Court stated[295] that law retrospectivity ban (fundamental juridical civilization principle) doesn't receive a favoured protection, so legislator could promulgate retrospective effects rules if they defend

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288) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 457-458.

289) Law Decree 112/2008 of July 2008 establishes the application of the tax to taxation period accruing from 1 January 2008, Law Decree 138/2011 establishes the extension and the increasing for three tax period from 1 January 2011. In addition article 56, line 3 of law 99 of 2009 that increased the additional tax of one point could have a not declared retrospective effect, starting from 2009. See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 458-459.

290) The doctrine make a distinction between authentic and not authentic retrospectivity. The first is present when the tax is related to a past fiscal period, in the other it is related to the current fiscal period. The first could more easily generate conflict with juridical certainty principle and even with ability to pay principle because it could be more easily related to an inexistent thing at the present time. See A. FANTOZZI and A. FEDELE, *I limiti della retroattività nel diritto tributario,*Milano, 2005, 68ss; F. AMATUCCI, *L'efficacia nel tempo della norma tributaria,* Milano, 2005, 39 ss; K. TIPKE, *La retroattività nel diritto tributario,* in A.AMATUCCI, *Trattato di diritto tributario. Annuario,* Padova, 2001, 103 ss.

291) See A.CONTRINO, *Modifiche fiscali in corso di periodo e divieto di retroattività “non autentica” nello Statuto del Contribuente,* in Rassegna Tributaria, 2012, III, 590.

He affirms that, in this way, legislator “deceives” taxpayer confiance.

292) See Italian Cassation Court Sentence 2221/2011.

293) See Italian Constitutional Court Sentence 247/2011.

294) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 458-467.

295) See Italian Constitutional Court Sentence 78/2012.

constitutional principles and rights that constitute imperative general interests reasons, as established by ECHR.[296]

So the compliance to Constitution of controversial rule would be the result of a value balancing: if is considered prevailing law certainty on State fiscal interest the rule is not compliant with our Constitutional Chart, otherwise yes on this point.[297]

In conclusion there is also a possibility[298] of contrast with EU State Aids discipline contained in art. 107 of TFUE[299].

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296) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 468

297) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 469-471.

298) See E.COVINO and D.MAJORANA, *É costituzionalmente legittimo l' aggravio di aliquota per un settore economico?,* in Dialoghi Tributari, 2011, IV, 393.

299) I report here the text of Article 107 of Treaty on the Functioning of the EU "aids granted by state"(ex Article 87 TEC):

"1. Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

2. The following shall be compatible with the internal market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.

3. The following may be considered to be compatible with the internal market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;

(e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission."

As we see the literally meaning of the rules it indicates subsidies but we have to reflect in term of a more extended concept where are included even negative content State intervention acts like taxation of only one productive sector.

In other words a rule that hit only a kind of economic operators could, consequently and indirectly, advantage the others. This thesis is not embraced by *Consiglio di Stato* that, in Sentence 4388/2011 denied the nature of the tax of State Aid.[300]

This tax, considered by Aldo Milone as an “Ethic tax”[301] because it hits short-term or speculative gains,[302] could be considered for some aspects, according with Massimo Procopio's thesis, as an exceptional instrument[303] used by legislator during financial crisis period (exceptional economic present-day situation) and so, for that reasons it respects ability to pay principle, constituting, also an expression of solidarity duty that justifies discriminations.[304]

Nevertheless the identification taxpayer threshold creates an irrational discrimination that is not compliant with our Constitutional system, so the part of the measure that determines it could be declared unconstitutional.

If the rule has to be considered unconstitutional for his retrospective effects it couldn't be applicable to part of some past fiscal years.

However, all the measure is clearly unconstitutional due the violation of legislative procedure (a mere procedural defect that involves all institutive fiscal

300) See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 477-481.

301) However, as affirmed in 2008 Bengasi Italia-Libia cooperation and friendship International Treaty, art.8 part of the revenues coming from this additional tax must be used to build infrastructures in Libya for a total value of 5 billion Euro for twenty years in order to indemnify Libia for damages caused during colonial period.

302)See A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 240-244. The Author compare Robin Hood Tax with Windfall Profit Tax saying that both are inspired by the same principle: to establish more important taxation rate on “not ethic gains” (they are considered in that sense because they are the consequences of a not ordinary situation).

303) See M. PROCOPIO, *Il sistema tributario italiano.Principi istituzionali,* CEDAM, Padova, 2012, 87.

304) See S. LA ROSA, *Eguaglianza ed agevolazioni fiscali,*Giuffré, Milano, 1965, 42. See, also, A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 190-194.

law) established in art.77 Constitutional rule (and also of art. 23 of Italian Constitutional Chart.).

I make this reasoning because if it is true and the rule is declared unconstitutional for this reason is, then, possible to introduce exactly the same rule respecting normal legislative procedure (if the rule is compliance even with art. 107 of TFEU).

We have also to remember that for IRAP (Added Value Production Tax) not all passive subjects, always the same rate: banks and insurance companies paid for some years a more important transitory rate. This caused the proposal of a constitutional compliance question related to Article 2, 3 and 53 of Italian Constitution. Constitutional Court in Sentence 21/2005 denied these allegations, affirming, also, an important principle: “The prevision of tax rates enters in legislative discretionary powers, it only mustn't be based on irrational reason of economic and distribution policy”. This statement, so, seems an, at least partial, acceptance of relative limit theory of ability to pay.[305]

Very important are, also, the rules against so called “dummy companies” or “dummy corporations”.

A dummy company is an entity created to serve as a front or cover for one or more companies. It can have the appearance of being real (logo, internet website, and sometimes employing actual staff such as for public relations), but it lacks the capability of functioning independently. The goal of a dummy corporation can be to conceal true ownership and/or avoid taxes.

To contrast this phenomenon, the Italian legislator introduced[306] rules that impose to corporation that doesn't reach presumed minimum earning[307] to declare not less

305) A.MILONE, *Sovraimposizione nell' imposta sul reddito delle società,* Hoepli, 2012, 433 ss.

306) Law 724/1994.

307) The basis for calculations are a percentage of current assets, real estate owned by corporation and capital assets.

There is a confrontation between the three previous years earnings and presumed than the presumed minimum income calculated on the basis of assets[308] owned in the financial cycle. This patrimonial nature tax is a sort of sanction for a corporation form abuse[309]: in that case corporation rules are used for a scope not protected by our juridical system. In that case legislator doesn't use a radical solution like corporation nullity but discourage the abusive conduct using a sort of estate tax.[310]

That rule effectively changes the ability to pay index from income to endowment[311]; if it was the income the rule would not be constitutional because it could tax even a non existent income.

Italian legislator respected equality principle because these entities are not like normal corporation (they are an abuse of that juridical form).

Many criticisms to the legislation arrived for the link of income inadequacy and dummy corporation provision but unconstitutionality is avoided due the *Interpello*[312] procedure that allows the taxpayer to give to the financial administration a countercheck[313].

4- Tax favourable regimes in the Italian fiscal system.

Article 47, paragraph 1, of the Italian Republican Constitution affirms: “The Republic encourages and protects savings in all its forms; it regulates coordinates

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minimum earnings that are calculated on the basis of cited factors.

308) The basis for calculations are a percentage of current assets, real estate owned by corporation and capital assets.

309) From PEVERINI, *Società di comodo e imposta patrimoniale: il contrasto tributario all' utilizzo distorto della forma societaria.* Giurisprudenza commerciale, 2013, II, 260.

310) *ibidem.*

311) *ibidem.*

312) Paragraph 4 bis, article 30, law 724/1994.

313) ibidem, See also G.MELIS, *Lezioni di diritto tributario,* Giappichelli, Torino, 2013, 62-63.

and controls the exercise of credit." This rule, that is also linked to the substantive equality principle, is the basis of a favourable taxation system for savings. European Union also supports the introduction of this special regime.

It is important to remember that in Italy capital income is subjected to a separate favourable taxation system[314]. Before 2011 they were taxed with a 12,5% withholding tax that was raised to 20% with 2011 summer financial measure[315] but remained to 12,5% for Italian government securities and for investments in real estate mortgage funds. The protection of savings is an important issue but Italian system excessively favoured that sector, especially during the period *ante* 2011 reform: if you think that the lowest physical person income tax rate is 23%, that measure appears as not fair.[316] It could advantage many very high income receivers; however is also true that the State must encourage investments, especially in a crisis period.

The right solution could be to hold withholding tax system and raise the rates for government securities and investments in real estate mortgage funds to 18 % and the other tax rates to 25%. This solution could advantage State finances, guarantees a better redistribution of wealth and also not discourage the investments in this important sector.

Even capital gains realized by physical persons who are not entrepreneurs are also subjected to separate taxation if the conditions of Article 67 Income Tax Act are respected. This favours operations of private citizen over corporations operations.

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314) Until 1988 Capital income were connected with produced income notion including only profits deriving from the conclusion of speculative acts (so the notion of Capital income was restricted comparing with French tax-law notion, linked to Revenue- income concept). The notion of Revenue- income, in this subject, was introduced by TUIR and successive Legislative Decree n. 461 of 1997. See F.GALLO, *Mercati finanziari e fiscalità*, Rassegna Tributaria, 2013, I, 21, 22.

315) Law Decree 138/2011.

316) For example, if a person has 10,000,000 Euro and buys CCT government securities, he receives a 3% annual interest rate, so he has a 300,000 Euro annual income, and has to pay only 37,500 Euros to the State, whereas a person that exercise a professional activity that receives a 105,000 Euro income has to pay, according to art. 11 of law 917/1986, has to pay a more important amount of taxes.

In order to avoid double economic taxation, Participation Exemption is adopted in our fiscal system: according to Article 87 of Income Tax Act capital gains realised[317] concerning shares or corporation or other entities participation quotes, respecting determined conditions[318] could be deducted from taxable income. If the receiver is a corporation the exemption is for 95% and is also possible to deduct from the few taxes participation management costs, if he is a physical person the exemption is for 49,72% so the person will be subject to double taxation for half of the income deriving from participation. That system was encouraged by European Court of Justice that with *Sentence Manninen (C-319/2002)* suggested to Finland the introduction of this system instead of tax credit system that was applied, at that time, also in Italy. Both systems prevent double taxation that could have as a consequence a worse and consequently unfair treatment to this kind of income receivers.[319]

However that rule don' t establish a properly a tax favour regime but a method to avoid double economic taxation in Italian juridical system.

5- Gender-based taxation: a special tax regime for a special situation.

As affirmed by optimal taxation theory (Ramsey principle), goods and services

317) The system is applied mainly to capital gains on shares, financial instruments similar to shares and titles.

318) One year Minimum Holding period, classification in budget as financial assets, the participated corporation mustn't be resident in a privileged tax system country and it must exercise a financial activity.

319) A person could have an income of 100 as first taxed for 27,5 % as IRES. The remaining 72,5% could be taxed to 43% rate, leaving them only 41,4. Carpentieri asserts that that fiscal regime creates discrimination between resident partners: between IRPEF taxation partners and IRES taxation partners. (here we have a complete elimination of taxation). See L. CARPENTIERI, *L' illusione della progressività,* Dike Giuridica, 2013, 84.

that have a more elastic supply should enjoy a better treatment from the fiscal system, paying less taxes than the others.[320]

As demonstrated by many researchers, woman labour supply is more elastic than men's, so women labour income taxes should be lower than men income taxes.[321].

It is also asserted that GBT provides substantial welfare and minimizes the aggregate social loss deriving from labour market distortions.

The consequence would be more bargaining power for women, and as other additional effect, the reallocation towards more equality of household duties.[322]

This proposal respects also the European Union Law principles, in fact Article 23 paragraph 2 of Charter of fundamental rights of the EU- that became legally binding after 2009 Lisbon Treaty -affirms that "*the principle of equality shall not prevent the maintenance or adoption of measures providing for specific advantages in favour of the under-represented sex*".

An exemple of Gender Based Tax operating in Italy is art. 3 of law 238 of 30 December 2010 that concedes, with the respect of some conditions[323], a temporary[324] reduction of taxable income for Italian people working abroad[325] that decide to return in their home State. This reduction is more important for women (80%) than for men (70%) making it, effectively, a kind of Gender Based Taxation.[326]

We could, also give the same consideration for article 1, line 95 of law 228/2012 that established a more important IRAP deduction for entrepreneur that hire a

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320) From A.ICHINO, A.ALESINA, Loukas working paper *Gender based taxation and the divisions of family chores*, Leibniz Information Center of Economics, 2007, 2.

321) *ibidem* .

322) *ibidem,* 27.

323) The beneficiary must be born after 1-1-1969, he must own a graduation title, he must be employed as dependent worker in Italy, he must transfer his residence to Italy in three months from his hiring time

324) Until the end of 2015.

325) He must, also, reside at least 24 months abroad before his return in Italy.

326) From Circolare CNR - Consiglio Nazionale delle Ricerche,19/12/2012, n.40/2012 "Incentivi fiscali per il rientro dei lavoratori in Italia".

woman with an open ended contract: in fact if he employs a man he got 10,600 Euro of deduction, if he hires a woman 13,500.[327]

It is possible to conclude that a different situation requests such a different treatment; for that reason an equal treatment of both sexes results as substantially unequal and this proposal is moving towards direction of Art. 3 par. 2 Substantive Equality Constitutional principle.

6- Family taxation proposals

In Italy, a long political discussion started over the introduction of familiar income division principle present, for example, in French tax system.

According to this principle, taxable amount should be divided for the number of people that compose family and should be paid according to tax class rate[328]. In our fiscal system the situation forty years ago was the exact opposite: the wife income had to be accumulated to the husband's and then taxed[329].

327) From L.BERTOLOZZI, R.BELLOTTI, *Lavoro autonomo e professionale nell' IRAP e nelle imposte dirette,* Giuffré, Milano, 2013, 307

328) For example, if we have a family of 5 and a 100,000 Euro income, it has to be divided and they have to pay for each part 23%. So they could pay 23,000 instead of 36,000 (with the actual fiscal system).

329) As established by article 4 of President of Republic Decree 29 September 1973, n. 597 three kinds of income have to be ascribed to passive subject income: wife's income (with the exception of incomes that are available for legally and effectively separated wife, incomes produced by non emancipated cohabiting sons and other incomes *de facto* available for passive subject.

The provision was founded on an extended concept of income possession that overrides formal ownership.

Obviously that rule generated Constitution compliance problems in reason of contrast with Articles 3, 24, 29, 31, and 53 of Italian Constitutional Chart.

The most evident, but not the only, violation was that spouses weren't considered morally and juridically equal by the rule. In addition married couples were effectively discriminated compared with *de facto* couples (these couples enjoyed a surely better taxation level if they received the same income of a married couple). From A. TURCHI, *La famiglia nell' ordinamento tributario,* Giappichelli, Torino, 2012, 102, 105, 110, 111.

That regime was declared unconstitutional[330] for the violation of equality principle as affirms Italian Constitutional Court Sentence 179/1976 because " ability to pay has to be recognized to every physical person"[331].

That system didn't favour family because two separated persons got a better treatment than a family. In contrast,The French system would aid family in our country and would also be another step in the direction of substantive equality because the fair treatment involve also children and if the family is economically well treated also the children will be economically well treated.

Neverthless there are, probably, also Constitution compliance problems about this measure because, in that case, single people could have a different fiscal treatement than people that constitute a family. In addition it is, at least partially, also against GBT idea that wants lowered taxes for women in order to realise a substantive equality scope.

However, these observation could be overcame with this reasoning: on the strength of equality principle we could say not that we mustn't have any discrimination but that discrimination have to be based on rational criteria.

In the specific case the criterion of encourage family is a constitutional based criterion (Article 31, line 1 of Italian 1948 Republic Constitution affirms "The Republic supports with economic measures and other actions the formation of the family and the fulfilllment of relative tasks, with special attention to numerous families. It protects Maternity, Childhood and Youth, favoring institutes necessaries to this goal.") that, in value balancing must prevail over other

330) Italian Constitutional Court recognized the violation of articles 3, 29, 31, and 53 of Italian Republican Constitutional Chart. So this taxation form was a discriminatory taxation form for married based families and it also violated ability to pay principle because it establishes that ability to pay must be, necessarily, personal.

Twenty year before a similar rule in Germany was declared unconstitutional by *Bunderverfassungsgericht* in reason of its discriminatory effects for families. Due to this sentence familiar accumulation became an optional taxation regime in that country. From A. TURCHI, *La famiglia nell' ordinamento tributario*, Giappichelli, Torino, 2012, 118-121 and 135-137. See, also, L. CARPENTIERI, *L' illusione della progressività*, Dike Giuridica, 2013, 43.

331) From Constitutional Court Sentence 179 of 15 July 1976.

principles.

We could, so easily affirm, that due the presence of very low deductions for families the principle expressed by Article 31 Constitutional rule wasn't really realized and that a financial reform introducing Income splitting realizing a situation similar to France would, finally give fulfillment to Constituents intentions.

However, in this economic and financial situation[332] is very difficult to find funding satisfactory for the realization of a similar reform.

7- Other measures to increase the fiscal system progressivity.

The *Buffett Rule* is named after American investor Warren Buffet, who publicly stated in early 2011 that he believed it was wrong that rich people, like himself, could pay less in federal taxes, as a portion of their income, than the middle class, and voiced support for increased income taxes on the wealthy people.

Proposed in 2011 by Obama administration, *Buffet rule* would limit deductions available for high income taxpayer imposing a 30% minimum tax to taxpayer with income equal or superior to 1 million dollars per year, that progressive reform wasn't ever realized due the opposition of the US Congress. Certainly that reform respects the principles of fairness, equality, ability to pay and progressivity.

I think in Italy there is probably a very low number people that pay less than 30% for an income higher than 750,000 Euro. It could happen only due to special capital income rules.

Italian taxation system would be surely more progressive, and so more fair with low income receiver if we had a no tax area for the first 5,500 Euro of income as

332) Italy is also well known for his very huge public debt that reached in 2012 the amount of 2,000 billion Euro.

in France. It could be a better vital minimum guarantee than the exclusion that we have only for people that receive a pension income of less than 7,500 Euro.

The system could also be fairer if we had lower personal income tax rates, especially for medium income receivers[333].

333) I think it would be best to have a reduction of the first class (0-15000) from 23% to 22%, of the second (15,000-28,000) from 28% to 26%, of the third (28,000-55,000) from 38% to 29%, of the fourth from 41% to 32% bringing also this class (55,000-75,000) to 55,000-100,000 Euro, while over 100,000 Euro we would have the last class with a 38% rate.

Chapter V

General Conclusions

Fairness between low income and high income receivers is based on the equality principle expressed in Article 3 of Italian Republican Constitutional Chart that contain a formal equality principle (characteristic of all XIX century liberal constitutions) and a substantive equality principle that creates an obligation for the State to the promotion of the socio-economic condition of citizens, on ability to pay, and on progressivity system taxation principles, both expressed in Article 53 of Italian 1948 Constitution.

After the analysis of the previous pages it is possible to conclude that flat tax income rate like East European Countries wouldn't be fair for low income receivers, that environmental tax, higher taxations over stock options, familiar income division and gender based taxations respect ability to pay principle and fairness idea, that so called “ethic taxes” contribute to realize substantial equality and discourage some dangerous or unfair activities.

Also, after the analysis of confiscatory taxes, the solution proposed by German, Argentinean and Brazilian constitutional courts can be accepted, concluding that an income taxation of more than 50-55% wouldn't respect Constitutional ability to pay principle and would also be absolutely unfair.

In Italian fiscal system is possible to find rules against fairness between low income and high income receivers in the very low important exclusions present in art.11 of Income Tax Act that didn't really and totally guarantee the vital minimum exemption principle, and in the capital income taxation that is taxed less than any professional activity or dependent job income.

In any case the realization of every proposal must be compatible to Italian financial situation that has not been good since 1991, when our GDP growth, which had been strong in the previous three decades, start slowing down, leaving to Italy one of the highest public debts in the world.

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FAIRNESS IN TAXATION ON DIFFERENT TYPES OF INCOME

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Contents

CHAPTER 1

INCOME TAX SYSTEM IN ITALY: ORIGINS AND EVOLUTION

ORIGINS AND EVOLUTION

The Italian taxation of income is regulated by Presidential decree 917/1986, also known as TUIR [1](testo unico delle imposte sui redditi),that is essentially divided in three parts(titles):

The first one is entitled "Imposta sui redditi delle persone fisiche"(IRPEF) and regulates the taxation of individuals;

The second one deals with the income of corporations and other legal entities other than individuals and is named "Imposta sui redditi delle società"(IRES);

The last title contains common rules either for individuals and for corporations.

The current income tax law derives from the tax reform that took place from 1970 to 1973, which had the purpose[2] to provide a personal overall income tax for individuals[3], marked by the principle of progressivity, and an income tax for corporations and legal entities carrying on business activities[4]. In fact, the previous tax system was especially characterized by three land taxes and by a movable tax for individuals, while the corporate income tax concerned only corporations[5]; it was no longer responding to the new economic environment and to the constitutional principles.

[1] That replaced dpr 597/1973 and 598/1978 concerning irpef and irpeg.
[2] G. FALSITTA, Manuale di diritto tributario parte speciale, Padova 2013 pag.2
[3] Presidential decree 597/1973(IRPEF)
[4] Presidential decree 598/1973(IRPEG);now IRES
[5] F. TESAURO, Istituzioni di diritto tributario parte speciale, Milano, 2013 pag.9

TAXABLE INCOME

Italian tax law does not have a general notion of income. Indeed, Article 1 [6] of TUIR states that all income – either monetary or in kind - held by an individual, included in one of the categories provided by article 6[7], are taxable. Every category contains a precise definition of income and own rules to determine the taxable revenue. To make an example, land income is determined with the cadastral method; capital income is taxed on a gross basis and employment income as well, but in this case deductions are provided; [8]business revenue instead is taxed on the base of the profits and loss statement.

1.2 THREE DEFINITIONS OF INCOME GIVEN BY THE ECONOMISTS

The term income can be considered very functional. It can mean differently by field to field wherein it is used.

So, according to the financial science, there are three meanings of income that could be regarded: factors income, consumption and full income.

Factor income is the return accruing for a person, or a nation, derived from the "factors of production": rental income, wages generated by labor, the interest created by capital, and profits from entrepreneurial ventures.

Consumption income, instead, is the part of factors income consumed;

Full income, finally, is a more general concept which includes not only factor income, but also any other increase or decrease of wealth, largely meant. In other words, this kind of income results from the sum of factor income, plus any other increase or decrease in equity (e.g. revenue deriving from gift, inheritance, lottery wins etc).[9]

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[6] The same sentence is used for corporation ex article 72 TUIR

[7] Which are:
a) land income
b) capital income
c) income from employment
d)income from self-employment
e)business income
f) other income (redditi diversi)

[8] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit pag 5

[9] I.MANZONI-G.VANZA,Il diritto tributario,Torino,2008 pag.146

Although Italian tax system does not have a general definition of income, it can be deduced considering the taxable kinds of income stated by the law. Seen that every category, in principle, indicates income arising from the same factor of production, taxable income can be defined as a new flow of wealth, an increase in equity deriving from one factor of production (land, labor, capital, business) except the category of other income, which derives from very different sources.[10]

After this introduction to the taxable income, I would like to focus on two issues concerning the definition of income.

The first one is that Italian income tax system can be considered as a "close box"; so are really taxable only the income included in each category?

The answer to the question is negative. Indeed, although the intention of the legislator in 1973 was to create a close definition of taxable income, Article 67 of TUIR, concerning other income, contains a clause that makes Italian system "open": not habitual self employment income and doing, not doing or permitting duties. [11]

From this point of view, then, it is easily comprehensible that a clear definition of income, as that one elaborated by Italian doctrine, is necessary to establish when a wealth is taxable or not: only if it represents a new wealth deriving from a factor of production, then it is considered taxable.

The second issue that has to be remarked regards the term of source of income.

In fact, even if current tax law has adopted the concept of factor income, it must be considered not literally; in every category there are income not properly resulting from a source of production. (E.g. the kind of business income includes not only the revenue by business, but also capital gains and other revenues; income from employment contains scholarships, and so on).[12]

1.3 THE PRINCIPLE OF THE ABILITY TO PAY

As aforementioned, the purposes of the legislator in 1973 were to create an income tax based on the principles of the ability to pay and progressivity, stated by Article 53 of the Italian Constitution.[13]

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[10] G.FALSITA, Manuale di diritto tributario parte speciale, cit. pag.6-11
[11] G.FALSITTA, Manuale di diritto tributario parte speciale, cit.pag.54
[12] F.TESAURO, Istituzioni di diritto tributario parte speciale, cit. pag.7
[13] F.FALSITTA, Manuale di diritto tributario parte speciale, cit. pag.1-2

Can this purpose be considered achieved? We need to analyze these principles.
The first part of Article 53 claims: “Every subject should contribute to the public expenses according to his ability to pay”. This means that every subject, either individual or legal entity, without any distinction, have a tax burden that is commensurate to his economic capability. In other words, the economic capability is a measure of the wealth of a subject that is usually expressed by income, wealth or consumption, depending on the definition chosen.
Furthermore, in order to consider a wealth taxable, two other conditions must be met: it must be effective and it must be current. Indeed, nobody can be taxed on the base of his past or future possessions, but only on the effective current ones.[14]
Having said this, we have to analyze the last part of Article 53 of Italian Constitution, in which is alleged the progressivity principle: “the tax system is marked by the progressivity criterion”. It means that the tax burden of a subject has to be calculated according to his wealth[15].
After introducing these principles in general, we are going to analyze the way in which they are applied in our income tax system.
Theoretically then, according to the principle of the ability to pay, both the income of individuals and legal entities should be taxed on the base of the net income, that is the result of income after having deducted the cost due to production. This is the principle of effectiveness that is the result of the principle of the ability to pay stated in the previous article. However, in reality, the TUIR grants cost deduction, arising from the production, only for business income and self-employed one, and only according to the rules stated by the tributary law, inspired by the simplicity and convenience criterions. The tax legislator, indeed, does not say that the tax base is the result of the difference between gross income and all the related costs; however this rule arises from the enforcement of the rules provided by the law.
Subsequently, this implies that the net fiscal income differs from the economic one, and therefore the principle of the ability to pay, declined by the effectively of the taxable wealth, is not applied in total. Hence, we should ask ourselves the reason why the Constitutional Court has never declared the constitutional

[14] G.FALSITTA, Manuale di diritto tributario parte generale,Padova,2010
[15] as a result, the tax burden will be higher for those with higher wealth

illegitimacy of the TUIR. In actual fact, the high court has always overlooked this issue claiming that the legislator has the exclusive competence to determine the amount of the tax base, of deduction in our legal system.[16]

The progressivity criterion has been enforced through the IRPEF. This is due to the wide impact of IRPEF that results from the fact that every individual has to carry that burden and so it allows the whole system to become progressive. But then again, as for the ability to pay, the reality of its application differs from the theory. Indeed, as we are going to see, nowadays this principle is put into effect only in relations to the income from employment.[17]

1.4. ISSUES CONCERNING A NET WEALTH TAX

Despite the fact that lots of European states provide for a net wealth tax, the Italian tax system does not provide for it: no taxation is provided on the base of wealth assets of a subject; however it introduces different taxes that strike different elements of the subject's wealth.

Actually, for many years, there has been a passionate debate about the possibility to introduce a net wealth tax, and nowadays, with the always changing political situation it keeps on being an interesting topic. Those who[18] are adverse to this introduction state that such imposition would be unfair because the same wealth would be taxed firstly as income and then as wealth; at the same time, this would bring people not to invest, to invest abroad or to escape taxes.

On the other hand, however, the possibility of a net wealth tax is seen as a tool able to obtain a fair distribution of the fiscal burden: both income and wealth are indicators of the ability to pay, it would be unfair to concentrate the taxation mainly on income. Indeed, there is a difference between taxpayers whose only

[16] Many authors criticize the term unquestionable competence in this meaning because they believe that this is only a synonymous of the non-reasonability of the choices made by the legislator.
[17] G.FALSITTA, Manuale di diritto tributario parte speciale, cit.pag.11-13
[18] For example Padoan, economist and current economic minister.

ability to pay is income and those who also have wealth; the latter, indeed do have a greater ability to pay than the first ones. [19]

Similar to the last point of view, the Italian legislator has introduced in 2011 rules that agree with this last school of thought. Indeed, a series of duties have been adopted, with the aim to tax singles wealth elements such as houses: the purpose is to restore the public debt and to deal with the economic crisis. Actually, there are some criticisms to this reform; on the one hand, taxations have started to focus on wealth but, on the other hand, income taxation remains so high that Italy has still one of the highest tax burden in Europe. [20]

1.4.1 TAXATION OF IMMOVABLE ASSETS

It has been more than 20 years since Italy has had a taxation of immovable assets, which has been modified several times, and has been fields of debates. Therefore, I will try to explain the evolution of the current system.

In 1992 the ICI (imposta comunale sugli immobili) was introduced. It taxed the owner of buildings, building lots and cultivated lands. Furthermore, in 2008, the current governing body, leaded by Berlusconi, abolished the tax on the main abode, however, ICI was left in the other conditions; on the other hand, the same legislature provided a new tax on immovable assets, the IMP (imposta municipale propria), which should be enforced in 2014 and which should replace the ICI and the IRPEF on buildings.[21]

Monti's government, however, with law n. 201, 6/12/ 2011, named "urgent dispositions for growth, and equity" (also known as " *Salva Italia financial measure*") later converted with modifications, from law n. 214, 22/12/2011, modified the nature of the tax by transforming it into a net wealth tax on properties and lands, and by increasing the basis of tax assessment, and anticipated its enforcement to 2012.

It was implemented in order to reduce the public debt consistent with the EU commitments assumed by the previous legislation.

[19] F.GALLO, Premesse per l'introduzione di un'imposta patrimoniale, in Riv.dir.fin.,1,1986
[20] UBALDO PERRUCCI, Il mito ricorrente di un'imposta patrimoniale, in Boll.trib,4,2013
[21] G.FALSITTA, manuale di diritto tributario parte speciale, cit. pag. 146-147

Nevertheless, we have to consider that the IMU stood in for the building income. Until 2011, the main abodes did not contribute to the ICI's tax base and their cadastral value could be deducted by the IRPEF, this was the removal of the duty of the main abode for the purposes of IRPEF. On the contrary, with the Monti financial measure, the main abode was taxed with IMU. However, at the same time, the tax rate was reduced to 0.4% and it was provided a deduction from the IRPEF of 200 euro; the amount of the deduction could be increased with 50 Euro for every child in the family as long as their age is under 26.

The budget law of 2014 [22]introduced a new immovable tax called IUC (imposta unica comunale),created by the union of TARI, TASI and IMU. [23]Therefore, the new IMU has the same regulation of 2011, so it does not tax the main abode as before, but with the exception of refined dwellings, castles and buildings with a high artistic and historical value. Those are taxed with a rate of 0.4% and a deduction of 200 Euro from IRPEF, no longer affected by the number of children in the family.

The new introduced TASI is a tax on services delivered by local municipalities: is paid by the actual user (so by tenants and owners); The TASI has a tax base that does comprehend the value of main abodes. Therefore, the owner of a building does not pay the IMU on his main abode but he has to pay the TASI on it. Secondly, the sum of the TASI and IMU on buildings other than main abodes cannot exceed the maximum rate fixed at 10.6 ‰; this boundary was already provided by the former IMU legislation: the aim is to guarantee that the sum of the new taxes is not bigger than the amount due with the previous IMU.[24]

Besides the IMU the "Salva Italia financial measure" introduced the IVIE[25] (imposta sui valori immobiliari detenuti all'estero); the purpose of this tax is to ensure the equity between resident individuals, which have immovable assets in Italy (subjected to IMU), and those who have assets abroad. Indeed, in the latter case these individuals would not be subjected to IMU. Therefore, Art.17 of the

[22] L. 147/2014

[23] TASI (tassa sui servizi indivisibili), a service tax
TARI (Tassa sui rifiuti) is a tax on litter

[24] S.BARUZZI, L'imposizione immobiliare per il 2014 nel rapporto tra TASI e IMU, in Il Fisco,1,2014, pag. 53

[25] ART. 17 co.13 and ss of dl 201/2011

aforementioned order states that the IVIE is levied on immovable properties held abroad by individuals resident in Italy.[26]

Notwithstanding the purposes of fairness that have led to the introduction of these rules, there can still be problems of enforcement.

First of all, the assumption of the tax is the property of an asset or any other beneficial right; however, these are institutions of civil law, unknown to other common law countries.

Secondly, it is not easy to determine the nature of the tax paid abroad: is it a net wealth tax or an income one? Indeed, only the first type is deductible in Italy.[27]

For example, in France two types of taxes are provided: one, is the so-called "taxe d'habitation", comparable to the Italian IMU; the other, the "taxe foncière", instead taxes only the property. The deduction is limited to the latter type, having the first one a net wealth tax nature. [28]

The IVIE may also be considered in conflict with the main principles of the EU. Firstly, one violation may be linked with the principle of free movement of capitals: the reason for the illegitimacy of the tax may be the value of the tax base (the purchase cost or the market value), that the building has in the state it is placed: this value, however, is different from the one applied in Italy for IMU, which, as we have seen, considers the cadastral value. In this way, there is a different treatment between building placed in Italy or abroad. The IVIE may be considered also a violation of the free movement of workers as it obstructs Europeans who work in Italy. [29]

1.4.2 TAXATION OF FINANCIAL ASSETS

The "Salva Italia financial measure" and the law 228/2012 introduced new form of taxation of financial assets; in particular the stamp duty on stock accounts, the

[26] AS for the IMU, it is provided a tax rate of 0.76% on the value of the immovable asset, which value results from the purchasing cost or the market value. Starting from 2012 the tax base of the immovables placed in the UE region or in EEA derives from the cadastral value, calculated according to the rules of the country in which it is placed. Moreover, it is provided a tax credit for the tax paid on the same building abroad.

[27] G.FALSITTA, Manuale di diritto tributario parte speciale, cit. pag 81

[28] Agenzia delle entrate circolare numero 28/E del 02/07/2012

[29] L.SCAPIN, La Tassazione degli immobili all'estero, in Riv.dott.comm.,2,2012, pag.329

IVAFE (imposta sul valore delle attività finanziarie all'estero): a special stamp duty, an extraordinary stamp duty and a financial transaction tax (FTT).

Firstly, the stamp duty on stock accounts effects the recurring communications concerning checking accounts and financial instruments. An annual stamp duty of 34.20 Euro is provided for bank statements if the client is an individual, whereas a stamp duty of 100 Euro if it is a subject other than an individual.[30]On the other hand, an exemption is provided for checking accounts under 5000 Euro.

The communications concerning financial instruments, initially, were taxed with a rate of 1‰ for the year 2012 and 1.5 ‰ starting from the year 2013. Anyway the tax could not be less than 34.20 Euro and not greater than 1200 Euro. The last maximal boundary becomes of 4500 Euro staring from 2013 for taxpayers different from individuals.

However, law 147 of 2013 abolished the minimal tax of 34.20 Euro on financial instruments; indeed, this boundary made the tax regressive for small investors[31] (in contrast with the constitutional principles).

On the other hand, the aforementioned law increased the tax rate to 2‰; then, all the investors will be levied.

Article 19 clauses 18 to 22 of the law decree 201 of 2011 introduced the IVAFE , a tax on financial activities held abroad by individual residents in Italy. The aforementioned tax is justified by the need of coherence and fairness of the system: bank statements and financial instruments held by Italian brokers are taxed with the stamp duty, whereas foreign investments may benefit from a lower taxation. The IVAFE tax base is calculated on the fair value of the financial assets, recorded at the end of the previous solar year, and the tax rate is the same as the IVIE. Furthermore, a tax credit is provided for the possible wealth tax paid in the country where the assets are held. Actually, this tax was introduced in order to level individuals who invest in Italy to the ones that invest abroad. At the same time this tax may represent a violation of the principle of capital freedom of movement due to the fact that IVAFE taxes also financial assets that in Italy

[30] Art 13 comma 2 bis, tariffa allegato A parte prima DPR 642/72.

[31] For example an individual with an investment of 1000 Euro was taxed more than someone with an investment of 100000 Euro.

would not be subject to the stamp duty. Secondly, another form of discrimination concerns the fact that only individuals are levied by IVAFE.[32]

The law decree "Salva Italia" introduced a special stamp duty[33] which taxes financial assets repatriated through different laws (tax shelters): they were introduced by article 13-bis of the law decree 78/2009 (the tax shelter of 2009) and by articles 12 and 15 of the decree 350/2001 (the tax shelter of 2002-03).

The new stamp duty effects all the financial assets repatriated both physically and juridically, in other words without the physical return of the asset in the Italian territory. This duty is levied annually starting from the year 2012 and its base is the detection of financial assets still confidential according to the rule of the tax shelter.

Moreover, the stamp duty is charged for every year with a rate of 10‰ for 2012, 13.5‰ for 2013, 4‰ for 2014 and for the following years.[34]

As the tax base of new stamp duty is the existence of confidential financial assets in the previous year, the only way not to pay that tax is to make those assets no longer confidential; thus, he's invited to a full disclosure.[35]

This duty has clearly some features of unconstitutionality because there's an obvious discriminatory treatment between financial assets that have always been in Italy and the ones repatriated through the tax shelter, which have an unequal privileged treatment.[36]

Linked to the theme of unconstitutionality, we can also consider the extraordinary stamp duty[37]. It is an extraordinary duty, applied only on financial assets emerged from tax shelters of 2001 and 2009 and that no longer belongs to the taxpayer. Therefore, some issues emerge concerning the retroactivity of the law under exam. Moreover, the constitutional court[38] stated the constitutional legitimacy of those measures for two main reasons: first of all that is because there is a

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[32] L.LUGANO-M.NESSI,Le nuove imposte dovute sulle comunicazioni alla clientela, sulle attività finanziarie possedute all'estero e sulle transazioni finanziarie, in Riv.dott.comm,2, 2013, pag. 363.

[33] Art 19 commi 6 e ss dl 201/11

[34] L'imposta di bollo speciale sulle attività oggetto di emersione ancora segretate di Enzo Mignarri, il fisco 35/2012 pag 5591 a 5593.

[35] G.ANDREANI-F.GIUMMONI, Imposta di bollo sulle attività finanziarie scudate: valutazione di convenienza, in cor. Trib., 10,2012.

[36] G.FALSITTA, Manuale di diritto tributario parte speciale,cit. PAG. 1006-1008

[37] Art 19 comma 12 dl 201/2011

[38] Sentenza corte costituzionale 20 luglio 1994 numero 315.

presumption of possession of the taxed wealth by the taxpayer; secondly, because the legislative action is considered predictable. In any case, the doctrine does not share this interpretation of the law made by the Constitutional Court because it considers that such a rule taxes past wealth, violating then the affectivity and actuality principles of the constitutional ability to pay.[39]

1.4.3 TAXATION OF PARTICULAR MOVABLE ASSETS

We can see that the aforementioned "Salva Italia financial measure" provided[40] also some luxury taxes starting from the 1st of January 2012. This kind of taxation was introduced in the Italian legislation in order to increase the tax return against the public debt and the economic crisis. The legislator's purpose is to tax only those assets that express high wealth according to the Constitutional principle of solidarity. We are now going to analyze those taxes.

The first one is the surtax on high performance vehicles (already present in our tax system[41]) that was increased: this surtax is applied on vehicles with an engine size greater than 185 kw. The surtax amount is fixed according to every kilowatt that exceeds that limit, and to the seniority of the vehicle[42]. Alongside the aforementioned surtax, it was provided also an annual tax on parking braking and mooring of domestic or foreign pleasure crafts with a length greater than 10 feet. At a later stage, this tax was provided not only on those bases but also on the actual property of those crafts. The purpose was to avoid the escape from Italian ports. Likewise, the tax is reduced in relation with the length of service of the craft.

The last one is the tax on air taxi and on private jets: In the first case, the tax is paid in relation to the km made, while the second according to the jet's weight.[43]

1.4.4 SOLIDARITY TAXES IN ITALY

The happening of solidarity taxes is very hard to describe. Firstly, during the process of reformation of 2003 it was proposed for the very first time a solidarity

[39] G. Falsitta, l'illegittimità costituzionale e le norme retroattive imprevedibili, la civiltà del diritto e il contribuente Nostradamus, Per un Fisco civile, Milano, 1996,pag. 69.
[40] Art 16 dl 201/2011.
[41] Art 23 co 21, dl 98/2011.
[42] Co. 15 ter
[43] G.PUTZU-P.BRUCATO, La tassazione dei beni di lusso, in Il fisco, 42,2012, pag. 1-6720

tax at the expense of taxpayers with high income. The legislative decree of 2003 had the purpose of providing only two tax rates: one of 23% for income up to 100000 Euro and the other of 33% for the income that exceed that limit. During the approval of the financial law of the 2005[44], the tax rates became three and it was proposed to increase the last income bracket with a solidarity tax of 4% according to the article 2 of the Constitution. Nevertheless, the income revenue authority affirmed that that would be a forth tax rate in spite of the name.[45]At a later stage, between 2010 and 2011, new solidarity taxes were implemented in order to fight the economic and financial crisis. Nonetheless, those measures were very criticized by the doctrine. Consequently, two sentences of the constitutional court declared those solidarity taxes unconstitutional because of their contradiction with article 53 of the Italian Constitution.

Going on with the reconstruction of the evolution of solidarity tax, article 9 second clause of the legislative decree n. 78 of 2010 provided for a reduction of the income of public employees; the amount of the reduction was of 5% for those income greater than 90000 Euro and of 10% for those greater than 150000 Euro. Art.18 of the legislative decree n.9820/11 extended that tax to pensions, and provided a third tax rate of 15%.

Lastly, the legislative decree n.138/2011 stated a solidarity tax of 3% based on the overall income of individuals for the part beyond a threshold fixed at 300000 Euro.[46] This taxes also the aforementioned public employees and retired people. These solidarity dues have some features in common: they are limited in time, they are special and they have the purpose to fight the economic crisis and to restore public debt.

At the same time, these duties can be questioned in the light of the application of art.53 of the Constitution: the sentence of the Constitutional Court n.223 of 2012 stated that the clauses 21 and 22 of articles 9 and 12 were unconstitutional. The first issue concerns the aforementioned clauses 21 and 22, on the adjustments of wages and allowances of judges that were provided by the law n. 448/1998. These adjustments would not be applied to the years 2011, 2012 and 2013; this rule

[44] Legge 331/04.
[45] Circolare 03/01/2005 num 2/E
[46] G.FALSITTA, Manuale di diritto tributario parte speciale, cit., pag129-131

would not affect the year 2010, 2009 and 2008. Furthermore, clause 22 states a reduction of judiciary allowance by 15% and later by 25% for the year 2012 and by 32% for 2013. The Constitutional Court claims that those clauses are not justified by their extraordinary ability to battle the economic crisis; this dealing is considered unreasonable, discriminatory and almost "punishing" toward the judge trade.

The court stated the unconstitutionality of Article 9 second clause, in which a solidarity duty of 5% based on wages of the public employees for the part exceeding 90000 Euro is provided; this duty becomes of 10% for wages greater than 150000 Euro.

According to the Court, the constitutional principles of tax discipline are applied to this rule; the reason is that this duty, in spite of its name, is considered a tax, due to its mandatory feature and its purpose to support the public expense. Actually, this rule infringes upon the principle of taxation universality stated by Article 53 of Constitution. Moreover, its discriminatory feature stands out even more if we compare this duty with the one that affects income greater than 300000 Euro: an obvious disparity emerges between public employment income and the others.

To conclude, the Court explains the reasons for its decision: the unconstitutionality of the article 9 is not linked to its extraordinary feature but to its lack of universality.

Thus, a solidarity duty would have been legitimate if it had affected all the individuals with a certain income. Considering this, there would be a redistribution of wealth in relation to the solidarity principle stated by the Article 2 of the Constitution.

Inevitably, another judgment, number 116 of 2013, arising from the previous one: it states the unconstitutionality of the clause 22-bis of article 18 of the law decree n.201/2011. This article provides for a solidarity duty for golden pensions as aforementioned at the beginning of the paragraph. Indeed, this duty effects only retired people with the same income, infringing upon the constitutional principle of ability to pay and equality.[47]

[47] O.BONARDI, La corta vita del contributo di solidarietà, in ADL, 6, 2012, pag.1248-1264

Without further ado, we are going to analyze the solidarity duty of 5% based on the part of income exceeding 300000 Euro. The income revenue authority[48] stated that the considered duty should not be seen as a further tax rate of the IRPEF because the tax base is calculated starting from the overall income excluding deductible duties.[49]

The recent law n.147 of 2013 extends the application of the aforementioned duty also for the years 2014, 2015 and 2016.

Many criticisms have arisen: the first one concerns the fact that this duty effects only few rich people (in Italy, only 30000 people have an income greater than 300000 Euro), therefore the purpose of solidarity is compromised because the taxpayers are too few to solve the situations of the State. Maybe it would have been better to enforce a bracket duty[50], in order to increase the number of people that can contribute to the recovery of public debt; moreover, the tax return would be higher.

A second criticism is about the unfairness of the aforementioned duty because, it is not applied to income levied by distinct taxation and withholding tax. In fact, capital income are excluded from this provision. In a paradoxical way, a subject with 300000 Euro of capital income is not levied by this duty whether an entrepreneur has this tax burden besides the ordinary fiscal pressure.[51]

1.4.5 INHERITANCE AND GIFT TAXATION

The inheritance taxation is necessary, both mortis causa both inter vivos, to guarantee the ability to pay principle. That is because an increase in the wealth of a taxpayer represents a new economic resource and, as such is taxable.

Furthermore, such a tax claim is justified by the Italian Constitution as shown by article 42 c. 4, which states that law provides for the rights of the State concerning inheritance. Nowadays the inheritance and gift tax is regulated by the legislative

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[48] Circolare Agenzia delle entrate numero 4/E del 28/02/2012

[49] F. DELLI FALCHI-G.MARIANETTI, Chiarite le modalità applicative del contributo di solidarietà, in corr.trib.,21,2012, pag. 1648

[50] An example of bracket duty would be a tax rate of 1% for income greater than 100000, of 2% for the one greater than 200000 and of 3% for the others.

[51] G.MARONGIU, Contributo di solidarietà su pochi "paperoni": meglio un'equa imposta patrimoniale?, in corr.trib.,37,2011,pag.3021

decree 346/1990[52], modified by the law decree 262/2006 [53]which has reintroduced this tax, abrogated in 2001. Previously, the inheritance tax was regulated by the Presidential Decree 637/1972 and by the Presidential Decree 346/1990. Both those laws stated either a taxation of a global net hereditary estate or a taxation of the single hereditary shares and legacies, with the exception of the spouse and of the close relatives. Based on the former legislation, the tax base was the call to inheritance; this entails that potential heirs had to pay jointly the tax even if they did not accept the inheritance. The inheritance acceptance generated the translation of the goods inherited to the heirs; only later on, they could obtain a tax refund.

This regulation however, was harshly criticized because it was considered to be in contrast with the principle of ability to pay: tax liability here arises only from a potential wealth increase.[54]

Based on those criticisms, the legislator from 2006 no longer considers the withdrawal on the net global estate, but only on the single inheritance shares.

Secondly, only heir who has accepted the inheritance is the obligated: in other words only those who enter in possession of the inheritance. [55]

Because of this discipline, part of the doctrine considers this tax as a direct wealth tax based on the enrichment of the heir, thus the tax base is the acquisition mortis causa of the estate and the true taxpayer is only the one that has accepted the inheritance.[56] On the other hand, the main doctrine considers it as a tax on transfers[57], in other words it is seen as a tax on the de cuius estate.

Some problems may arise from a possible overlapping between the inheritance tax and the wealth tax; in particular, this may happen if the self-employed income produced by an individual is received by heirs because of the death of the subject that produced it. In fact, article 7 clause 3 of the TUIR states that the de cuius

[52] That is the so called TU Successioni.

[53] Art 2 dl 262/2006 which institutes the "l'imposta sulle successioni, donazioni, sui trasferimenti dei beni e diritti per causa di morte, per donazione o a titolo gratuito e sulla costituzione di vincoli di destinazione".

[54] G.FALSITTA, Manuale di diritto tributario parte speciale, cit. pag.926-936.

[55] Art 7 comma 4 states that the heirs are those who have been called to inheritance and have not refused it until its acceptance.

[56] [56] G. FALSITTA, Manuale di diritto tributario parte speciale, cit pag 999

[57] S. GHINASSI, Imposte di registro e di successione profili soggettivi ed implicazioni costituzionali, Milano, 1996, p.83 e ss

income, if not collected yet, is levied on heirs at the moment of the perception. This rule, however, represents an exception from the source principle, which states that only the income included in the categories (source of income) of the TUIR at the article 6 are taxed. Moreover, this exception is justified from the fact that every increase of wealth is taxed as income before it becomes estate; thus, if the income were not levied on the heirs, we would have an impartial treatment that derives from a tax gap. Therefore, heirs would perceive the result of the de cuius professional activity without paying the income tax.[58]

On the other hand, this system requires a double taxation of the same wealth: it is taxed, indeed, both as income both as capital gain iure successorio.

Moving to the discipline of the inheritance taxation, the legislator considers the de cuius residence as the main criteria to determine which goods and rights are subjected to that tax. In particular, in relation to the residents the tax effects all the assets and rights of the de cuius no matter where they are placed. On the other hand, the tax is levied only on the assets and rights placed in the State territory for those who are not residents.

The tax base is calculated as the overall net income of the assets transferred to every heir; the net income is the result of the assets minus the liabilities and deductible burdens.

In order to stay away from tax avoidance or frauds, in the assets of the de cuius are included also cash, jewelry and furniture which contribute to the overall net value as a lump sum of 10% of their value; that lump value is a presumption of existence of those assets. This presumption can be overcome with a contrarian proof.[59]Furthermore, in order to avoid property claims, the inheritance assets include financial movables, until proven guilty, but only the ones declared in the previous tax statement.[60]Besides the assets rules, we have to consider the ones regarding deductible liabilities: The principle rule is that de cuius burdens, medical and surgical expenses of the last 6 months of the de cuius life and funereal expenses are to be considered deductibles. However, de cuius burdens, in

[58] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit pag 15-16

[59] Art 9 Presidential Decree 346/1990
[60] Art 11 Presidential Decree 346/1990

order to be deductible, must result from a written act with a certain date, which is previous of the inheritance opening.

To calculate the tax rates, these are determined on the base of the degree of kinship of the heirs[61]. In any case, some allowances are stated: one is of 1 million of Euro for the spouse and direct relatives and 100000 Euro for brothers and sisters.

To reassume, in order to fix the tax base, we firstly have to determine the amount of the inheritance assets, and then on that base we have to calculate allowances and to apply rates. As aforementioned, the tax graduation is related to the degree of kinship or its lack; that is due to the fact that enrichments obtained by stranger are considered unjustified whereas the ones that are obtained by individuals with a close degree of kinship are explained with their broad contribution to the production of the wealth.[62]

Furthermore, to determine the tax base, from the share obtained by heirs or legatees we have to subtract the contingent gifts made to them by the de cuius before his death. The reason for this rule is to avoid the inheritance tax to be eluded or reduced with gifts made before the event.

The TU considers some exemptions that, not considered as part of the tax base; for example:

- The transfers made towards the State, Regions, Locals and other territorial entities, the transfers towards public entities, foundations, associations or towards other nonprofit entities. [63]
- Public debt securities and values written in the public automobile register[64]
- Cultural heritage [65]

In particular, we have to analyze the exemption provided for transfers of firms, branches or shares.[66]These transfers can be made also trough family

[61] A: 4% towards spouses and direct relatives;
B: 6% towards other relatives up to the 4th grade and towards relatives in marriage;
C: 8% towards other individuals.

[62] G. Falsitta, Manuale di diritto tributario parte speciale, cit pag 931 e 943

[63] Art .3 TU successioni

[64] Art 12 lett H e I

[65] Art 13

[66] Art 3 comma 4-ter TU successioni

agreements[67]towards heirs or spouses. On this matter, a problem arises regarding the application of the exemption, whereas it can be applied only to transfers towards heirs and spouse or towards anybody else.

Part of the scholars seems to agree with the interpretation which extends the application of the rule to any subject, both in order to guarantee the going-on of the firm both to agree with the principle of the ability to pay and equality, expressed by the Italian Constitution.[68]

In any case, the application of the aforementioned benefit is limited to the case in which the following conditions are met:

- Concerning shares in corporations, the exemption is due only for those shares with whom heirs acquire or integrate the control over the company, according to article 2359 clause 1 number 1 of Italian civil code[69];
- Concerning firms, branches, or any other kind of participation, the tax exemption works providing that heirs continue the business activity or held the control for a period of time not lower than 5 years from the transfer date. If this condition is not met, the benefit decays and consequently the heir has to pay the ordinary inheritance tax and a fee, which is equal to the 30% of the due tax.

In conclusion, other rules state some reductions of the taxation: For example, in the case of an inheritance opened in 5 years starting from another inheritance or gift, the taxation is reduced of an amount inversely proportional of a tenth per year. [70]

As aforementioned in the previous paragraph, the law decree number 262 of 2006 reintroduced the inheritance and gift taxation. The reason for pulling together those two tax assumptions is that they both represent an enrichment, and because of the tax avoidance that would derive if only one form of assumption was taxed. The gift tax differs from the previous discipline of 1990 because the new taxable

[67] Art 768-bis e ss cc

[68] Part of the tenant who agrees with this interpretation is F. Falsitta: op cit pag. 945

[69] With this expression we indicate only the legal control which is the detention of more than half of shares and rights to vote in the normal assembly of a company.

[70] Art 25 TU Successioni

subject is wider: not only generosities and other gifts[71] are levied but also free acts and the establishment of destination obligations.

Particular attention must be paid to the category of free acts: the reason is that the extension of the tax assumption also to those acts that are not generosities, may be considered unconstitutional under article 76.[72]

This is due to the fact that the parliamentary decree n. 825/1971 limited the sphere of application of this tax only to gifts and other generosities inter vivos.[73]

Furthermore, the establishments of destination obligations are levied only if they transfer properties; among them trusts must be enlighten.

In common law legal systems, a trust is a relationship whereby property is held by one party for the benefit of another. A trust is created by a settlor, who transfers some or all of his property to a trustee. The trustee holds that property for the trust's beneficiaries. In particular, if the trust is established in favor of an identified beneficiary, then the gift tax should be directly applied to that beneficiary because the trust is a transparent entity. On the other hand, if property is transferred to a purpose trust, then the tax is levied on the trust.[74]

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[71] Art 1 TU n. 346/1990

[72] The law function may be delegated to the government only determining principles and the legislative criteria and only for a limited time and for defined objects.

[73] G. FALSITTA, Manuale di diritto tributario parte speciale, cit pagg 952-3

[74] G.FALSITTA, Manuale di diritto tributario parte speciale, cit, pag.954-955

CHAPTER 2

INCOME TAXATION FOR INDIVIDUALS

2.1 TAX ASSUMPTION AND CATEGORIES

As mentioned at the beginning of our work, the Italian taxation system, in principle, has adopted an idea of overall income: Article 1 of the TUIR states that the income of individuals is taxable only if contained in one of the income categories supplied by article 6. All those categories are devised as to include all the taxable income and every one of them has its own rules to determine the tax base.

The IRPEF is designed in order to tax the overall income of individuals in respect to the principles of progressivity and equality stated by the constitution; actually many substitute systems, exemptions and tax breaks have been introduced.[75]

2.2 DETERMINATION OF THE TAX BASE

The gross tax base is calculated on the overall income, wherever produced, for residents, whereas on only the income produced in Italy for non-residents; The only exception in this regard is the municipality of Campione d'Italia, located within the borders of Switzerland: the residents are subjected to Italian income tax, but the computation of income earned in Swiss francs is based on a (very favorable) exchange rate, periodically established by the competent authorities.[76]

In order to determine the overall income, first of all, we have to qualify the single kinds of income to check the category they belong to; secondly, the taxable income is calculated applying the deductions from the overall income; finally, the tax is established, applying the rates to the taxable income.

The income taxation of individuals is a personal tax, but the overall income is determined considering also the personal and family situation of the taxpayer.

[75] On this matter, many authors consider a dual model in which not all the incomes are taxed in a progressive and effective way inspires our tax system.
F.TESAURO, Istituzioni di diritto tributario parte speciale, cit., pag 10;
[76] IBFD, "Individual taxation in Italy" 16 febr. 2014

This is realized through two different types of deductions: deductions are expenses that can be subtracted from the overall income, and to resume, are deductible medical expenses and those of specific assistance, alimonies, social duties etc.[77]After the deduction from the overall income of those expenses, we have to consider deductions of a different kind: those expenses that can be subtracted from the gross tax[78], and these can be identified in three groups:

- Deductions for family members, which are attributed to those who have to maintain family members; their amount decreases at the increase of the overall income.[79]
- Deductions for employees and retired people, which are substitutes for production expenses; these are measured in a decreasing way on the overall income, and they have the purpose to guarantee the progressivity of the taxation with the rates. Moreover, deductions for employees have also the aim to obtain "at forfeit" the deduction of production costs.[80]
- Deductions for particular expenses, which are permitted only up to the measure of 19% of their amount.[81]

After applying these other types of deductions the net income is determined; this differs from the due amount, which is obtained subtracting possible tax credits and already paid down payments.

2.2.1 SEPARATE TAXATION

Some income, mandatorily identified by the legislator, are taxed separately[82]: the purpose is to avoid that an income, formed during many years but perceived in one fiscal period, is taxed using the progressivity method. The main characteristic is the fact that they were accrued in many years. Some examples of these income are:

- Severance pay and similar;

[77] Art 11 TUIR
[78] In Italy there is a distinction between normal deductions and the so called "detrazioni", as aforesaid are those than can be deducted from the gross tax.
[79] Art 12 TUIR
[80] Art 13 TUIR
[81] Art 15 TUIR
[82] Art 17 TUIR

- capital gains realized through the transfer upon payment of enterprises, had for more than 5 years;
- capital gains realized through the transfer upon payment of buildable lands;
- Payments for the transfer of the customers' list or other intangibles.

Moreover, also the income of the de cuius perceived by heirs is taxed separately. This is the only hypothesis of separate taxation not contained in the article 17 of the TUIR.[83]

All those income are levied with the same mechanism of taxation, with the only exception of the severance pay. The separate taxation consists in the application of a rate equal to the half of the overall net income of the previous two years. This system, hence, allows not to apply the progressivity. However, the taxpayer may choose to be levied with the regular taxation if the amount of the separate one is higher; this may happens if in the two previous years, the taxpayers had high income and the income to tax separately is lower.

The severance pay has a particular separate taxation. Indeed, it considers the period of time in which the income is accrued; it is taxed with a lower rate the severance pay that was accrued longer.[84]

2.3 INCOME CATEGORIES

The income tax for individuals gathers together income in different categories; we are now going to analyze every single one of them in order to figure out if the Italian income taxation can be considered "fair and equal" according with Article 53 of the constitution.

2.3.1 INCOME FROM LAND AND BUILDINGS

The first category is land income, which is identified as that income deriving from soils and buildings placed within the territory of the State[85], registered in land cadastres[86].

[83] Art 7,clause 3
[84] G. Falsitta, Manuale di diritto tributario parte speciale, cit pag 141-145.
[85] Those immovables that do not have those criteria produce miscellaneous income
[86] Art 25 TUIR

The discipline is contained in articles 25 and 41 of the TUIR. However, many of those rules are no longer applied after the introduction of the IMU (explained in par.1.4.1), which substitutes it in many cases. The main characteristic of land income is that it has always been quantified through cadastral indices; only for buildings sometimes, the effective income is used. This feature waives the effectiveness principle, which states that the ability to pay must be measured on effective measures, not on abstract ones. However, this waiver is balanced with the fact that the predetermination of a normal average income may represent an incentive for production, because it rewards those who obtain a higher income and punishing those with lower one.[87]

We can see that land income may be further organized in two broad categories: soil income and building income.

The first one may be distinct in landlord income and in agrarian one. The landlord income is the one that derives from the possession of the land obtained by ownership or any other right on goods.

On the other hand, the agrarian income arises from the cultivation of soils.

Even in this case, the income is determined in an abstract way; usually the effective income deriving from agriculture is higher than the one calculated through cadastral indices. Therefore, as abovementioned, this phenomenon may be justified with the legislator's intention of promoting the development of those activities no longer exercised as before.

The building income, instead, is obtained as the normal average income that derives from urban immovables.[88]

As said in the first chapter, nowadays the IMU absorbs part of the IRPEF on buildings as long as they are not rented. Indeed, if the building is rented and the rent is higher than the cadastral value, then the tax base is calculated as the rent less the 5%: as we can see, the tax base is determined as the effective income in despite of the general rule applied to land income. Notwithstanding the fact that the effectively sustained expenses are not deductible about the maintenance of the building but only with a forfeit of 5%, this represents a violation of the principle

[87] G.FALSITTA, Manuale di diritto tributario parte speciale, cit., pag. 148

[88] We consider urban immovable as those buildings or any other constructions that are capable of producing an autonomous income.

of the ability to pay if the actual expenses are greater than that percentage. Indeed, a higher income than the actual one would be taxed.

The legislative decree number 23 of 2011 introduced an optional favor regime for that income that arises from rent of residential building; this regime provides for a withholding tax of 21%, calculated on the full amount of the rent and excludes the IRPEF application.[89]

2.3.2 CAPITAL INCOME

The capital income is a category defined by the legislator through a list[90] in which two main groups of income are identified: the first results from income obtained through participations in companies or other entities; the second one concerns interests and other proceeds that arise from mortgage and other forms of capital use. This list ends with a residual rule[91] in order to attract in capital income interests and other proceeds that arise from other dealings that employ capitals, with the exception of those that can realize capital gains and losses in relation to an uncertain event. [92]

The main rules, which determine the capital income, are two:

- the gross taxation, which prevents deductions or deductions for the expenses for the production of that income. This rule is based on the presumption that the income production does not involve any production activity for the taxpayer; so the capital income is considered to be deriving strictly from the investment.
- the second general rule is the taxation according to the cash principle: That income is, taxed at the moment of perception regardless at the accruals. Consequently, the taxpayer may delay the perception of the income and therefore the taxation to later periods in order to have a greater convenience. .

[89] G.FALSITTA, Manuale di diritto tributario parte speciale, cit. pag. 162-164
[90] Art 44 TUIR
[91] Art 44, H) TUIR
[92] In fact, these capital gains and losses produce other income.

This last principle, however, has some exceptions: one is that interests from mortgages are considered perceived at maturity in the predetermined amount; a second exception to the cash rule concerns the management entrustment of some capital to qualified financial intermediaries[93]where capital is taxed at maturity with a withholding of 20%. The peculiarity of this method is that on one hand, it gives importance to the maturity rule, and on the other hand, it permits the compensation between positive and negative elements that arise from capital and other forms of investment.[94]Capital income are not always taxed in an ordinary way, but often they are taxed through withholdings which are preferential treatments both because the taxation is proportional both because the tax rate is low.[95] This withholding is justified by Article 47 of Italian Constitution, in which saving is identified as a state purpose; On the other hand, it represents an exception to the ability to pay principle and, in particular, to progressivity. In this way, there is discrimination between individuals, which perceive income taxed in an ordinary way, and investors.[96]

The first kind of capital income consists of dividends that we are now going to analyze, and of participation proceeds.[97]

Dividends are of particular interest because of the phenomenon of the possible economic double taxation and the participation exemption system; this problem arises from the fact that the same income may be taxed firstly on the company that produced it as business income, and once distributed to partners as dividends, it is taxed as capital income.

The double economic taxation of dividends may be solved with various instruments. In order to avoid this problem, since 1977[98] Italy has adopted the tax credit system (also known as the imputation system): through this system the company paid the tax on its income but only temporarily because a tax credit was given to resident partners according to the tax paid by the company: dividends

[93] We refer to administrate saving.

[94] We refer to the fact that capital income may be compensated with other forms of investment.

[95] Since 1st of January of 2012 the withholding rate is of 20% as it was stated in the law decree 138 of 2011.

[96] F.TESAURO, Istituzioni di diritto tributarario parte speciale, cit. pag. 53

[97] Art 44 lett E)

[98] Legg1e

were part of the IRPEF tax base of partners but from the gross income was subtracted the tax credit.

With the legislative decree 344 of 2003, Italy eliminated the credit tax system and adopted the tax exemption one also known as participation exemption. This change derived from EU, in particular from a decision of the ECJ.[99]This decision identified a violation of the principle of free movement of capitals in all those cases in which a law system applied more favorable tax criteria to national dividends then foreigner ones. It was the case of Italian law, that granted a tax credits to residents only if it was linked to dividends paid by resident companies.[100]

Thus, with the participation exemption system, income is taxed definitely on the company that produced it, whereas dividends given to partners are not taxed. Actually, the main goal of the exemption was realized only in the case that the partner is a company, where the given dividends are excluded from taxation in the measure of 95%.

In the case of individuals instead, such exemption is only partial: dividends received from 1th of January 2012 by individuals outside the aim of a business activity are subject to a 20% withholding tax in settlement of whereby they concern no qualifying holdings. Qualifying holdings consist of shares (other than savings shares) and any other investment in the capital or equity of a company to which voting rights are linked in the ordinary Shareholders' Meeting exceed 2% or 20%, if the securities are traded on a regulated market, or 5% or 25%. In the case of a qualified holding, dividends are part of the IRPEF tax base with an amount of 49,72%.[101]

Thus, it's clear that there is still a double economic taxation for individuals; the participation exemption system, even if adopted in order to prevent the avoidance of European principles, is still unfair under many points of views: First, amongst individuals there is a different treatment depending on the holding amount; another discrimination is amongst individuals and companies: indeed, is not clear

[99] Sent. C-35/98 of 6/6/2000, Staatssecretaris van Financiën vs. B.G.M. Verkooijen

[100] G. FALSITTA, Manuale di diritto tributario parte speciale, cit., pag. 136-139

[101] Art 47, clause 2 TUIR

the reason why the double economic taxation has been only lessen but not completely reduced for individuals[102]; moreover, income taxation is higher than any other form of financial proceeds,generally taxed with a withholding of 20%.

2.3.3 EMPLOYMENT INCOME

Income from employment is defined as that income derived from a relationship having as its object the performance of work in the employ of and under the direction of others[103], including domestic labor in the cases provided by labor law. Pensions of all types and allowances treated as the equivalent are considered employment income.[104]

Some types of income are assimilated[105] to the employment one even if they do not have some of the features that define an income as an employment one: for example there may be the lack of the subordination (priest revenue) or of business activity (scholarships, alimonies etc.).

The main rule to determine the employment income is article 51 of the TUIR, which states the all-comprehensively principle: income from employment consists not only of salaries but all compensation, whether in cash or in kind, received during the tax period, including any compensation received as profit sharing with reference to an employment relationship, reimbursement of expenses relating to the production of income and gratuitous payments.[106]

Although, there are some types of income that are not taxed in spite to the all comprehensively rule[107], for example:

- The subsidies that the employer pays for social services; they will be taxed at the moment of perception.
- Ticket restaurants and the sums paid for nurseries which are excluded for anti-elusive reasons seen the great difficulty to determine their actual amount.

[102] G. FALSITTA, Manuale di diritto tributario parte speciale, cit. pag. 195
[103] IBFD, "Individual taxation in Italy", cit. pag. 13
[104] Art 49 TUIR
[105] Art 50 TUIR, which provides for a mandatory list.
[106] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit. pag. 57-58
[107] Art 51 comma 2

2.3.4 PROFESSIONAL INCOME

Professional income is income derived from exercising an art or profession[108], engaging in activities of independent work in a habitual even though not exclusive way.

Besides self-employed income in the strict sense, there are also some types of income, which are not self-employed, but that are assimilated to them because of some common features[109]: amongst them we have to remember those coming from the utilization of literary and artistic works, patents etc, by the author or the inventor[110]; for the aforementioned types of income, a deduction at forfeit is stated and it is equal to 25% of the received payment; if individuals younger than 35 years receive those payments, the deduction is fixed at 40%.

Other types of income assimilated to the self-employment ones are, for example, the participation by promoters in corporations, and income given in joint ventures when a work activity is provided. All those kinds of income are taxed at gross; therefore, no deduction is provided because there is a presumption that those income do not need any type of production expenses.[111]

The determination of the tax base is calculated as the difference between payments and costs; therefore, self-employment income is net taxed. The positive elements of income are actual payments both in nature and in cash, capital gains of instrumental assets even immovable's, and payments that coming from the transfer of the clientele.

Concerning capital gains, we can see that they are part of the tax base only if they are realized with transfer upon payment, with refund for the lost or damage of assets and in the case of self-consumption.[112] However, capital gains are not part of the tax base if they concern art objects, antiques and collections.[113] In any case, we have to stress that those capital gains are part of the base only since 2007.[114] Up until 31 of December of 2006, capital gains were not levied: that was

[108] article 53 of the TUIR
[109] Art 53 clause 2 which contains a mandatory list of assimilated income.
[110] Those income if are obtained by different subjects than the author or the inventor are considered to be other income.
[111] G. Falsitta, Manuale di diritto tributario parte speciale, cit pag 219-221
[112] Same for Ires
[113] Art 54, clause 1bis TUIR
[114] Law decree 223 of 2006 and the law 286 of 2006.

considered unfair because it was an unjustified exclusion of those assets from the tax base.[115] Besides capital gains, we can see that the relative capital losses are deductible if they arise from transfers upon payment or as refunds.

Nowadays, since 2006, profits deriving from the transfer of customers' list and other intangibles are part of self-employed income[116]. Actually, the income revenue authority, before the modification of the rule, stated that those profits were part of the income but as other income.[117] Furthermore, those profits may be taxed separately according to the article 17 lett g) ter of the TUIR if they are received in one solution or even with more payments but in the same fiscal period.[118] The reason for the separate taxation is that the high payment received, which was produced in many years, would be part of only one fiscal period because in this way there would be very high rates and brackets. [119]

On the other hand, deductible expenses are those that arise during the business activity. Therefore, to deductible expenses two main principles are applied: the relevance and the cash principles. However, there can be some exceptions to those rules since there are some long-term costs that are deductible at maturity[120], others that are not deductible at all or not entirely[121] and some costs at forfeit.[122] The limitation of deductions can be seen as an instrument to contrast elusive cases and to avoid problems about the exact amount of those costs that sometimes are difficult to quantify.[123]

[115] G.FALSITTA, Manuale di diritto tributario parte special, cit., pag. 222-223.

[116] Art 54 clause 1 quater TUIR introduced by the article 36 clause 29 of the law decree 223 of 2006.

[117] In particular, those income were part of the article 67 lett L) of the TUIR. (doing, not doing or permitting duties)

[118] Circ. A.E. number 11/E 2006 par. 7.1

[119] G.FALSITTA, Manuale di diritto tributario parte speciale, cit. pag. 223.

[120] For example, leasing and amortization of instrumental assets, that at the same time cannot be entirely deducted.

[121] Are entirely deductible the costs for instrumental assets with a value not bigger than 516,46 Euro; other assets are deductible every year in the maximum value determined with the amortization. Costs related to the pursue of immovable are not deductible. Rents, on the other hand, are entirely deductible.

[122] Costs at forfeit are for example those relative to service cars that are deductible up to the 40% of the cost or the telephone usage up to the 80% of the value.

[123] G. FALSITTA, Manuale di diritto tributario parte speciale, cit pag 226-228.

2.3.5 BUSINESS INCOME

The discipline of business income may be divided in two groups of rules: the first is related to the income source and the other specifies how to calculate the tax. With the reform of 2003, the discipline of business income has changed; indeed, nowadays in the IRPEF discipline, there are the rules to determine the source of the income, whereas in the IRES one there are the rules to determine the tax base [124]. Therefore, we are now going to analyze when the business income is realized, whereas the determination of the tax base will be analyzed in the following chapter.

In our legislation Business income are those, which arise from the exercises of commercial enterprises. With this last expression, we mean the exercise with habitual, even not exclusive, exercise of those commercial activities defined in the article 2195 of the Italian civil code, regardless at the organization as enterprises. On the other hand, business income are also those which derive from the exercise of an activity organized as enterprise in order to produce services different from commercial activities. Finally, business income are also some agricultural activities overcoming the boundaries stated in the article 32 of the TUIR.

As we can see, the difference between business income and self-employed one is the presence or the absence of an organization as enterprise.[125]

As aforementioned, business income is determined for individuals and commercial partnerships according to the rules of corporations. However, there are some particular rules that are applied only to business income taxed with IRPEF as stated in the articles from 56 to 66 of the TUIR. For example, we are going to underline some of the most important amongst them[126]:

- Between the revenues the normal value of goods assigned to the personal consumption of the entrepreneur, those distributed to the stockholders, or assigned to destinations that differ from the business purposes (in this case

[124] G. FALSITTA, , Manuale di diritto tributario parte speciale, cit pag 232

[125] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit pag 69-72

[126] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit pag 80 ss.

both for capital gains and revenues must be included every time they separated from the corporate domain) must be included.

- Art 56 states that losses of a period may be deducted from the overall income but only net from the proceeds that are not taxed. [127]
- Wage spent for the work exercised by the family of the entrepreneur, or by the entrepreneur himself are not deductible, and this in order to avoid the simulation of employment, that could reduce the taxable income[128].
- Capital gains that do benefit of the PEX regime are exempted only for the 50.28% of their amount and the remaining part is taxed.[129]Therefore, capital losses are deductible only for the 49.72 %. Dividends are taxed only for 49.72% of their amount. [130]
- Interests are deductible only in the amount calculated as the ratio between revenue that are part of the business income or those that are excluded from it and the overall revenues.[131]

Particular rules are provided for minor taxpayers, according to which individuals that do not go beyond a certain threshold of income are admitted to such a privileged set of rules, this legislation is indicated in par. 3.7.1.

2.3.6 OTHER INCOME

This category of income is defined as a residual one because it contains types of income that are different from each other and that do not arise from a common source. In other words, other income contains all those income that cannot be inserted in a different category.

Other income can be divided in three categories: capital gains, occasional activities and other income.[132]

Capital gains differ from those in other categories because they are not realized during a habitual economic activity: Capital gains can be related to real estates or financial instruments. The first one contains both capital gains realized through

[127] Art 56 clause 2 TUIR
[128] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit pag 81
[129] Art 58 clause 2 TUIR, recalling art.87 TUIR.
[130] Art 59 TUIR
[131] Art 61 TUIR
[132] G. Falsitta, Manuale di diritto tributario parte speciale, cit pag 248

the subdivision of lands or through the transfer upon payment of immovables, had for no longer than 5 years (with the exception of haired immovables and those which have been used as the main residence) and those that are realized through the transfer upon payment of buildable lands. In relation to the second type of capital gains, those are the ones that are realized through the transfer of shares or bonds or any other financial instruments that cannot be taxed using the participation exemption system as they lack some of the features required by the article 87 of the TUIR.

Moreover, a second group of other income is the one arising from commercial activities or self-employment activities that are not habitual and from those income that arise from the assumption of doing, not doing or permitting duties. [133]

To conclude, other income can be for example land income whose amount is not determined by cadaster, lottery wins, prizes for artistic, scientific or social causes etc.

2.4 PARTNERSHIPS

Article 8 of the TUIR states that income of simple partnerships, general partnerships and limited partnerships, residents in Italy, is attributed to each partner in proportion to his participation in the profits, regardless of the amount actually received by that partner.

Factual partnerships, professional associations, simple partnerships and shipping partnerships are, from the tax point of view, compared to partnerships.

In the Italian tax system, therefore, partnerships are subjected to the transparency principle; this means that they do not have tax liability but only formal duties as the presentation of tax returns. The reason at the base of this rule is that partners of those partnerships take actively part to the business, not considering it only as a capital investment. The other justification of such regime is that the structure of partnerships usually is quite simple and, therefore, the discrimination between distributed profits and retained one would be difficult.

However, we have to make a difference between the tax regimes of those partnerships depending on whether they carry out a business activity or not.

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[133] Art 67 lett. L) TUIR

Indeed, if the partnership has a business activity it produces business income; this category includes general partnerships and limited partnerships: Therefore, the profit perceived by partners is taxed as a participation income, which is a further category of income but has some features of the business income.[134] Moreover if the partners are corporations or sole proprietors then the profit of those partners would be business income. Furthermore, losses of business partnerships are subdivided amongst partners in the same way as profits; but if the amount of losses exceeds profits for the period, than the difference may be offset in the following years but not beyond the fifth. [135]

On the other hand, partnerships, which do not carry out a business activity, are simple partnerships[136] and professional associations, which are compared to the first type. Those partnerships do not produce business income but other kinds of income as land income, self-employment income, capital income and other income. Therefore, they are taxed with the particular rules of every category.

[134] See paragraph 2.3.5 business income.

[135] On the other hand, for corporations, in Italy losses may be offset forward without a maximum period of time but they can be deducted only for an amount that is equal to the 80% of the profit. This is stated in the article 84 of the TUIR.

[136] Simple partnerships are adopted by factory farms, real estate's enterprises and professional activities.

CHAPTER 3

THE ITALIAN CORPORATE INCOME TAX

Italian legislator makes a distinction between individuals, partnerships and corporations. The Italian corporate income tax (in Italian, IRES) is a proportional and personal tax whose rate amount to 27,50%. It's calculated directly on the result of income statement.

IRES, established with the legislative decree n. 344/2003, took the place of IRPEG and entered into force the first of January 2004. The aim of the legislator was to modernize the Italian system of taxation on capital gains, and to create a mechanism more similar to the other states of European Union[137].

3.1 TAXABLE SUBJECTS

With respect to resident legal entities, corporate income tax is levied on[138]:

Companies:

- joint-stock companies;

- limited liability companies;

- partnerships limited by share;

- cooperative societies;

- mutual insurance companies;

Moreover are taxed with the IRES public and private entities and trusts, with or without legal personality (other than companies), whether or not their sole or main business purpose is the exercise of business activities.

Nonresident companies will be described later in this paper, now I describe the discipline of non commercial entities.

[137] F. TESAURO, *Istituzioni di diritto tributario parte speciale,* cit pag 91
[138] art. 73 of the TUIR.

3.1.1 NON COMMERCIAL ENTITIES

First of all, what we have to understand is what according to our legislation can be considered as non commercial entity: this category includes all entities that do not make as a first activity a commercial activity. In the Italian legislation companies, cooperatives, and mutual insurance companies are considered just for their form commercial entities; for other structures instead, we have to understand if they are commercial or non commercial entities, through the evaluation of certain points:

- In order to establish the purpose of the corporation we have to pay attention to the entity's bylaw, or in case of a lack of the latter, of the activity actually performed by the subject.
- In case of different activities, the principal activity has to be considered the instrumental one in order to achieve the entities' purposes[139].
- The commercial nature of such activity is determined on the basis of Art.55 of Income consolidated tax act, presidential decree n.917 of 1986 (from now on, the TUIR).

The entity loses its non commercial feature, in case of commercial activity exercised for more than one tax period.

Taxation of non commercial entities finds common points both with individuals and with companies, here are explained some of the most important rules:

- The entity receives, such as individuals, income of different kinds, not only attributable to business income;
- The dividend are exempt for the 95%, (same discipline of companies), but for capital gains instead we have to make a distinction: if such gains are acquired outside the business income, then they follow the individuals' regime (whose taxation varies according to the entity of such participation[140]), if they are acquired within the business income then the rules applied are those for the entrepreneur (taxed for the 49.72%of their amount, regardless at the share of such participation).

[139] T.U.I.R art 73, commi 4-5

[140] The individuals' regime is described in par.2.3.2

- Non commercial entities in case of a business activity must establish a separate account, in order to make a distinction between what is inherent with such an activity (that would then be ruled by IRES) and what is not: this distinction is made up following the same criteria applicable to the entrepreneur.

3.2 TAXATION OF COMPANIES' BUSINESS INCOME

3.2.1 GENERAL

All income derived by companies in the exercise of commercial activity is to be considered business income, and is subject to corporate income tax[141].The rules are explained in Art.83 and following of the TUIR, and as we've seen are the same enforced for individuals and partnership in order to calculate the income: however, as we've seen, specific rules are provided for them.

The IRES taxable base is the worldwide income shown on the profit and loss account prepared for the relevant financial year according to company law rules and adjusted according to the tax law provisions concerning business income; and this could lead to variations, on the income statement, positives or negatives. Exempt income and income subject to a final withholding tax are not taken into account in determining taxable income[142].

For companies adopting the IAS/IFRS, the accounting treatment under IAS becomes fully relevant for corporate income tax purposes. I'm referring to the criteria set forth by IAS for the qualification, timing accrual and classification of items of income and cost; these rules are applicable also for corporate income tax purposes and prevail over any provisions contained in the Income Tax Code[143].

[141] (IRES) (article 81 of the TUIR).

[142] article 91 of the TUIR

[143] Detailed rules for the determination of the taxable income of companies drafting their financial statements under IAS are provided by the Ministerial Decree of 8 June 2011.

Taxable business income is determined under the accrual principle[144], with certain relevant exceptions such as dividends, and directors' fees (later discussed). The main rules for determining the positive components of taxable income may be described as follows[145].

3.2.2 TAXABLE PROCEEDS

Gross receipts are receipts arising from the sale of goods or the provision of services whose production or exchange constitutes the main business activity of the company. The following items are also deemed to be gross receipts:

(1) payments received for the sale of raw materials, subsidiary materials, semi-finished goods, and other goods acquired for use in the production process, excluding fixed business assets;

(2) payments received from the sale of shares, bonds and similar securities that are not classified as financial assets in the balance sheet;

(3) indemnities, including insurance, for loss or damage of the above goods, whose sale creates revenues: this substitutes the gain that the company would receive for the sale of such goods.

(4) contributions received under a contract;

(5) contributions received under the law to cover operating expenses.

The above-listed items are considered receipts even when assigned to a shareholder. In such a case, the taxable income is equal to their market value, and it is also the case of partnership, as previously seen.

Capital gains and losses are also included in taxable income, but are subject to special rules later discussed.

[144] article 109(1) of the TUIR
[145] Italy Corporate Taxation, Carlo Gallo, IBDF, cit. pag 27ss

Extraordinary income. Extraordinary income may be defined as income that does not belong to the financial year under the accrual principle and/or income that has been taken into account in previous financial years. These are[146]:

- extraordinary income derived from items relating to costs and expenses deducted in prior financial years;

- extraordinary income derived from items relating to liabilities shown in the balance sheet in prior financial years;

- income derived from the later discovery of the non-existence of costs and expenses deducted in prior financial years;

- income derived from the later discovery of the non-existence of liabilities shown in the balance sheet in prior financial years.

Typical examples are the recovery of debt claims considered lost, the refund of taxes deducted in previous financial years and indemnities for damages (other than those giving rise to gross receipts, or to capital gains.

Extraordinary income also includes sums received in money or in kind as a contribution or a gift (except those contributions regarded as gross receipts under (4) and (5) above). At the taxpayer’s option, this type of extraordinary income may be included in taxable income in the year of receipt or in equal installments in the year of receipt and the following 4 years. Contributions received to purchase depreciable assets are not included in the taxable income. However, their amount is to be deducted from the cost of the asset for the purposes of determining the depreciable base[147].

Gains from the disposal of capital assets are included in taxable income for corporate income tax purposes. Special computation rules apply. Capital gains on qualifying participations are exempt from tax.

[146] article 88 of the TUIR.
[147] article 88(3)(b) of the TUIR

Dividends. Dividends derived by resident companies from other resident companies are *excluded* from corporate income tax for 95% of their amount[148]. This term is very important, because the difference between exemption and exclusion, leads on the fact that for the latter is admitted the expense' deduction; the exemption instead, as we will later see, does not grant this possibility.

Moreover, contrary to the accrual principle, non-exempt dividends are included in taxable income on a cash basis. A special tax regime applies to shares and similar financial instruments held by companies preparing their financial statements according to the IAS/IFRS. The regime differs, depending on whether or not the shares are accounted for as "held for trading" under IAS/IFRS. If the shares are accounted for as "held for trading":

- the 95% exemption regime otherwise generally applicable does not apply to the dividends received on such shares; instead, those dividends are subject to tax for their entire amount;

Interest. Interest is included in taxable income on an accrual basis (unless exempt). If the rate of interest is not specified in writing, it is deemed to be equal to the statutory interest rate, which is 2.5% with effect from 1 January 2012.

Interest paid in on current accounts is included in taxable income in its entirety, even if it is partially or fully offset by interest paid out on the same account[149].

Interest on bank deposits, state bonds and shares in foreign mutual funds received by entities subject to corporate income tax and not exercising a commercial activity are subject to a final withholding tax; such interest is, therefore, not included in taxable income. Interest on "repo" contracts constitutes taxable income for the part accrued in the period between the purchase and resale of the security. The difference between the purchase and resale price, net of the interest accrued, is also included in taxable income to the extent it refers to the financial year[150].

[148] article 89 of the TUIR.
[149] article 89(7) of the TUIR
[150] article 89(6) of the TUIR

Income from immovable property. For IRES purposes, income from immovable property is subject to different regimes, depending on the character of the property from which it originates. If the property is exclusively used for the exercise of the business activity (or because of its characteristics, can only be used for the exercise of the business activity), income originating from the property is included in taxable income as it is shown on the profit and loss account. Income derived from other immovable property is also considered business income, but is determined under specific rules on income from immovable property. According to those rules, income from immovable property is equal to the higher of cadastral income or actual income (e.g. rents) reduced by relevant expenses up to a maximum of 15% of the actual income[151]. If the property is situated abroad, income is determined according to the rules in force in the state in which the property is located. If the sale and purchase of immovable property constitutes the main activity of the company, the sale of property gives rise to gross receipts and is treated as described above. Otherwise, it gives rise to capital gains or capital losses.

3.3.2 TAXABLE PERIOD

The taxable period for corporate income tax purposes is the financial year of the company, as determined by law or the articles of incorporation. In case of no determination, or if the financial year is longer than 2 years, the taxable period has to be considered the calendar year[152].

3.3 CAPITAL GAINS

Gains from the disposal of capital assets are included in taxable income. Special computation rules apply. In the case of devaluation, the capital loss is not deductible, as we will later see instead, the goods from which receipts arise can be subjected to depreciation.

3.3.1 CAPITAL ASSETS

With “capital assets” the legislator means all assets which do not give rise to gross receipts, with some exceptions. Generally, these assets are recorded in the balance

[151] article 90 of the TUIR
[152] article 76 of the TUIR

sheet as fixed assets (immobilizzazioni). This is typically the case with depreciable assets and financial assets. Capital gains and losses on motor vehicles whose depreciation for tax purposes is limited are taxable in the proportion of deductible depreciation to total depreciation[153].

3.3.2 REALIZATION

Capital gains are included in taxable income for corporate income tax purposes if they are:

- realized by a sale;

- realized as indemnities for property loss or damage, including insurance payments; or

- assigned to the shareholders or used for purposes other than business purposes[154].

Capital gains are deemed to be realized when they are derived from the sale for consideration of the asset or from indemnities for loss or damage of the property. A capital contribution of assets is also considered a sale of the assets. The designation of assets to purposes other than business or their assignment to the shareholders is a deemed disposal and gives rise to capital gains, but the gains are not considered realized. In such cases, the transfer value is deemed equal to the market value of the assets.

3.3.3 COMPUTATION OF CAPITAL GAINS AND LOSSES

A capital gain or loss is equal to the difference between the sales price, less the costs directly attributable to the sale or the indemnity received or the value, as the case may be, and the value of the asset for tax purposes, i.e. net of the depreciation taken.

No gain or loss is recognized if a capital asset is exchanged for another capital asset (not necessarily of like kind) and the new asset is recorded in the balance

[153] article 164(2) of the TUIR
[154] article 86(1) of the TUIR

sheet at the same value as the old asset. Any money compensation is, however, considered a taxable capital gain.

3.3.4 PEX and Exemption of capital gains

95% (84% before 2008) of the amount of capital gains derived from the disposal of shares and other participations by corporate entities is exempt from tax, provided that the participation has been held continuously from the first day of the 12th month prior to the disposal; for this purpose, the LIFO principle applies[155].

In order to qualify for the exemption, the following criteria must be met through the 3 financial years preceding the year of the disposal:

- the participated company must be a resident of a state or territory which is included in the white list for CFC purposes , unless a ruling has been obtained that the holding of the shares in the non white-listed company does not achieve the localization of income in a non white-listed state or territory ("subject to tax" test);

- the participated company must perform a real business activity (companies the value of whose assets is mainly represented by real estate not used in the business activity are deemed not to perform a real business activity) ("active business" test). The active business test does not apply in the case of participated companies listed on a stock exchange; and

- the participation must have been accounted for as a long-term investment (fixed asset) in the first balance sheet of the holding period).

In the case of shares held in a holding company, the "active business" and "subject to tax" tests are met if they are met by the subsidiary whose shares represent the majority of the assets of the holding company.

The holding of participations qualifying for the participation exemption triggers limitations in the deductibility of capital loss. The exemption is denied up to the amount of deductible capital losses generated on participations in financial years 2002 and 2003.

[155] article 87 of the TUIR

A taxpayer may choose to include realized capital gains in the taxable income of the current financial year or spread them in equal installments over the current year and the following years, up to the fourth year. The spreading option is limited to gains on assets held for at least 3 years[156].

The spreading option is also available for financial assets (other than participations qualifying for the participation exemption) which have been classified as such in the last three annual balance sheets. The LIFO method applies for determining the holding period.

3.4 DEDUCTIONS

3.4.1 General principles

According to the main rule, three principles must be met in order to consider an expenses as deductible:

- costs and expenses may be deducted only if they are incurred for the production of income. This rule does not apply to certain deductible items, such as interest subject to a special rule (*see* below), certain taxes, social security contributions and costs incurred for the general benefit of employees (e.g. recreational facilities).
- The deduction of business expenses is allowed on an accrual basis, with some exceptions (e.g. directors' remuneration). In addition, costs and other expenses are deductible in the financial year in which they are certain or casn be considered as such[157].
- The third general rule is that, to be deductible for tax purposes, expenses must be entered in the profit and loss account pertaining to the relevant financial year[158]. Expenses are also deductible if they are entered in the profit and loss account of a previous financial year if the deduction was postponed in compliance with the law[159].

[156] article 86(4) of the TUIR
[157] article 109(1) of the TUIR
[158] article 109 of the TUIR
[159] article 109(4) of the TUIR

3.4.2. EMPLOYEES' REMUNERATIONS

Remuneration paid to employees, both in nature and in cash, is deductible by the company even if it does not constitute taxable income for the employee (for example small gifts).

Certain rules are set in order to limit the deduction of nature remunerations, deductible only in part or not deductible at all[160].

3.4.3. DIRECTORS' FEES

Directors' fees, both in fixed amount or as a proportion of profits, are fully deductible on a cash basis[161]. This rule is designed to combat tax avoidance by small companies where the shareholders are also directors and where the company could reduce taxable income by deducting directors' remuneration that was never paid.

3.4.4. DIVIDENDS

No deduction is provided for dividends.

3.4.5. INTERESTS

The deduction of interest is subject to several limitations, and to particular rules, that depends on the type of company , such as[162]:

- interest expenses (irrespective of whether they are related to loans granted or guaranteed by related parties), other than capitalized interest expenses, are deductible up to an amount equal to interest income accrued in the same tax period. Any excess over that amount is deductible up to 30% of "gross operating income" derived through the core business of the

[160] Expenses incurred by the company for the general benefit of employees for educational, recreational, sanitary or religious purposes are fully deductible only if these benefits must be provided under a collective labor agreement; if the employee benefit is not mandatory under such an agreement, it is deductible only up 0.5% of the total expenses for employment according to article 100(1) of the TUIR.
Sums paid to pension funds for the benefit of employees are deductible under certain conditions. For companies drafting their financial statements according to IAS/IFRS, the costs accrued in the profit and loss account for employee share schemes are deductible.

[161] article 95(5) of the TUIR

[162] F.Tesauro, Istituzioni di diritto tributario parte speciale, pag.145.

company[163]. Any excess of interest expenses over the above threshold (i.e. 30% of EBITDA) may be carried forward (hereinafter "interest carried forward") for deduction in the following unlimited number of tax periods to the extent that the net interest expenses (i.e. those exceeding interest income) accrued in such tax periods are less than 30% of EBITDA. Any excess of 30% of the EBITDA over net interest expenses realized from tax periods beginning on or after 1 January 2010 may be used to increase the relevant threshold for the following tax periods[164].

- In case a company is party to a tax consolidation regime, any excess interest expenses (accrued after the inclusion in the consolidation group) over 30% of EBITDA (or any interest carried forward) generated after the inclusion in the tax consolidation may be used to offset the taxable income of another company within the tax consolidation up to the amount of (30% of) such company's EBITDA that has not been used to deduct its own interest expenses. Most of the time this is a tool exercised by companies, in order to deduct interest that otherwise would not have been deducted[165].

3.4.6. ROYALTIES

Royalties paid for patents, trademarks, know-how and similar rights are deductible.

3.4.7. SERVICE AND MANAGEMENT FEES

Service and management fees are deductible.

3.4.8. RESEARCH AND DEVELOPMENT

Research and development expenses are deductible in the financial year in which they are incurred or in equal portions in that year and the 4 following years[166].

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[163] The "gross operating income" (earnings before interest, taxes, depreciation and amortization, EBITDA) is calculated as the difference between (i) the value of production and (ii) costs of production excluding depreciation, amortization and financial leasing installments relating to business assets. The relevant items are those resulting from the statutory profit and loss account of the company.

[164] article 96 of the TUIR

[165] F. Tesauro, istituzioni di diritto tributario parte spaciale, pag. 145-146.

[166] article 108(1) of the TUIR

3.4.9. OTHER DEDUCTIONS

3.4.9.1. DONATIONS

As regards gifts, the following are deductible:

(1) gifts made to or on behalf of all employees for the specific purposes of education, recreation or religious or social welfare, provided they do not exceed 0.5% of the amount of the employee payroll as shown in the annual tax return of the company;

(2) gifts to entities devoted to education, scientific research, recreation, religious or social welfare, not exceeding 2% of taxable income;

(3) gifts to universities, not exceeding 2% of taxable income;

(4) gifts to legal entities in the developing area of southern Italy (*Mezzogiorno*) which engage solely in scientific research, not exceeding 2% of taxable income;

(5) gifts to public entities, institutions, non-profit foundations and associations which engage solely in entertainment, to be used for building new structures or restoring or expanding existing structures, as well as for production in various entertainment sectors, not exceeding 2% of taxable income;

(6) gifts to cover expenses for maintaining, protecting or restoring property having a cultural and/or artistic value and being subject to legal restrictions under Law 1089/1939 and DPR 1409/1963;

(7) gifts to the state and registered non-profit entities to be used for purchasing, maintaining, protecting or restoring property which has been determined to have cultural and/or historic value by Law 1089/1939 (article 1) and DPR 1409/1963; and

(8) gifts to private licensees of EU-wide radio broadcasting, up to 1% of taxable income.

Advertising and other publicity expenses are deductible in the financial year in which incurred or in equal portions in that year and the 4 following years[167].

[167] article 108(2) of the TUIR

3.4.9.2. ENTRATEINMENT COSTS

Entertainment expenses must be written off in the financial year in which they incurred. These expenses are deductible to the extent that they are inherent, adequate and related to the income generated. The expenses must also be properly documented[168].

Ministerial Decree 11/2009 provides for a list of entertainment expenses and the limit under which deduction is admitted:

- 1.3% of the revenue, up to EUR 10 million;
- 0.5% of the revenue, for the amount above EUR 10 million up to EUR 50 million; and
- 0.1% of the revenue, for the amount exceeding EUR 50 million.

Small business gift expenses whose value is less than EUR 50 per unit are fully deductible.

3.4.9.3 MISCELLANEOUS EXPENSES

Other expenses relating to more than 1 financial year are deductible up to the amount chargeable in each year. Expenses relating to more than 1 financial year that cannot be capitalized under the IAS can be deducted in equal installments in the year in which they are incurred, and in the following 4 years[169].

Newly established companies may deduct expenses for studies, research, advertising, publicity and entertainment, together with the costs of formation, as of the first year in which the company has gross receipts[170].

Regardless of the method of accounting for leasing transactions, leasing fees paid by the lessee are deductible tax expenses. They can be deducted over a period corresponding to more than half of the statutory depreciation period (or the whole statutory depreciation period, in the case of leasing of motor vehicles), with a minimum of 8 years and a maximum of 15 years in the case of leasing of immovable property[171].

Taxes paid are deductible for IRES purposes, unless the law specifically states otherwise. The most important deductible taxes are:

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[168] article 108(2) of the TUIR
[169] article 108(3) of the TUIR
[170] article 108(4) of the TUIR
[171] article 102(7) of the TUIR

- in the case of companies bearing interest payable and similar charges (net of interest receivable and similar income), a 10% lump sum of the IRAP paid during the tax year and up to the amount due for that period;
- from tax year 2012, the non-deductible amount of IRAP related to labor expenses (i.e. subordinate employees and similar)[172].
- non-creditable VAT, registration tax, stamp duty, customs duties, duties on company books, company registration duties, and some local and other minor taxes.

3.4.10. NON DEDUCTIBLE EXPENSES

A fundamental rule according to Italian legislation is that Expenses pertaining to exempt income are not deductible, with certain minor exceptions: Expenses pertaining to both taxable and exempt income are deductible up to the amount determined by applying the ratio between taxable income and gross income.
Expenses paid to companies resident in tax havens are deductible only if certain conditions are met (but will discuss it better in the following chapters); Costs incurred for immovable property that is not a business asset are not deductible.
The deductibility of specific costs incurred for the acquisition, maintenance, repair and operation of certain vehicles is limited. Costs for cars and motorcycles are deductible only if such vehicles are used directly in, and absolutely necessary for, the business of the company.
IRES is not deductible. Penalties are also not deductible.

3.4.11. ACE: AID TO ECONOMIC GROWTH

On Monday, December 5th, 2011, the Italian Government leaded by Mario Monti, within the “Salva Italia” financial measure, presented a reform that aims on the one hand to restore a balanced budget in 2013, on the other to stimulate company

[172] In order to avoid infringement of the Italian Constitution, DL 16/2012 provides that the deductibility of IRAP related to labor costs will also apply to tax years from 2007 to 2011 (through a refund mechanism);

capitalization, by means of the so-called "Aiuto alla Crescita Economica" (Aid to Economic Growth) instrument. [173]

The allowance is calculated by applying an imputation rate to the equity invested into the company. Ordinary return, approximating the opportunity cost of new equity capital, is exempt, while exceeding income is taxed at the corporate level. Therefore, by ensuring the deduction of the imputed income of equity capital, ACE reduces or even eliminates the tax advantage of debt finance, thereby encouraging firm capitalization.

According to the Italian Government, ACE has two aims[174]: 1) it is expected to boost Italy's economic growth through a reduction of firm tax liabilities; 2) it is designed to enhance capital structure of Italian companies. [175]

GENERAL PRINCIPLES

The ACE system shares some characteristics with the Italian Dual Income Tax (DIT)[176]: under both regimes, profit is split into two components, ordinary and above-normal income.[177]

Under the ACE regime, the imputation rate used to calculate ordinary income for the three years starting from 2010 is equal to 3%. Subsequently, it has to be determined by the Minister of Economy and Finance (to be issued not later than January 31st of each year),in line with the average return of public bonds, increased by three percentage points. The budget law of 2013/n.147 identifies the imputation rate for years 2014/2016:

- Tax period up to 31/December/2014: tax rate at 4%,

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[173] This relief shares the acronym and the main characteristics of the British ACE.

[174] *Italy's ACE Tax and Its Effect on a Firm's Leverage,* P. Panteghini, M. L.Parisi, and F. Pighetti, Economics-ejournal.org, June 27, 2012

[175] this provision is in line with both the European Commission's and the International Monetary Fund's recommendations, which stress the importance of implementing tax devices aimed at discouraging companies' excessively high leverage and therefore, reducing systemic risk.

[176] in force from 1998 to 2003.

[177] Unlike DIT, which taxed ordinary income at a lower rate, ordinary income is exempt under ACE.

- Tax period up to 31/December/2015: tax rate at 4,5%
- Tax period up to 31/December/2016: tax rate at 4,75%.

The ACE benefit is applied to new equity, the starting level was net wealth existing on December 31st, 2010, the first year of application. If the notional value of the ACE return exceeds the total amount of income, it will be deductible against income in the subsequent tax periods. In the first year of application, the ACE base is equal to the existing equity at the end of the previous year, less the profit earned during that year. This starting value is increased by the shareholders' new cash contributions and retained profit.

ACE applies not only to corporations but also to individual firms and limited partnerships. Although the treatment of individual firms and limited partnerships has to be ruled by a forthcoming decree of the Minister of Economy and Finance, the inclusion of all these kinds of business is an important measure, as it ensures neutrality in terms of organizational form.

THE ACE BASE

The increase of capital relevant to the facility comes from the algebraic sum of positive and negative elements. Positive elements are cash contributions (capital increases, payments to fund lost) and allocations of profit to reserves, except non-distributable reserves. The decree also assigns shareholders' waiver of repayment of loans to positive items. Negative elements are voluntary distributions to shareholders (distribution of retained earnings, return of capital, allocation of assets) as well as some reductions due to anti-avoidance rules. The ACE base besides includes profits allocated to the reserve profit used to cover losses or carried forward. In order to widen the Ace base, profit made in 2010 is also included. No surplus fund arising from differences on exchange rates are included.

SUBJECTS

As already said ACE is applied not only to corporations but also to sole proprietors and partnerships. However, this benefit is not granted to bankrupt firms; companies under either compulsory liquidation or extraordinary administration.

ANTI AVOIDANCE RULE

To avoid "cascade effects" if shareholders inject new equity in a company and this money is again transferred to a subsidiary, the contribution in cash is sterilized and the benefit is only guaranteed to the subsidiary.[178]

3.5 LOSSES

3.5.1. ORDINARY LOSSES

The determination of a loss follows the same rules as the determination of a profit. The regime of loss carry-forward has been amended by DL 98/2011. Under the new regime tax losses may be carried forward indefinitely. However, losses cannot be used to offset more than 80% of the taxable income in any tax year[179]. This new regime is extended to the tax losses accrued prior to tax year 2011. Losses derived in the first 3 years from the beginning of the business activity may be set off in full, and for these losses the 80% limitation does not apply, provided that the losses are generated by the new activity (i.e. an activity that was not previously carried on by another person (even unrelated)). Losses may not be carried back.

A company can use either losses incurred during the first 3 years of its activity (as we have said without limitation) or losses belonging to subsequent years (with the aforesaid limit of 80%). If the losses incurred during the first 3 years are fully utilized but the taxpayer still has taxable income, the losses from the subsequent years may only be used if the remaining taxable income exceeds 20% of the total taxable income and only in respect to the amount that exceeds the 20% threshold.

[178] By doing so, the law aims at eliminating the duplication of tax reliefs, especially in groups, against a single injection of capital or "refreshing" of the old capital with operations considered to be elusive.

[179] According to the previous legislation losses could have been carried forward for 5 years.

For taxable periods commencing after 17 September 2011, if a company incurs losses in at least two out of three consecutive tax periods, it may qualify as a non-operating company.

Losses cannot be carried forward if:

- the majority of the voting rights of the company is transferred; and
- in the financial year in which the transfer occurs or in the two preceding or following periods, the activity of the company is changed from the one originating the losses.

This limitation does not apply if the transferred company has had in the financial year preceding the transfer at least ten employees, and produced an amount of gross receipts and incurred costs for employment higher than 40% of the average of the 2 preceding financial years[180]. If a company has exempt income, the loss available for carry-forward is decreased by an amount equal to that part of exempt income which exceeds non-deductible costs.

In the case of exempt entities, the part of losses that corresponds to the income, which has been exempt in the previous taxable periods cannot be deducted or carried forward.

However this limitation just seen is not applicable to partnership, and individuals: the rule indeed is the same, but there's not in this case the limitation of 80% of the losses; such subjects then, can carry-forward the entire amount of the losses, with the only limitations of the five years time.

3.6 ALLOWABLE DEPRECIATIONS

3.6.1. DEPRECIABLE ASSETS

Depreciable assets are both tangible and intangible fixed assets used in the business of the company.

Such assets are valued at their historic cost, less depreciation. The historic cost is determined by adding to the purchase or production cost incidental costs directly attributable to the assets. Such cost is to be decreased by an amount equal to the

[180] article 84 of the TUIR

contributions received for the purchase or construction of the relevant asset. Incidental costs also include interest on funds borrowed for purchasing the assets and included in the cost of the asset by operation of law. Other costs, not specifically attributable to the assets, may also be included in the cost according to the same criteria[181].

Construction companies may also include in the value of property interest on loans incurred for constructing or restoring the property[182].

Inflation adjustments to the value of depreciable assets are not allowed. Special laws, however, have allowed the revaluation of business assets for limited periods.

Acquired goodwill is valued at the purchase price and must be depreciated each year. Different rules apply for companies accounting under the IAS or the IFRS.

3.6.2. NON-DEPRECIABLE ASSETS

Securities are considered fixed assets if they are recorded as such in the balance sheet. In this case, they are valued at their historic cost. At the end of each financial year, the value can be adjusted to take into account the difference between the historic cost and the market value, but the adjustment cannot lead to a value lower than the minimum value provided for tax purposes. Such adjustments are also taken into account as capital gains or capital losses for purposes of computing taxable income. Such adjustments do not apply to shares and other participations.

For partnership and for sole proprietor instead several rules are stated: expenses for the acquisition or lease, even the financial lease of movable goods, assigned miscellaneously to the personal use of the entrepreneur and to business' purposes are allowable to depreciation or deduction of 50%; the same rules is applied also for immovable properties.

3.7. SME TAX SYSTEM

The tax system provided for small enterprises is a special set of rules from both the substantial and the formal point of view[183]:

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[181] article 110(1)(b) of the TUIR
[182] article 110(1)(b) of the TUIR

Italian legislation provides for special tax regimes for enterprises that can be considered as SME (small and medium enterprise). The so called "minor enterprises" are those exercised by individuals or partnerships that do not go beyond a certain threshold fixed by the law: in particular are admitted to a more simple accountability system in case of limited revenues.

The threshold below which such regime is admitted is of 309.847,14 Euro for those enterprises whose main activity is provision of services, and of 516.456,90 Euro for the others[184].

The choice to be taxed under such a regime is not mandatory and the entrepreneur or the partnership can decide to be taxed under the ordinary regime. Otherwise, if the SME regime is chosen, the rules enforced permit the enterprise to keep only the value added tax register, in which relevant income element must be identified.

On the other hand however, being the balance sheet reduced as explained, the enterprise won't be able to benefit of the PEX regime on capital gains (see par.) because of the fact that no indication relating the assets would be given. Indeed the special discipline would touch the following points:

- Notwithstanding the application of the accrual principle, business income is made up by the difference between positive and negative income.
- The only reserves admitted are those for social security and for abeyance; others are not permitted (because of the fact that it depends on the allocation in the balance sheet).
- Allowable depreciations on instrumental goods are admitted only in case of a describing register of such goods.
- According to expenses deduction are generally enforced, but there is no prevision according to limits of negative interests.

3.7.1 "MINOR TAXPAYERS"[185]

For practical reason, here we explain the rules regarding the legislation for individual minor taxpayers.

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[183] F. Tesauro, istituzioni di diritto tributario parte speciale, pag.82

[184] D.p.r 29 sept.1973, n.600, art.18

[185] F. TESAURO, Istituzioni di diritto tributario parte speciale, cit pag 76-77

It is a favor system, introduced in 2007[186]and modified in 2011[187]; the main purpose is to favor new enterprises leaded by young people or by unemployment subjects. In particular, this system is applied to those whose income or payments are beneath the fixed threshold of 30000 Euro. Furthermore, in order to apply the discipline, the following criteria must be met:

- they have started their activities later than 2007;
- they are not older than 35 years;
- they do not have made exportations or any other international exchange;
- they do not have sustained any expense for employers or any other partners;
- they do not have purchased in the previous three years instrumental goods with a greater value than 15000 Euro;
- they do not have in the previous three years exercised art, professional or enterprise activities;

The income of those taxpayers for 5 years is calculated as the difference between income and revenues obtained and costs and other expenses incurred during the fiscal period; capital gains and losses from transfers of instrumental goods are included. To the income that results from that operation, a tax rate of 5% is applied. Those individuals are also excluded from VAT and IRAP[188]. Furthermore, these taxpayers have also a simplified individual tax return.

3.8. GROUP TAXATION

3.8.1. CONSORTIUM RELIEF

The Italian tax system provides a "consortium relief", i.e. the option to have companies taxed under a look-through approach[189].

Indeed our legislation provides for an ordinary group relief, according to which only companies are admitted, and another group relief, to which limited liability

[186] Law 244 of 2007, art 1 clause 96-117
[187] Law decree 98 of 2011 art 27
[188] Regional production tax.
[189] Articles 115 and 116 of the TUIR

companies with a small individual base can participate: we will now see the way by which these two provisions differs one from the other.

The ordinary option is available for Italian resident companies, and in particular:

- limited liability companies

- partnerships limited by shares

- cooperative societies; and

- mutual insurance companies;

the shareholders of which are the same resident and/or non-resident entities. In case of non-resident companies, few criteria must be met: they must be exempt from Italian withholding tax on dividends under the Parent-Subsidiary Directive, or must carry on a business activity through a permanent establishment in Italy in whose books such participation is recorded. The option must be exercised jointly by the relevant company and by all its shareholders and cannot be revoked for a 3-year period. If a partnership participates in an Italian company, the option is not available. Moreover the option is not available in two cases regarding the subsidiary company: exemption of the income business tax, or In case of bankruptcy or procedure of assignment for the benefit of creditors or liquidation process. In the consortium relief another remark needs to be underline: these conditions must be met for the whole period: in case a company loses the necessary pre-requites, is enforced the principle all-in all-out, according to which the consortium relief ceases its application for the entire group.

Each shareholder must hold at least 10% but not more than 50% of voting rights and is entitled to the corresponding percentage of the profits (this double provision is stated because of the fact that this two concepts can actually differ one from the other[190]). In case of participation that goes beyond this threshold we would met the case of control, and then consolidated income would be enforced;

[190] F. Tesauro, *Istituzioni di diritto tributario parte speciale*, pag. 165

The minimum limit of shares instead, is established in order not to adopt such legislation in case of a too fractionate base[191].

Despite the limits provided for the subsidiary, the shareholders can instead be part of a consolidated, or be taxed under the look-through approach as well, giving rise to a hypothetic consortium relief's chain.

Under the "the consortium approach", the profits of the company are imputed to the shareholders, regardless the effective distribution, in proportion to their rights to participate in the profits (i.e. for this purpose voting rights and other financial rights are not relevant): in this case then, under a fiscal point of view, the dividend's distribution is not relevant. The same thing is to be said regarding Losses[192].

The participated company is jointly liable with each shareholder for the payment of taxes, penalties and interest arising from the imputation of the income. Interest expenses that otherwise are not deductible, under "the consortium approach" may be recaptured if the participations are disposed of within 3 years from the purchase.

3.8.2 SPECIAL REGIME FOR SMALL LLC

As already said this regime can be adopted also by limited liability companies, respecting several provisions; the aim of the legislator in this field is to permit these companies, to adopt a form of taxation, more similar to that provided for partnership, giving relevance to the economic substance of such companies[193]. Indeed, as we have seen for the other regime, this choice is not mandatory at all, and the company can decide to be taxed according to this rules, or can decide to be subjected to the traditional business income tax (IRES): however in this case the shareholders would suffer a double taxations of dividends, both in the hands of the company, and in theirs'.

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[191] F.Tesauro, *istituzioni di diritto tributario parte special*e, pag 165

[192] Losses can be used in order to offset the taxable income in any tax year; in this case however there's a limit of the amount of the net asset: beyond that threshold losses be used.

[193] F.Tesauro, *istituzioni di diritto tributario parte special*e, pag 170

As stated, this regime can be adopted if the following conditions are met[194]:

- volume of revenues must not exceed the threshold set for the sector studies (5.164.568,99)
- The shareholders can only be individuals, whose number can differ from one to ten.
- The company must not be subjected to bankruptcy, procedure of assignment for the benefit of creditors or liquidation process

Moreover, in case the company owns participations having the conditions for the Participation exemption regime, the legislation enforced won't be the one provided for IRES (Exemption for the 95% of the value) but the one provided for individuals: such rule is provided in order to disrupt individuals to take advantage of a regime provided for IRES taxable subjects.

For other rules, the ordinary regime is applied.

3.8.3 DOMESTIC TAX CONSOLIDATION

Consolidated balance sheets are not taken into consideration by the tax authorities for purposes of determining taxable income of the group. Therefore, each legal entity, even if it is a member of a group, is regarded as a separate taxpayer, and maintains its subjectivity both from the fiscal and from the liability point of view: what is done is not the creation of a new entity, but the income calculation is determined on the basis of a single overall taxable base, made up of the algebraic sum of the profits and losses of the Parent Company and all the subsidiaries, regardless of whether the entity of the control actually amounts to 100%[195].

The domestic tax consolidation regime is available for companies in "control relationship", where one owns, in a direct or in an indirect way, more than 50% of the capital of the other and is entitled to more than 50% of the profits of the other[196]. However in case of an indirect participation, the same threshold must be reach through the gear method.

[194] Art. 116 TUIR
[195] Italy corporate taxation, IBFD, Carlo Gallo, Milan
[196] article 117 et seq. of the TUIR

The control relationship must be in place at least from the beginning of each financial year of the consolidation. Once opted, the consolidation is irrevocable for 3 years, and must be made jointly by the controlling company and the participating companies.

Such regime can be adopted by the following subjects: The controlling entity must be an Italian resident or even a foreign entity, resident in a treaty country and carries on a business activity through a permanent establishment in Italy in whose books the shareholding participation is recorded; the subsidiary entity instead can only be a resident company, and in particular:

- Limited liability companies
- Partnership limited by shares
- joint-stock company

However, in this case as well several rules must be met: The financial year of each participating company must coincide with that of the controlling company, as well as the domicile that must be elected to the controlling company[197].

The controlling company is responsible for the calculation and the payment of the tax (including higher taxes on the consolidated income that might become due pursuant to adjustments to the taxable income of the participants) and, jointly and severally, for penalties imposed for own violations of the participants. Each participating company is (i) jointly and severally liable with the controlling company for higher taxes and interest assessed as a consequence of a violation of the participant and (ii) directly liable for all penalties due in relation to their own share of consolidated taxable income. Payments made between the participating companies as a consideration for the "transfer" of the taxable base are not taxable/deductible. If the algebraic sum is negative, the controlling entity is entitled to carry the loss forward; tax losses suffered before the entry into the consolidation can be used only by the specific company that suffered the loss. Excess tax credits generated before the entry into the consolidation may be used alternatively by the company that generated them or by the controlling

[197] article 119 of the TUIR

company[198]. Resident companies that are granted a partial or total exemption from corporate income tax cannot be part of the consolidation group. Also partnerships are not allowed to participate in the consolidation group[199].

CHAPTER FOUR: *CROSS BORDERS SITUATIONS*

4.1. INDIVIDUALS

4.1.1 DIVIDENDS

In case of individuals receiving dividends from a resident company the situation is explained as follows:

Dividends paid by resident companies on non-substantial participation to resident individual shareholders not engaged in a business activity are subject to such a final withholding tax[200] that from the 1st of January 2012 (with the DL 138/2011) fixed at a rate of 20%[201]. However, mention must be made of the fact that in the last days the new prime minister Matteo Renzi is introducing a legislation whose aim is to transform this tax from 20% to 26%.

Dividends paid on substantial participations instead, as we've seen, are exempt for 50.28% of their amount: The remaining 49.72% of the dividend paid is taxable at the ordinary progressive income tax rates[202]. Dividends paid to non-resident shareholders on participations not connected with Italian permanent establishments are subject to withholding tax at a rate of 20%[203].

[198] article 118 of the TUIR
[199] Italy corporate taxation, IBFD, cit.pag.83ss
[200] article 27 of the DPR 600/1973
[201] previously it was 12.5%
[202] article 27 of the TUIR
[203] 27% before 1 January 2012

If the recipient can show (by documentation issued by the tax authorities of its state of residence) that it has paid a final tax on the same dividends, up to one fourth of the withholding tax may be refunded by the Italian tax authorities[204].

4.1.2. INTERESTS

On a general basis as well as with dividends, interests paid to foreign individuals are subjected to the same rules provided for residents. Those are subjected to a final withholding tax whose rate is fixed at 20%[205]. Interests paid to non-resident on deposit accounts with post office and banks are exempt.

Interest paid to non-residents on bonds issued by the state, banks or quoted companies is exempt if the beneficial owner is a resident of a country with which Italy has adequate exchange of information arrangements. In order to benefit from this exemption, the nonresident must deposit the bond with a resident bank or other approved intermediary. These requirements must be certified by the nonresident in a special statement to be submitted to the resident bank or intermediary.

After having stressed the way by which dividends are taxed regarding different subjects, and in particular referring to business income tax ad to individuals taxation of dividends, we now must analyze on this topic regarding cross border individuals, and cross borders companies, receiving dividends from a resident company.

4.1.3 COORDINATION WITH THE ECJ

Nowadays our tax system has not any pending case against the European Court of Justice, regarding the taxation on different types of income. However, there's one field in which Italian tax law could be blamed of potential infringement of the European system of rules, and in particular of free movement of workers; here I'll try to explain the topic, recalling cases in which similar rules have led to an infringement by the Member State.

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[204] article 27(3) of DPR 600/1973

[205] 12.5% before 1 January 2012

In the Presidential Decree n.600 of 1973, the following rules are provided: A withholding tax is applied, according to Art.25, for individuals, resident within the territory of the state in case of self-employed income paid in cash or in kind, whose rate is fixed at 20%[206]; but the following clause states that in case this income is assigned to non-resident individuals, the same withholding tax would be increased to 30%, even for income arising from the exercise of business activities. The same tax rate is applied for use or authorization to use, still for a non-resident individual, of Industrial and commercial equipment[207].

Indeed one point must be analyzed: it is worth nothing that three judgments[208] of the ECJ in the last fifteen years are focused on one particular profile of such a withholding tax, that is the one of a tax that cannot be on a gross base, but must be at net of the expenditures.

Particularly how established in the Skorpio judgment, a withholding tax is an appropriated mean in order to ensure the taxation of income that otherwise won't be taxed both in the resident state and in the state of which such income is produced. In the Gerritse case, the European court of justice underlines the importance to tax the income arising from employment not on a gross basis, but at net of the expenses connected with the activity as such, in order to grant the same fiscal treatment of those resident individuals, not creating then, a disparity of treatment between resident and non-resident workers.

Indeed a discrimination, according to the intervene the court has made on the same Gerritse case, could be already provided by Art.25, according to the provisions contained therein in case of resident and non-resident workers: for the first one the withholding tax has the nature of an advanced payment, whereas in case of non-resident workers, the withholding tax has the nature of immediate income tax.

[206] This withholding tax is applied by subjects identified in art.23, c.1, of the same presidential decree, who pay out in cash or in kind, payments for the exercise of self-employed performance.
[207] Falsitta "Le leggi tributarie fondamentali" cit. pag 364, Giuffré, Milano, 2007
[208] *Wallentin*, C-169/03; *Skorpio* 3 oct/2006, C-290/04; *Gerritse* C-234/01;

4.2 COMPANIES

Dividends, interest and royalties paid by Italian resident companies to non-resident companies without a permanent establishment in Italy are normally subject to a final withholding tax, subject to reduction under the relevant treaty provisions.

If dividends, interest and royalties instead, are received through a permanent establishment in Italy, they are taxed as if received by an Italian resident company. In the absence of a treaty containing a provision similar to article 7 of the OECD Income and Capital Model, however, the force of attraction provided under domestic law may result in taxation in the hands of the permanent establishment even if the payment is not attributable to it[209][210].

4.2.1 DIVIDENDS

In order to conform the Italian regime of withholding taxes on exit dividends to the European discipline on free movement of capitals and free of establishment, the financial law of 2008 equalized the tax burden on dividends distributed to subjects resident in the EU or in the EEA to that provided for resident subjects' profits.

As a result of the reduction of the IRES rate from 33% to 27.5%, the withholding tax on dividends was indeed reduced and fixed at an amount of 1,375% (5% of 27.5%)[211]. However, before analyzing this discipline we have to make clear that it doesn't find application in case the conditions of the subsidiary-mother directives are met: in that case indeed no withholding tax would be enforced[212].

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209 Corporate taxation IBFD, cit.pag.63

210 article 151(2) of the TUIR

211 With effect from the distribution of profits accrued in tax years starting on or after 1 January 2008

212 To qualify for the exemption from withholding tax, the parent company must meet the following requirements:
- it must be a resident for tax purposes of an EU Member State;
- it must have one of the legal forms listed in the Annex to the Directive;
- it must be subject to one of the taxes listed in the Annex to the Directive, without the possibility of benefiting from an exemption, unless temporarily or territorially limited; and
- it must hold at least 10% of the capital of the subsidiary for at least 1 uninterrupted year (regardless of whether such time has already expired at the moment of distribution).

The withholding tax is applied on dividends and on profits or gains that do have the dividends' characteristics, such as joint pursues agreements, and except those connected with an Italian permanent establishment of a non-resident companies.

Subjects that can benefit of this provision are foreign companies and entities that meet the following conditions:

- Resident in a Member State or in a state belonging to the EEA.
- is a company subject to corporate income tax in another EEA country that allows an adequate exchange of information with the Italian tax authorities.

4.2.2 INTERESTS

No withholding tax is levied on interest paid to non-resident entities on:

(1) deposit accounts and current accounts with banks and post offices;

(2) bonds issued by the state, banks or quoted companies, if paid to:

(a) foreign central banks and bodies investing the public reserves of the foreign country;

(b) residents of states or territories that allow an adequate exchange of information;

(c) institutional investors (e.g. funds), whether or not subject to tax, established in states or territories that allow an adequate exchange of information

(3) deposit accounts and current accounts, not being cash loans, with debtors other than banks and post offices (e.g. intercompany current accounts and intercompany deposits) if paid to recipients mentioned in (2) above.

In order to benefit from the exemption in (2), the non-resident must deposit the bond with a resident bank or other approved intermediary.

Interest on bonds other than those mentioned in (2) and any other type of interest is subject to a withholding tax (*ritenuta sugli interessi*). In respect of interest accrued from 1 January 2012, the withholding tax rate is 20%.

With respect to interest accrued before 1 January 2012, different rates are applied[213].

The withholding tax on payments to non-resident companies is final.

Under the domestic law provisions implementing the EU Interest and Royalties Directive (2003/49) with effect from 1 January 2004 (Law Decree 143 of 30 May 2005), outbound interest and royalty are exempt from any Italian tax imposed on those payments, whether by deduction at source or by assessment, provided that the beneficial owner of the interest or royalties is a company of another EU Member State or a permanent establishment situated in another EU Member State of a company of an EU Member State.

The exemption applies if the person making the payments and the beneficial owner of the payments are companies (or permanent establishments of companies) that fulfill certain requirements regarding the legal form and the fact of being subjected to a corporate income tax, like our IRES.

A further condition requires that the company that makes the payment, and the company that benefits from the payment, must be "associated", it means:

- the first company directly holds a participation equal to at least 25% of the voting rights in the second company; or

- the second company directly holds a participation equal to at least 25% of the voting rights in the first company; or

[213] - 27% on interest on deposits and current accounts with banks and post offices;
- 12.5% on interest on corporate bonds (including convertible and profit-sharing bonds) issued by *quoted* companies and by resident banks and traded on a regulated market or multilateral trading facility in an EU Member State or in an EEA country included in the Italian "white list" (*see* above), with a maturity of at least 18 months;
- 12.5% on interest on bonds issued by *unquoted* companies with a maturity of at least 18 months if the interest rate did not exceed 200% of the official discount rate in the case of bonds listed on a regulated market or multilateral trading facility in an EU Member State or in an EEA country that is included in the Italian "white list", or 166% of the official discount rate in the case of other bonds.

- a third company, fulfilling the requirements under Annexes A and B of the Decree, directly holds a participation equal to at least 25% of the voting rights in both the first and the second companies.

The above-mentioned participations must be held for an uninterrupted period of at least 1 year.

Regarding the definition of “interest”, the Decree follows the Directive: the term includes income from debt claims of every kind, secured or not by mortgage, and in particular income from securities and income from bonds or debentures, including premiums and prizes attached to such securities, bonds or debentures.

Law decree 98/2011 introduced new rules applicable to intercompany loans between a resident company and a non-resident affiliated company where the beneficial owner condition is not satisfied. In such case, a 5% withholding tax is applied by the resident company on the condition that the interest payment received by the non-resident affiliated company is used for the interest payment of its notes (by means of which it has executed the intercompany loan agreement with the resident company), listed on a regulated market of an EU Member State or of an EEA country that allows an adequate exchange of information and guaranteed by the resident company. Under article 15 of the agreement (Savings Agreement) of 26 October 2004 between the European Union and Switzerland providing for measures equivalent to those laid down in the EU Savings Directive, the EU Member States must exempt interest and royalty payments to companies resident in Switzerland under essentially the same conditions as those laid down in the EU Interest and Royalties Directive. The provisions of the agreement are effective from 1 July 2005[214].

We now analyze the situation of a foreign investor, individual or company, who decide to exercise business within our country; we study the different tax burden affecting the case of such activity through a subsidiary, and through a permanent establishment, according to the OCSE model, and will later see the tools used by

[214] Corporate taxation IBFD, cit.pag.64ss

Italian legislator (still according to the different instruments given by the OCSE model) in order to prevent double-taxation.

As we have seen talking about the corporate income tax, in the indication of taxable subjects[215], no remark is made referring to subsidiary of a foreign company: such entity indeed, is a company totally independent from the mother company, and would be then taxed under Italian company law, regardless the nationality. The subsidiary is a company with juridical personality that would, in case the conditions are met, benefit of the subsidiary-mother directive. Regardless this last statement however, such entity would as aforesaid be subjected to corporate Income tax.

Moreover the establishment of Italian subsidiaries by foreign investors who are allowed to become shareholders of Italian companies is regulated by the same provisions as the establishment by Italian shareholders. Indeed these stated are some of the reason way, between subsidiaries and branch, as tools to exercise activities in other countries, often the first is chosen: it grants a separate accounting, that doesn't raise any responsibility to the mother company (however it doesn't permit the deduction of losses as the permanent establishment does). It is responsible then, only for the activity exercised in such country, without any obligation according the activity of the mother company.[216]

4.3 TAXATION OF NON RESIDENT COMPANIES WITH A PERMANENT ESTABLISHMENT IN ITALY

4.3.1 CORPORATE INCOME TAX (IRES)

The income produced by companies fiscally nonresident in Italy through a permanent establishment located within the territory of the state is to be considered Italian income, and as such is subjected to the corporate income tax, IRES.

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[215] article 73 of the TUIR

[216] Websterncompany.net, "*I trattati contro le doppie imposizioni, rapporti tra branch e subsidiaries*"

Apart from some specific exemptions[217], the definition of permanent establishment contained in the TUIR[218] coincides with the one provided by the OCSE model. Article 5(2) of the OECD Income and Capital Model contains a list of examples that could be regarded as permanent establishments, including a place of management, a branch, an office, a factory, a workshop, a mine, quarry or any other place of extraction of natural resources. The OECD considers this list by no means exhaustive. Italy, however, regards it as a list of installations which constitute, a priori, a permanent establishment.

The income produced by companies fiscally nonresident in Italy, but operating through a permanent establishment should be calculated according to a separate account of profit and loss, related to the p.e, using the same rules provided for Italian companies.

However, permanent establishment of companies fiscally nonresident, some elements of the income attributed directly to the non-residence company, without the passage through the p.e must be anyway attributed to the latter for the calculation of the income, this is the so called "force of attraction of the p.e". If a non-resident company or other entity does not have a permanent establishment in Italy, Italian-source income is taxed according to the rules for the relevant category of income. This applies to both the computation and levy of the tax.

Therefore, income from capital, royalties and service fees, for example, are taxed by way of a final withholding tax on the gross amount (as we have seen).

[217]These the exceptions:
- computers and auxiliary equipment for the collection of information and the transmission of data for the sale of goods or services do not by themselves constitute a permanent establishment;
- an agent (other than a broker, commission agent or any other independent agent acting in the ordinary course of his business) who habitually concludes contracts in the name of a non-resident constitute a permanent establishment of the non-resident, unless the agent's activity is limited to the purchase of goods;
- maritime trade agents or trade brokers entitled to manage vessels of non-residents do not by themselves constitute a permanent establishment;
- a building site, construction, assembly or installation project or supervisory activities connected therewith, constitute a permanent establishment provided such site, project or activity continue for a period of more than 3 months.

[218] article 162 of the TUIR

4.3.1.1 BUSINESS PROFITS

Only when arising from the activities exercise by the permanent establishment a business income, i.e. income derived from a commercial activity, such as the sale of goods or the rendering of services, is taxable in Italy.

If a foreign company or other entity has a permanent establishment in Italy, it is subject to the same provisions provided for resident companies. Therefore, all Italian-source income is considered business income and taxed accordingly (this is the so called principle of "force of attraction of the permanent establishment").

If a tax treaty applies, the taxable income of an Italian permanent establishment of a non-resident company is determined according to the relevant treaty provisions. Most of the tax treaties concluded by Italy contain a regime for permanent establishments identical to article 7 of the OECD Income and Capital Model. Therefore, the profits must be attributed to the permanent establishment as if it were a distinct and separate enterprise, engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Thus, the profits must be determined according to the arm's length principle, and all expenses incurred for purposes of the permanent establishment, either in Italy or elsewhere, must be allowed as a deduction. The permanent establishment must maintain a separate profit and loss account in order to determine the income taxable in Italy[219][220].

DIVIDENDS INTERESTS AND ROYALTIES

As we have seen Dividends, interests and royalties paid by an Italian company to a nonresident company, without a permanent establishment in Italy are normally subjected to a final withholding tax.

If dividends, interest and royalties are received through a permanent establishment in Italy, they are taxed as if received by an Italian resident company. In the absence of a treaty containing a provision similar to article 7 of the OECD Income

[219] article 152(1) of the TUIR
[220] Corporate taxation, IBFD, cit. pag.83 ss

and Capital Model, however, the force of attraction provided under domestic law may result in taxation in the hands of the permanent establishment even if the payment is not attributable to it[221].

Regarding royalties instead, they are always deemed to arise in Italy when paid by the state, by an Italian resident or by an Italian permanent establishment of a non-resident person[222].

CAPITAL GAINS

The tax treatment of the capital gains of non-resident companies depends on whether or not the non-resident company carries on business in Italy through a permanent establishment. In the presence of a permanent establishment, due to the operation of the "force of attraction" principle, all gains taxable in Italy are taxable in the hands of the permanent establishment[223]. In such a case, capital gains constitute business income and are taxable in the same way as for resident companies[224].

4.3.2 IRAP

Companies nonresident in Italy are subjected to the regional tax on the added value only regarding the production created by permanent establishment In the territory of the state. The calculation has to be made following the same rules provided for Italian companies.

4.3.3 BRANCH TAX

Italian legislation do not provide for any further imposition for the entry of income produced by companies fiscally nonresident through the permanent establishment.

[221] article 151(2) of the TUIR
[222] article 23(2)(c) of the TUIR
[223] article 23 of the TUIR
[224] In the absence of a permanent establishment instead, the taxation of capital gains depends on the kind of property from which the gains arise.

4.4 CFC RULES: BLACKLISTED COUNTRIES AND TAX HAVENS

4.4.1 GENERAL RULES

According to income coming from tax havens, Italian legislation provides several rules indicated in the so called CFC (controlled foreign company) legislation. In this case indeed certain conditions must be met, otherwise the subject, an individual or a company, regardless of the effective distribution of dividends is taxed including them in the income base.

The Italian rules provide[225] that the income generated by a (directly or indirectly) controlled foreign company located in a black-listed country (CFC) is taxed directly in the hands of the Italian shareholder, regardless of the distribution of the CFC income: to this consequences follows the calculation of such income according to the business income rules, provided by the TUIR[226].

The legislation however gives the resident the possibility to avoid these provisions, by proving (by way of an advance tax ruling) one of two different exceptions, autonomous and independent one from the other:

Art. 13 of law decree n.78/2009 provided several modifications to the CFC discipline: these are explained in the guidance 51/E ,6 October 2009, whose aim is also to clarify doubts regarding the legislation[227].

First Exception

- *Market Link*: The Guidance clarifies that the Market Link is met if the activity of the CFC is mainly carried out towards local customers or suppliers[228]. Not meeting this test may be an indicator of a lack of business substance. It is also clarified that the local market is not necessarily comprised within the boundaries of the state or territory where the CFC is

[225] Art 167 of the TUIR

[226] International Tax Alert, **"***New Italian CFC rules and black-list rules",* 18 October 2010

[227] Fisco Oggi, "*Disciplina CFC, istruzioni per l'uso*", 6 ottobre 2010.

[228] As explicitly provided, banks and insurance companies satisfy this requirement in case the majority of their resources and investments are derived from the local market

located but, on the contrary, shall be extended to the contiguous geographic area connected to the CFC state by means of economic, political, geographic or strategic links[229]. ; Indeed, what is necessary is a stable and continuous participation of the controlled company to the economic life of the blacklisted country in which is established[230].

CFC with more than 50% of passive income: However, the legislation provides that this exception cannot be claimed in the case of a CFC with more than 50% passive income. This restriction is justified by explaining that going beyond this threshold could be a symptom that such company has not an actual business. However, resident parent company may supersede this presumption by filing an advance tax ruling under the First Exception and by additionally proving the absence of any tax avoidance purpose[231].

Second Exception

- *Adequate level of CFC taxation:* Italian parent companies may, as an alternative to the First Exception, prevent the CFC rules from application by proving that the participation in the foreign black-list company does not result in the allocation of income to a tax haven. Regulations implementing the original CFC rules[232] state that the Second Exception requirement is met when it is proved that at least 75% of the CFC income is derived in a non-black-list country and subject to an ordinary level of taxation. This second exception test may also be met by considering the final tax burden of a group in respect to the income derived by a CFC which is part of the same group. Specifically, one should prove that the global effective tax rate on the CFC income is adequate when compared to the Italian effective tax rate. Moreover, the taxpayer should also demonstrate that the profits are systematically distributed and that the structure was not created for tax avoidance purposes. As to the adequate level of taxation, a positive example is included in the Guidance whereas a

[229] CFC area of influence
[230] Fisco Oggi, "*Disciplina CFC, istruzioni per l'uso*"
[231] First Exception with additional burden of proof.
[232] Ministerial Decree No. 429/2001

CFC derives income by way of dividends paid by its subsidiaries located in non-black-list countries.

White-List CFCs

Effective tax rate lower than 50% of the Italian hypothetical burden

This legislation however, is not limited to subsidiary companies located in *Black-listed* countries: indeed the CFC rules, because of the 2009's modifications, are extended to subsidiaries resident in white listed country[233], if several conditions are met[234]:

- their effective rate of taxation is less than 50% of the Italian effective tax rate that would be applied if they were resident in Italy;
- they have more than 50% passive income;

The Guidance provides some clarifications as to how to compare the effective tax burden of the foreign corporation with the hypothetical Italian one.

This comparison between the effective tax burdens, as well as the passive income test, shall be carried out each year as the result of both exercises may depend on the specific items of income in each particular period.

When both the conditions are met, however, the cfc issue can be avoided demonstrating that the controlled foreign entity "does not represent an artificial structure aimed at achieving an undue tax advantage." This concept, as pointed out by the court, arises from the decision of the ECJ Cadbury Schweppes[235].

4.4.2 EFFECTS

- Deduction of black-list costs

Italian tax law provides for specific deduction requirements for companies entering into arrangements with foreign black-list suppliers as regards to any

[233] even if resident in the European Union
[234] The guidance contains explanations on how this comparison should be made (consider the entity on a stand-alone basis, Italian regional tax should not be included, etc)
[235] ECJ C-196/04

payment made to the latter entities as well as for any other cost incurred in connection with such transactions: Indeed, the Italian company must be able to prove: the substance of the black-listed supplier[236], or on the other hand provide evidence that such transaction has actually been carried out, and that it responds to an actual business interest of the company (for example the possibility to buy at a lower price).

- Black-list dividends

The presence of a non-black-list Conduit

Under Italian tax law, dividends paid by black-list subsidiaries are fully taxed at the level of the Italian recipient. This holds true even if the black-list subsidiary is held indirectly, by means of a participation in a non-black-list entity[237].

It is clarified by the guidance that, however, in the case of a non-black-list conduit, dividends "deriving" from profits generated at the level of non-black-list lower-tier subsidiaries should not be subject to full taxation when repaid to the Italian shareholder provided that the latter is in the position to track the origins of the dividends and prove it by means of proper documentations (i.e., balance sheets of the relevant subsidiaries, etc.)[238].

According to interests and royalties, such income would not be included in the application of the Interest and royalties directive, leading then to a full income taxation in the hand of the receiver.

[236] The Guidance clarifies that the market link, afore seen, is not required in order to prove the substance of such entity.

[237] This interpretation is confirmed by the Guidance which recalls that the relevant provision was, with this purpose, changed in 2006 by replacing the term dividends "paid" with the term dividends "derived."

[238] International Tax Alert, **"***New Italian CFC rules and black-list rules",*

CHAPTER FIVE

FTT: THE ITALIAN TOBIN TAX

5.1. THE PROPOSAL OF 14 FEBRUARY 2013

As already stated at the beginning of the work, my country does levy a FTT: however several provisions like exempted subjects and operations differ from the one indicated by the proposal[239]. Indeed Italy, France and the others southern Union countries, endorsed that a minimum levy of 0,1% on the transaction on obligation (including state bond), as established in the proposal, would aggrieve the market on such instrumentals[240].

5.2. GENERAL

Italy has introduced the so called Tobin tax, a financial transaction tax: this idea, which has always been widespread since the 90's, has been introduced by the Monti's government with the budget law of 2013[241]. This tax is imposed on certain financial transactions executed as from 1 March 2013 and on others executed as from 1 July 2013. The reason why the tax was introduced was on the one side, a contribution to the crises of those who had speculated on financial market, and another purpose was to limit those operations on the market that could be considered as too risky.

The main discussed concept regarding this topic is the fact that despite its introduction, Italy has provided a FTT that exempts almost 90% of the operations made by banks[242]; moreover on the derivates there would be a very small tax rate. Critics related to the Italian FTT also claims that in this way foreign investors would then leave the Italian financial market, and at the same time there's a widespread doubt upon the amount that could be gained from the state for the tax enforced in such a manner[243][244].

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[239] On which however Italy was one of the states asking for the reinforced cooperation.
[240] La Repubblica.it, 10 sept 2013
[241] Legge n.228, 2012
[242] IL GIORNALE, *"La Tobin tax: flop annunciato un anno fa", 14/12/2013*

[243] Il Sole 24ore: "*Tobin tax, arriva il decreto. Come funzionerà il prelievo sulle transazioni finanziarie"*, 18 sett 2013

At the same time also, the Italian law seems to be incoherent: it provides the taxation of high frequency operations, but leaves out the intraday-transactions.

Relevant Transactions, Excluded Transactions and Exempt Parties

The FTT is applied on certain financial transactions (the Relevant Transactions), wherever executed and regardless the nationality of the parties. Whoever buys such actions would be subject to the FTT.

The categories of Relevant Transactions are:

- Transfers of shares and participating financial instruments issued by Italian resident entities (Shares and PFIs), including those transfers on conversions of bonds (except for newly issued shares). Bonds, quotas and fund units are, instead, excluded (further exclusions may be introduced with a subsequent ministerial decree).
- Derivatives transactions, whether cash or physically settled, securitized or not, having as a main underlying asset such Shares or participating financial instruments.
- the FTT applies to high-frequency trading (HFT) transactions executed on Italian financial markets

The following transactions instead, are excluded from the FTT (the Excluded Transactions):

- new issues and cancellation of Shares (including on conversion of bonds) and PFIs
- transfers by way of gift or inheritance
- transactions such as stock lending or stock borrowing or the lending or borrowing of other financial instruments, a repurchase or reverse repurchase transaction, or a buy-sell back or sell-buy back transaction

[244] At the time of its introduction, the amount arising from the FTT was estimated around 1 billion Euro a year.

- transfers of Shares and PFIs issued by so called “small caps” (companies whose average market capitalization in the month of November of the year preceding the year of sale does not exceed €500,000,000), and
- Transactions on qualifying “ethical” financial products.

Specific exemptions also exist for transactions where the counterparty is the European Union, the European Central Bank, the central banks of EU Member States or those institutions established by international agreements entered into by Italy.

Moreover, the FTT is not applicable to transactions carried out by certain qualifying entities (Exempt Parties),:

- transactions falling within the scope of the “market making activities” as defined under the relevant EU legislation;
- transactions executed by financial intermediaries acting in a market making capacity on behalf of an issuer with the aim of providing liquidity, within the limitation as set out in the relevant EU legislation
- transactions executed by social security entities, certain pension funds and similar entities
- Transactions executed by companies where one of them can exercise the control (as defined by the Italian Civil Code), or whether executed in the context of a corporate reorganization – specifics and conditions of this exemption still to be defined in the Decree.

5.3 TAX RATES AND TAXABLE BASE

The FTT is levied at different rates depending on the type of transaction and relevant market. Transactions on Shares and PFIs are subject to:

- a 0.12 per cent FTT (for 2013) if executed on a regulated market or a multilateral trading facility established in a EU member State or in a European Economic Area (EEA) State allowing an adequate exchange of information with Italy. This rate falls to 0.1 per cent after 2013; or

- 0.22 per cent FTT (for 2013) in any other cases, falling to 0.2 per cent after 2013.

The FTT is applied on the net daily balance of transactions on the same security by the same person.

Transactions on derivatives and other financial instruments relating to Shares and PFIs are subject to a fixed tax ranging from €0.01875 to €200.00, depending on the type of instrument and the value of the agreements. If derivative contracts are executed on a regulated market or multilateral trade facilities, the tax is reduced to 20% of the original notional amount.

HFT transactions are subject to a 0.02 per cent tax on the counter-value of orders automatically generated (including revocations or changes to original orders) by a computerized mathematical algorithm within a time frame – still to be specified by the Decree. The tax is applied in addition to the FTT due on transfers of Shares and PFIs as well as on transactions on the relevant derivative instruments.

In case of physically settled derivatives (as opposed to the cash settled ones), the relevant transaction may trigger the payment of FTT not only in connection to the derivative itself but also in connection with the transfer of the underlying shares or equity-like instruments.

5.4. TAXABLE SUBJECTS

The person liable for the FTT, from an economic point of view, must be identified according to the operation: for Transactions on shares the taxable person is the transferee only, whilst the one on Transactions on Derivatives is due from each party to the transaction.

As regards HFT transactions, the FTT is borne by the person on whose behalf the cancellation or amendment orders are executed.

Those persons acting as intermediaries in the Relevant Transactions would be responsible for applying and paying the FTT, being them considered withholding tax agents. Also non-resident intermediaries will be withholding agents for the purposes of the FTT, although they may appoint an Italian-resident tax representative for handling the payment and other compliance matters.

The party (or parties) to the relevant transaction must pay directly the FTT, in case of no financial intermediaries is involved.

Specific provisions regarding FTT reporting and payment obligations and other compliance duties will be included in the Decree, to be issued in due course.

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Fairness and anti-avoidance measures

Alessia Polli

TABLE OF CONTENT

INTRODUCTION

One of the main purposes of a tax system should be realizing a fair distribution of the tax burden among taxpayers. Every State tries to achieve this result, but in different ways.

In the Italian tax system, taxation's fairness is pursued trough the ability to pay principle. According to this principle, which is codified in the Italian Constitution, everyone, that is to say citizens and not, has to contribute to the public expenses in accordance with his effective ability to do that. Moreover, the Italian Constitution, in the same article, provides that the Italian tax system has to be marked by progressivity criteria. This characterization contributes to realize a fair tax system as much as possible because, in a progressive tax system, the higher is the ability to pay of the taxpayer, the higher is the rate to apply to its income.

Even if the Italian tools for realizing a fair tax system seem to be quite appropriate, in the practical application of tax laws, taxpayers are able to bypass the mentioned principles and, consequentially, the Italian tax system is not fair anymore. It is through avoidance conducts that taxpayers fail to pay lower taxes than their ability to pay. The avoidance behaviors are different from the evasive ones because while the second violate a tax law, the first simply dodge it. The evasive conduct does not fulfill an arose tax burden; in the avoidance conduct, instead, the tax burden does not arise at all because the taxpayer does not realize the tax assumption. In other words, the avoidance conduct is formally in accordance with tax laws, but it is substantially in contrast with their ratio and with the spirit of the whole tax system, which is marked by ability to pay principle and progressivity criteria, as mentioned above.

Indeed this is not only an Italian problem, but it affects all States because it is connected with the inevitable legislator's inability to regulate all the ways to achieve the legal and economic effects taxpayers want.

Particularly, in order to obtain tax savings, taxpayers realize, not only national, but also international, abusive schemes. In fact, it is especially taking advantage of the different tax burdens provided by the different States that taxpayers achieve their aim to saving tax. For this reason, all States adopt anti-abusive measures for especially fighting the avoidance schemes that involve tax havens.

Moreover, taxpayers usually bypass not only national rules, but also treaties' provisions. This particular kind of abusive behavior is called "treaty shopping" and it essentially consists in the interposition of a third person only for profiting of the more advantageous treaty stipulated with its residence State.

In this text we are going to show how the Italian tax system contributes to a fair distribution of the tax burden among taxpayers in respect of anti-avoidance measures. After a focus on the existence of a general anti-avoidance rule in the Italian tax system, we are going to analyze the specific anti-avoidance measures that are provided, firstly in the Italian domestic tax law, secondly in the Italian treaty tax law.

CHAPTER 1

TAX AVOIDANCE AND ABUSE OF RIGHTS PRINCIPLE IN THE ITALIAN TAX SYSTEM

1.1. LACK OF A GENERAL ANTI-ABUSE CLAUSE IN THE ITALIAN TAX SYSTEM AND DEVELOPMENT OF THE ITALIAN SUPREME COURT'S CASE LAW ABOUT THE ABUSE OF RIGHTS PRINCIPLE

In the Italian tax system we cannot find a general anti-abuse clause, but only specific clauses which have an anti-avoidance aim.

While in the Italian tax literature the attention to the avoidance concept develops since '80s, the Italian tax case law starts to create anti-avoidance tools only since 2005. In fact for long time it was adopted a formalistic approach, deeming necessary explicit positive rules to limit private contractual autonomy and taxpayer's freedom of choice.

Afterwards, exactly from 2005, Italian Supreme Court asserts the possibility to use private law tools in tax law and, according to the articles 1344 and 1418 of the Italian civil code, it states the invalidity of contracts which are stipulated only for saving tax, so to avoid the application of an imperative rule[1]. In this way the Italian case law finds the explicit positive base to fight abusive transactions in the civil code.

Very important for the development of the Italian tax case law about abuse of rights principle is the Halifax sentence of the European Union Court of Justice[2]. In

[1] See Cass., Sez. trib., 26th October 2005, n. 20816, in *Riv. dir. trib.*, 2006, II, p. 690; Cass., Sez. trib., 14th November 2005, n. 22932, in *Riv. dir. trib.*, 2006, II, p. 690; Cass., Sez. trib., 21st October 2005, n. 20398, in *Giu. it.*, 2007, IV, p. 867.

[2] From now on ECJ.

this sentence[3] the Court denies the right to deduct paid VAT because it is based on an abusive transaction. In this way the general anti-abuse principle, already developed in other areas of the European Union law[4], is asserted also in tax matter. After this sentence, Italian Supreme Court finds the explicit base to contrast avoidance in the ECJ's case law, asserting the possibility to apply the EU law's principle, according to which persons cannot unlawfully use EU law's rules, in the Italian tax system.

Naturally this principle can be adopted only for harmonized taxes. So, after an initial use of it also for income taxes, Italian Supreme Court, reacting to the authors' criticisms, continues in its search of an explicit positive basis in order to apply the general anti-abuse principle also to non-harmonized taxes.

It is in the constitutional principle of ability to pay that the Italian Supreme Court finds this positive basis with the judgments of 2008, known as Christmas's judgments[5]. In these sentences it asserts that, in the Italian tax system, exactly in the article 53 of the Italian Constitution[6], it exists an immanent principle according to which taxpayers cannot obtain an undue tax advantage using a legal tool in a distort way with the exclusive or principal aim to save tax, even if the transaction does not formally break any specific rule[7].

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[3] See ECJ, 21st February 2006, n. C-225/02, in *Guida al diritto*, 2006, II, p. 59.

[4] From now on EU law.

[5] See Cass., Sez. un., 23rd December 2008, nn. 30055, 30056, 30057, in *Giust.civ.*, 2009, I, pp.1873 ss..

[6] According to the article 53 of the Italian Constitution, everyone have to contribute to the public expenses on the basis of their ability to pay and the tax system has to be marked by progressivity criteria.

[7] These sentences have been urged by authors' opinions, in fact they have been influenced by the latter. In order to corroborate this statement, we can indicate a text, which is previous than the considered sentences, that is to say A. LOVISOLO, *Abuso del diritto e clausola generale antielusiva alla ricerca di un principio*, in *Riv. dir. trib.*, 2009, I, pp. 89-94.

Therefore current Italian tax case law derives the general anti-abuse clause from an EU law's principle for harmonized taxes and from the article 53 of the Italian Constitution for the other ones.

Within this evolution there is a position of the Italian Supreme Court, which finds the explicit positive basis of the general anti-abuse clause in the article 10, paragraph 1, L. n. 212/2000, which codes the good faith principle. Indeed, according to this article, relations between taxpayer and tax authority are marked by cooperation and good faith. So in its judgment of 2002[8], the Supreme Court asserts that taxpayer's duties include also the refrainment from transactions which are essentially aimed to avoid a right tax claim.

This link between anti-abuse and good faith principles had been already implicitly asserted by the Italian Constitutional Court with a judgment of 1992[9]. In this sentence the Court qualifies as disloyal the evader's behavior and considers disloyalty as a requirement of a conduct that violates good faith principle. Considering this argument in a solidarity view of the contribution to the public expense, it is easy considering as disloyal, so in contrast with good faith, also an abusive behavior because, even if tax rules are formally respected, the taxpayer with such behavior gains an undue tax advantage, bypassing tax rules' will and breaking solidarity duties.

A corroboration of this conception which considers good faith as the basis of the anti-abuse principle accrues from private law, where a general anti-abuse clause misses too. In this area of law, the abusive behavior is understood as the exercise

[8] See Cass., Sez. trib., 10th December 2002, n. 17576, in *Riv. dir. trib.*, 2003, II, p. 249.
[9] See Const. Court, 18th February 1992, n. 51, in *Riv. dir. trib.*, 1992, II, p. 561.

of a legal right in contrast with the purposes for which that legal right is attributed, so as the contra-good faith exercise of a legal right.

Probably this jurisprudence has been abandoned in favor of the reconstruction based on the ability to pay principle because the considered article (art. 10, L. 212/2000) seems to be a procedural rule, while the anti-abuse principle works on a substantial level. According to the article, the operability of good faith is collocated in the relations between taxpayer and tax authority, so in the phase of the fulfillment of the tax obligation, which is already arose. This literal formulation of the article does not permit to consider good faith as the basis of the anti-abuse principle, because abusive behaviors are realized in the previous phase, avoiding just the arise of the tax obligation. Moreover this wording can be also explicated with a substantial reason, which confirms that good faith cannot be considered as the basis of the general anti-abuse principle. In accordance to the article 1, L. 212/2000[10], the provisions of this act carry out some constitutional principles, especially rule of law and ability to pay. In this context the wording of the article 10, L. 212/200, seems to be specifically aimed to settle the potential conflict between these two constitutional principles in favor of the rule of law. So it seems that abusive behaviors can be contrasted only through specific and expressed anti-abuse clauses to ensure legal certainty, avoiding to give to tax authority and judge the power to claim taxes through the application of a very potential principle as the good faith one[11].

[10] According to the article 1, paragraph 1, L. 212/2000, the previsions of this law, implementing the articles 3, 23, 53 and 97 of the Constitution, represent the general principles of the tax system and they can be derogated or modified only expressly and never by special laws.

[11] In this regard, M. TRIVELLIN, *Elusione fiscale: la nullità civilistica come strumento generale antielusivo. Riflessioni a margine dei recenti orientamenti della Cassazione civile. – Brevi cenni*

1.2. GENERAL ANTI-ABUSE CLAUSE BASED ON ABILITY TO PAY PRINCIPLE, RULE OF LAW AND LEGAL CERTAINTY

As mentioned above, the Italian case law asserts the existence in the Italian tax system of a general unwritten anti-abuse clause based on the ability to pay principle. This principle expresses the criterion to distribute tax burden among taxpayers so as to ensure fairness: every taxpayer has to contribute to public expense according to his ability to do that. The link with the anti-abuse clause is realized emphasizing the effectiveness of the ability to pay. So the mentioned definition of the criterion can be reformulated in this way: every taxpayer has to contribute to public expense according to his *effective* ability to do that and not according to an artificially and unduly reduced manifestation of it.

Indeed considering the ability to pay principle as the basis of the general anti-abuse clause involves the same problems about rule of law and legal certainty, which are connected to the other reconstruction elaborated by the Italian case law on the basis of the principle of good faith, as mentioned above.

To illustrate these issues, we have to analyze the function of the article 53 of the Italian Constitution. It has a dual function: it is the parameter for both interpreter and legislator. The first has to interpret rules in accordance with it and, if this conforming interpretation is not possible, he has to bring the matter to the judge of the law. The second, instead, can give to tax authority the power to claim taxes only in cases which show wealth, in order to respect the ability to pay principle. In this case, the latter is also an assurance for taxpayers from legislator's choices[12].

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sulle relazioni tra abuso del diritto e clausola di buona fede. Alla ricerca di una norma generale antielusiva, in *Il Fisco*, 2006, n. 43.

[12] See G. MARONGIU, *L'abuso del diritto nella legge di registro tra principi veri e principi asseriti*, in *Dir. prat. trib.*, 2013, II, p. 361.

This means that the article 53 of the Italian Constitution cannot create directly a tax obligation because it is necessary an express clause[13], produced by the legislator and interpreted by the judge, in accordance with the character non self-executing of the constitutional provisions. This inability of the article 53 is corroborated by the article 23 of the Italian Constitution[14], which contains the codification of the rule of law, requiring an expressed prevision to levy tax.

It goes without saying that the unwritten general anti-abuse clause, based on the article 53, involves doubts about its conformity to the article 23 insofar this general clause permits to claim taxes according to the effective ability to pay even if there is not the necessary express clause, even better the missing of this clause is the assumption to have an abusive behavior and not an evasive one.

Naturally the infringement of the rule of law involves also a fading of the legal certainty, with negative implications about taxpayers' confidence and foreseeability of the economic transactions' consequences, because the rule of law is indispensable to assure certainty about taxable situations.

It is the application of the general unwritten anti-abuse clause by the courts to make the situation even more worrying because of two different approaches.

The first approach is about the duty of the judge to apply the general anti-abuse clause even if neither party exercises its attachment power. The reason of this judge's duty is the Constitutional or Community rank of this clause[15]. Omitting the fact that in the trial system there is not a rule, according to which principles of

[13] For the necessity of such express clause, see M. BEGHIN, *Abuso del diritto tra capacità contributiva e certezza dei rapporti Fisco-contribuente*, in *Corr. trib.*, 2009, pp. 823 ss.; F. PEDROTTI, *Il principio giurisprudenziale dell'abuso del diritto nell'imposizione diretta*, in *Riv. prat. trib.*, 2010, IV, pp. 611-621.

[14] According to the article 23 of the Italian Constitution, no personal or patrimonial duty can be imposed without a law.

[15] In this direction, Cass., Sez. trib., 11th May 2012, n. 7393, in *Giust. civ. mass.*, 2012, V, p. 600. This judgment recaps the previous case law of the Supreme Court.

a certain rank have to be noticed by judge independently from the parties' behavior, this approach completely denies the dispositive character of the tax process in favor of an inquisitive one and, before, the tax authority's duty to state the reasons of its notices of assessment. Indeed through this power, the judge is not obliged to follow the issues that tax authority and taxpayer cite to argue their case, but he may modify the object of the process, for example he may save a tax authority's act based on a non-existent evasive behavior of the taxpayer, en retraining the latter as an abusive one, which has been really realized. So he may substitute tax authority[16].

The second approach is about the retroactivity of the general anti-abuse clause according with the fact that it is based on the ability to pay principle. In fact this principle is codified in the Italian Constitution since its entry into force, so it can be qualified as an immanent principle in the Italian system. Nevertheless it is important to underline that for a long time Italian case law has denied the existence of a general anti-abuse clause and, only in 2008, it starts to assert its existence in the Italian tax system, as a general unwritten clause, based on the ability to pay principle. So this approach involves a deep violation of legal certainty and, consequentially, taxpayer's confidence.

The non-retroactivity of the clause can be argued following two directions: the first is based on the same article 53 of the Italian Constitution, the second on the article 3 of L.212/2000, which codifies taxpayer's rights.

First of all it is the same article 53 which does not permit to the legislator to give retroactive effects to tax dispositions, because he can create a tax obligation only

[16] About this problematic conduct of the courts, see M. CANTILLO, *Profili processuali del divieto di abuso del diritto: brevi note sulla rilevabilità d'ufficio*, in *Rass. trib.*, 2009, p. 475; F. TESAURO, *Elusione e abuso nel diritto tributario italiano*, in *Dir. prat. trib.*, 2012, IV, p. 683.

in cases which express a *current* ability to pay. In other words a retroactive tax disposition may violate the article 53 if, in the real specific case, the wealth does not exist anymore when the tax disposition entries into force with retroactive effects. In this way, assuming the retroactivity of the general anti-abuse clause, the latter should be based on the article 53, but, in the same, time it could violate it[17].

Devolving to the article 3, L. 212/2000, it asserts that tax dispositions have not retroactive effects and, according to the article 1 of the same law[18], also this prevision expresses a general principle of the Italian tax system. Indeed the non-retroactivity of legal dispositions is a general principle of the whole Italian legal system because it represents a basic value of the legal civilization, in favor of legal certainty and citizens' confidence, and the legislator can infringe it only according to reasonable reasons[19].

Considering all these observations we can share the current Italian authors' opinion, according to which the current Italian case law fades the traditional principles of articles 23 and 53 of the Italian Constitution in favor of the State's tax revenue interest[20].

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[17] To check these arguments, see Const. Court, 26th June 1964, n. 45, in *Giur. it.*, 1964, I, p. 1109*;* Const. Court, 26th June 1965, n. 50, in *Giur. it*., 1966, I, p. 554; Const. Court, 23rd May 1966, n. 45, in *Riv. dir. lav.*, 1967, II, p. 243; G. MARONGIU, *L'abuso del diritto nella legge di registro tra principi veri e principi asseriti*, cit., p. 361.

[18] See note n. 10.

[19] To check these arguments, see Const. Court, 4th November 1999, n. 416, in *Foro it.*, 2000, I, p. 2456; Const. Court, 13th October 2000, n. 419, in *Foro it.*; 2001, I, p. 1087; G. MARONGIU, *L'abuso del diritto nella legge di registro tra principi veri e principi asseriti*, cit., p. 361.

[20] In this regard, G. FALSITTA, *I principi costituzionali di giustizia tributaria tra teatro ed agonia*, in *Riv. dir. trib.*, 2009, II, pp. 22 ss.; G. FALSITTA, *I principi di capacità contributiva e di eguaglianza tributaria nel diritto comunitario e nel diritto italiano tra «ragioni del fisco» e diritti fondamentali della persona*, in *Riv. dir. trib.*, 2011, I, pp. 519 ss.; F. MOSCHETTI, *Il «principio democratico» sotteso allo Statuto dei diritti del contribuente e la sua forza espansiva*, in *Consenso, equità e imparzialità nello Statuto del contribuente,* Studi in onore del prof. Gianni Marongiu, a cura di A. BODRITO, A. CONTRINO, A. MARCHESELLI, Torino, 2012, pp. 3 ss..

On the other side, according to the Italian Supreme Court, the asserted general anti-abuse clause, based on the ability to pay principle, does not break rule of law and legal certainty, because the established existence of this general clause in the legal system involves that citizens have to foresee the unlawful of a behavior, even if there is not an express rule which qualifies it as illicit. In this way the rule of law is not a legislator's duty anymore, but it becomes a citizens' duty. This radical change of prospective relates also to the criminal law, where the rule of law can be defined as the reasonable foreseeability of the criminal rule.

Probably a way to avoid all these contradictions may be asserting the existence of a general anti-abuse clause without a necessary express positive basis, considering that it is common to all legal systems the principle according to which when a legal right is exercised beyond its limitations, we have a misuse of that right and, consequentially, that exercise is an illicit one.

Indeed this is the way followed by the Italian private law, although also in this case there was not and there is not a general anti-abuse clause[21].

1.3. GENERAL UNWRITTEN ANTI-ABUSE PRINCIPLE AND SPECIFIC WRITTEN ANTI-AVOIDANCE MEASURES

Aside the general unwritten anti-abuse clause, in the Italian tax system there are specific rules to fight against tax avoidance. Indeed there are implicit and explicit anti-avoidance clauses. The first are included among the rules which concern a single levy in order to prevent avoidance behaviors of taxpayers, but tax authority has the power to authorize their non-application if taxpayer requires so and in the

[21] See F. TESAURO, *Elusione e abuso nel diritto tributario italiano*, cit., p. 683.

real specific case it is not necessary to apply them[22]. Differently, the second attribute to tax authority the power to qualify as abusive a real specific transaction and, consequentially, to claim the connected taxes.

These specific anti-avoidance measures corroborate the existence of a general unwritten anti-abuse principle in the Italian tax system, because they are considered as manifestations of its existence in those sectors where abusive behaviors are more common[23].

1.4. ART 37-*BIS*, D.P.R. 600/73, AS EXAMPLE OF EXPLICIT ANTI-AVOIDANCE RULE: ITS REQUIRMENTS AND ITS PRACTICAL APPLICATION

An example of explicit anti-avoidance rule is the article 37-*bis*, D.P.R. 600/73, which can be defined as a sectorial anti-avoidance rule. In particular it concerns the income taxes' sector.

Firstly, it is important to clarify that also in the income taxes' sector, this article has not a general application because it can be applied only to cases which involve at least one of the transactions mentioned in the paragraph 3, like merger, demerger etc.. So article 37-*bis* is a sectorial specific anti-avoidance rule.

According to this article, when the taxpayer obtains an otherwise undue tax advantage, as the intended outcome of his single transaction or set of bundled transactions, which does not have genuine business purposes and which bypasses tax obligations or prohibitions, this taxpayer's behavior has to be considered as

[22] The article 37-*bis*, paragraph 8, D.P.R. 600/73, attributes to tax authority this power. See S. LA ROSA, *Nozione e limiti della norme antielusive analitiche*, in *Corr. trib.*, 2006, p. 3092.

[23] In this direction, G. MARONGIU, *L'abuso del diritto nella legge di registro tra principi veri e principi asseriti*, cit., p. 361.

abusive and the connected tax savings as tax avoidance[24]. When these three conditions (dodging of tax obligations or prohibitions, obtaining of an undue tax advantage, lack of valid commercial reasons) are cumulatively met, the whole transaction or set of transactions may be regarded as an instrument for carrying out a tax avoidance scheme, even if not all the steps pursue or achieve a result of tax avoidance[25].

It is important to clearly understand the real meaning of these three requirements of the tax avoidance behavior, because they are able to explain the real essence of tax avoidance.

The first requirement is able to differentiate avoidance from evasion. In fact, in the first case, tax obligations or prohibitions are simply dodged, so tax burden does not arise, because taxpayer avoids to realize the taxable situation and in this way he saves taxes. In the second case, instead, tax obligations or prohibitions are violated and this means that the taxpayer realizes the taxable situation, so the tax burden arises, but he does not fulfill it.

The same requirement is able to differ also avoidance from lawful tax savings[26]. Indeed taxpayers have different legal ways to achieve the same juridical effects and there is not in the Italian legal system a principle according to which taxpayers have to choice the more tax expensive one. For this reason taxpayers' behavior is completely lawful when they choice a legal way among the others and

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[24] According to the article 37-*bis*, paragraph 1, D.P.R. 600/73, all legal acts, facts or transactions, even when they are related to one another, cannot be opposed to tax authorities when they lack valid commercial reasons and they aim either at dodging tax law obligations or prohibitions, or at achieving undue tax savings or refund of tax.

[25] In this respect, F. A. CIMINO, *Tax avoidance and non-proportional demergers*, in *Intertax*, 2011, v. 39, p. 543.

[26] See Cass., Sez. trib., 21st January 2011, n. 1372, in *Riv. dir. trib.*, 2011, III, p. 95; See also E. ZANETTI, *Serve massima cautela prima di aggredire le organizzazioni societarie con l'abuso del diritto*, in *Il Fisco*, 2011, V, pp. 2-775.

they are all equivalent. In this case the obtained tax savings is a lawful one. Conversely, when there is a legal way, which is the only one in accordance with the ratio of the law, while the others are improper to achieve the pursued juridical effects, if taxpayers adopt one of the latter, the obtained tax savings is unlawful and in this case we have tax avoidance[27]. As mentioned above, this requirement permits to differ avoidance from lawful tax planning[28] and economic operators can exercise their economic freedom, which is codified in the article 41 of the Italian Constitution[29], considering that planning the tax burden is an aspect of this freedom.

The second requirement, the otherwise undue tax advantage, can be a tax refund or a tax reduction. In order to have a tax avoidance behavior, it has to be the direct expected result of the transaction which dodges tax obligations or prohibitions. So this second requirement is a consequence of the first one, in fact the tax advantage is undue if it is the result of a transaction which has adopt the improper legal way, because only in the latter case we have a dodging of tax obligations or prohibitions[30].

The third requirement is very important because it contributes to assure the economic freedom principle, which is codified in the article 41 of the Italian Constitution[31], as already said. Indeed a transaction with the previous requirements cannot be qualified as tax avoidance, if it is based on valid

[27] In this regard, R. LUPI, *Le operazioni societarie tra lecita pianificazione fiscale ed elusione*, in AA. VV., *La fiscalità delle operazioni straordinarie di impresa*, Milano, 2002, p. 764.
[28] In this direction, R. LUPI, *Elusione e legittimo risparmio d'imposta nella nuova normativa*, in *Rass. trib.*, 1997, V, p. 1100.
[29] According to the article 41 of the Italian Constitution, privates' economic initiative is free.
[30] In this respect, F. TESAURO, *Elusione e abuso nel diritto tributario italiano*, cit., p. 683.
[31] See note n. 29.

commercial reasons[32]. In other words and according to the EU case law[33], in order to have a tax avoidance behavior, the exclusive, or at least the predominant, reason of the transaction has to be saving tax. This means that taxpayer would not realize the transaction, if it has not a saving tax as its direct effect.

This requirement, which is a negative requirement, works as an exempting, that is to say that tax authority and judge would have to verify the lack of valid commercial reasons only if the other conditions, which are positive conditions, are assessed.

In accordance with the structure of this article, tax authority has to demonstrate the positive requirements, that is to say the improperness of the chosen legal way to achieve the pursued juridical effects and the consequential undue character of the obtained tax advantage, while taxpayer has to demonstrate that the transaction is based on economic reasons, other than the simply tax advantage[34].

Conversely, in the practical application of this article, tax authority gives an exclusive relief to the lack of valid commercial reasons, omitting the proof of the improperness of the legal way which taxpayer has adopted and of the consequential undue character of the obtained tax advantage, probably because it is surely more difficult to demonstrate these two requirements than the third[35]. In other words tax authority adopts a wider concept of tax-avoidance behavior: it is abusive a behavior which realizes a tax advantage, without pursuing valid commercial reasons. So it is as if there is no difference between avoidance and

[32] See G. ZIZZO, *Ragioni economiche e scopi fiscali nella clausola antielusione*, in *Rass. trib.*, 2008, p. 170.

[33] See ECJ, 21st February 2008, n. C-425/06, in *Riv. dir. trib.*, 2008, IV, p. 252.

[34] In this direction, Cass., Sez. trib., 21st January 2011, n. 1372, in *Riv. dir. trib.*, 2011, III, p. 95.

[35] About the practical application of the article 37-*bis*, D.P.R. 600/73, see L. DE ROSA, A. RUSSO, *Operazioni straordinarie*, Milano, 2009, pp. 628 ss..

lawful tax saving and the taxpayer has to choice the more tax expensive legal way to achieve the juridical effects he wants[36].

Sometimes also judges fall into this error, but in the most of the cases, they delete tax authority's acts which claim the saved tax on the basis of the simply lack of a reason other than obtaining a tax advantage, without demonstrate the undue character of the latter[37].

1.5. ART 37-*BIS*, D.P.R. 600/73 : CONSEQUENCES OF ITS APPLICATION AND DISCRIMINATION ISSUES

According to the article 37-*bis*, D.P.R. 600/73, a tax avoidance behavior has two juridical effects, which are connected. First of all it cannot be opposed to the tax authority. This means that the abusive contract is not invalid, but only ineffective towards to the tax authority. Consequentially the latter has the power to deny the obtained tax advantage, claiming the taxes which the taxpayer would had to pay, if he had achieved the wanted juridical effects through the proper legal way, that is to say without dodging tax obligations or prohibitions, naturally considering the amount which he has already paid because of the improper transaction[38]. This is a special power to claim tax because the tax authority claims taxes connected to a transaction, which the taxpayer has not effectively realized, but which he should have to realize. In other words, when tax authority assesses a tax avoidance

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[36] See M. BEGHIN, *L'elusione tributaria tra clausole generali e disposizioni correttive*, in *Il Fisco*, 2002, n. 24, I, p. 3804; C. ATTARDI, *Operazioni straordinarie ed elusione: osservazione sul ruolo delle valide ragioni economiche nella norma antielusiva*, in *Il Fisco*, 2007, n. 21, I, p. 3076; F. CARRIROLO, *L'elusione fiscale*, Milano, 2009, p. 10.

[37] In this regard, Cass., Sez. trib., 21st January 2011, n. 1372, in *Riv. dir. trib.*, 2011, III, p. 95.

[38] According to the article 37-*bis*, paragraph 2, D.P.R. 600/73, tax authorities, while rejecting tax advantages obtained through avoidance legal acts, facts or transaction, will apply taxes in conformity with the circumvented provisions, after taxes due on account of the same non-acceptable behavior.

behavior, taxpayer's tax burden is that connected to the juridical scheme which is, according to the law, the only one in accordance with the economic substance of the wanted juridical effects[39].

Just for its special character, this tax authority's power can be exercised only in the specific cases which the article 37-*bis* provides and not also against those behaviors which are qualified as abusive through the general unwritten anti-abuse clause.

Coherently, regarding the possibility to punish the tax avoidance behavior, the Italian Supreme Court asserts that the administrative penalty can be applied only to a behavior which is qualified as abusive according to the article 37-*bis* or to another written anti-avoidance rule and not according to the general unwritten anti-abuse clause, because in the latter case there is not the clear and unambiguous legal basis, which is necessary to apply a penalty[40].

Naturally this argument is even more strong about criminal penalty[41].

We can find an example of this criminal jurisprudence, according to which only the behaviors that are provided in a written anti-avoidance rule can have criminal relief, in a recent case, which concerns two famous Italian stylists Dolce & Gabbana[42]. Although it is widespread the opinion according to which abusive

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[39] About the special power that the article 37-*bis*, paragraph 2, D.P.R. 600/73, attributes to tax authority, see S. LA ROSA, *Elusione e antielusione fiscale nel sistema delle fonti del diritto*, in *Riv. dir. trib.*, 2010, I, p. 788; F. TESAURO, *Elusione e abuso nel diritto tributario italiano*, cit., p. 683.

[40] In this direction, Cass., Sez. trib., 30th November 2011, n. 25537, in *Giust. civ. mass.*, 2011, XI, p. 1695; A. CONTRINO, *Sull'ondivaga giurisprudenza in tema di applicabilità delle sanzioni amministrative tributarie nel caso di «elusione-codificata» e «abuso-elusione»*, in *Riv. dir. trib.*, 2012, pp. 261-280.

[41] See R. LUPI, *Fiscalità d'impresa e reati tributari*, Milano, 2000, p. 160; G. BERSANI, *Le condotte elusive e la loro rilevanza nel diritto penale tributario secondo la giurisprudenza della Corte di Cassazione*, in *Il Fisco*, 2012, n. 27, I, p. 4263.

[42] See Cass., Sez. II pen., 28th February 2012, n. 7739, in *Riv. it. dir. proc. pen.*, 2013, I, pp. 451-469.

conducts has not criminal implications, in this judgment the Italian Supreme Court asserts that an abusive behavior can be qualified as a crime. In the considered case, stylists' behavior is qualified as abusive by the court because they use a legal tools in a distort way, with the exclusive aim to obtain an undue tax savings. In fact they sale their brand to a Luxembourg company, which licenses it to another one of the same Italian group. Through this transaction the stylists obtain a dual tax savings. The first because royalties are taxable in Luxembourg, where the rate is lower than in Italy, so brand's sale represents an abusive use of the freedoms assured by the EU law, especially if we consider that the royalty company is resident in Luxembourg only formally. The second because brand's selling price, which is taxable in Italy, is lower than brand's market value. The first tax savings is not punished by the Italian Supreme Court because it assumes that, in order to have a tax crime, it is necessary the existence of an express clause which codifies the considered abusive conduct, while it is not sufficient the existence of a general anti-abuse clause developed by the case law. The second tax saving, instead, is punished because the required express clause is identified in the article which punishes the crime of unfaithful statement, through the adoption of a wide meaning of "unpaid tax". Precisely the latter is not only the difference between the paid amount and the declared one, but also the difference between the paid and declared amount and the one that the economic operator could earn, according to the market value.

These different consequences cannot be shared because the disvalue of an abusive behavior is always the same, whether there is a written specific anti-avoidance rule if it is missing, but there is a general unwritten anti-abuse clause. This argument is corroborated if we consider that the article 37-*bis* and the other express anti-avoidance rules are considered as the contingent expression of a general immanent anti-abuse principle[43].

The existence or not of an express clause, which codifies the abusive behavior, causes also other differences, concerning procedural aspects. Indeed paragraphs 4, 5, 6 and 7 of the article 37-*bis* provide a particular procedure to exercise the special power to claim tax, which the same article attributes to tax authority.

According to this procedure, tax authority can claim tax only after having asked to the taxpayer to explain his behavior, which seems abusive, showing the valid commercial reasons of his suspected transaction. Other procedural directions concern the reasons of the claim tax act, which have to take into account also the economic reasons, indicated by the taxpayer, the tax collection and the eventual refunds.

All these procedural directions have to be observed by the tax authority, not only about behaviors which are qualified as abusive according to the article 37-*bis*, but in every case of abusive behaviors, even if they are not codified neither in this article nor in any other express anti-avoidance clause. This is necessary to avoid a violation of some constitutional values: principle of equality (art. 3 Cost.), right of defense (art. 24 Cost.) and administrative authority's neutrality (art. 97 Cost.). Indeed, as mentioned above, taxpayer's behavior has the same disvalue in every

[43] In this direction, G. MARONGIU, *L'abuso del diritto nella legge di registro tra principi veri e principi asseriti*, cit., p. 361.

case of tax avoidance, so there must be the same juridical consequences to avoid an unjustified discrimination[44].

To complete the study of the article 37-*bis*, D.P.R. 600/73, it is important to clarify that this article is a substantive and a procedural rule at the same time. Firstly it is a substantive rule because it attributes to tax authority two different powers, the special power to claim tax towards to abusive behaviors and the power to authorize the non-application of the implicit anti-avoidance rules if the taxpayer requires so and it is not necessary to apply them in the real specific case. Secondly it is a procedural rule because it provides procedural directions which tax authority has to observe when it exercises the first mentioned power[45].

1.6. PREREQUISITES OF AN ANTI-AVOIDANCE TAX MEASURE TO BE REGARDED AS FAIR

To conclude this first chapter, we can identified the prerequisites that an anti-avoidance tax measure has to have to be regarded as fair, summarizing the considered issues.

According to the Italian Constitution, in order to have a fair tax system, taxpayers have to contribute to the public expense on the basis of their effective ability to pay. So it is necessary to have a general anti-abuse principle to recover the tax savings, realized by taxpayers, through transactions that dodge tax prohibitions or obligations. Nevertheless, the application of this anti-abuse principle and the specific anti-avoidance measures cannot hinder the exercise of rights and

[44] In this respect, G. MARONGIU, *L'abuso del diritto nella legge di registro tra principi veri e principi asseriti*, cit., p. 361; M. PIERRO, *Abuso del diritto: profili procedimentale*, in *Giust. trib.*, 2009, pp. 410 ss..

[45] About the dual nature of the article 37-*bis*, D.P.R. 600/73, see F. TESAURO, *Elusione e abuso nel diritto tributario italiano*, cit., p. 683.

freedoms, which are attributed to privates by the Italian Constitution and the EU law, for example the economic freedom[46]. So the State's tax revenue interest is not the only aspect that has to be considered and a fair anti-avoidance measure has to be able to mitigate all these interests. In other words, it is important always considering the mentioned difference between avoidance and lawful tax saving, which includes lawful tax planning, especially made by enterprises.

[46] In this regard, Cass., Sez. trib., 21st January 2011, n. 1372, in *Riv. dir. trib.*, 2011, III, p. 95.

CHAPTER 2

DOMESTIC MEASURES TO AVOID LOSS OF TAX REVENUE BECAUSE OF ABUSIVE TRANSACTIONS WITH AN INTERNATIONAL BREATH

2.1. CHARACTERS OF THE CURRENT ECONOMY AND BEPS DISCUSSION

Nowadays a serious problem for the tax system of the States is represented by the base erosion phenomenon, especially realized through profit shifting. Indeed this phenomenon is an important danger for tax revenue, tax system's fairness and sovereignty of the States and, just for its serious implications, the OECD is focusing on it.

Last year it published a report to illustrate the current situation[47]. According to this report, the international principles are not able to keep up with the relevant economic changes. Particularly, the current economy, with its global extent, permits to taxpayers, especially to enterprises which operate in several States, to take advantage of the differences, which exist among states' tax systems. So the global economy is not only a problem for taxpayers because of the double taxation, but it is also a way to optimize the tax burden with a tax planning based on the mentioned differences[48]. This effect is achieved through transactions that can be defined as abusive, because they do not formally break any legal rule, but they are not substantially in accordance with the spirit of the law.

[47] It is the "*Addressing Base Erosion and Profit Shifting*" report, published by the OECD on 12th February 2013.
[48] In this direction, P. VALENTE, *Aggressive Tax Planning. Profili elusivi delle transazioni finanziarie*, in *Il Fisco*, 2013, n. 22, I, p. 3372.

The current situation is aggravated by the other characteristic of the current economy, that is to say its digitalization, which makes more difficult identifying capitals and incomes.

In order to solve the current base erosion issue, it is necessary an internationally coordinated action against it. So the OECD published an Action Plan[49] to identify some specific, national or international, tools for fighting the base erosion, realized through profit shifting, focusing, for example, on digital economy's tax issues, double (non) taxation, CFC rules, LOB clauses, transfer pricing regime etc.[50].

In this short time, Italy did not adopt reforms in accordance to the OECD's Action Plan, but, in the Italian tax system, there were already some domestic measures aimed at avoiding loss of tax revenue because of international abusive transactions, with a special attention to those connected with tax havens. In fact, as also the OECD Report has underlined, in the current situation, it is very common the non-identity between the State, in which business is really localized, and the State, in which incomes are taxed. Naturally, in the most of the cases, the latter Sate is a tax haven.

2.2. ITALIAN DOMESTIC TAX MEASURES ABOUT TRANSACTIONS CONNECTED WITH TAX HAVENS

As mentioned above, Italian tax system gives a particular attention to the transactions that involve tax havens, because of the common practice to localize

[49] It is the "*Action plan on Base Erosion and Profit Shifting*", published by the OECD on 19th July 2013.

[50] In this regard, P. VALENTE, *Base Erosion e Profit Shifting. L'Action Plan dell'OCSE*, in *Il Fisco*, 2013, n. 37, pp. 1-5744.

incomes in these States. In order to ease the identification of these States, in Italy, there is a list, called black-list, which identifies them on the basis of their lower taxation level or of the lack of an adequate exchange of informations with them[51]. In reality, according to L. 244/2007, there will be a change of perspective because it will be adopted a list, called white-list, which will identify tax havens in those States that will not be mentioned in this list and which will adopt the lack of an adequate exchange of informations as its only criterion.

However, in order to avoid the allocation of incomes in tax havens, with consequential tax base erosion and loss of tax revenue for Italy, the Italian tax system provides two different tools: black-list costs regime and CFC legislation.

2.2.1. BLACK-LIST COSTS REGIME

Starting from the black-list costs regime, it is disciplined in the article 110, paragraphs 10 and 11, D.P.R. 917/86[52]. According to this article, a resident enterprise cannot deduct, from its tax base, costs deriving from transactions with another enterprise, which is liable to tax in a tax haven[53].

While the original black-list costs regime[54] required the existence of a control relation between the involved enterprises, for the current regime it is not necessary anymore[55]. In fact it is important to avoid the profit shifting from a

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[51] It is the D. m. 23rd January 2002.

[52] For an explanation of the relative discipline, see F. TESAURO, *Istituzioni di diritto tributario*, Milano, 2012, p. 143.

[53] It is important to underline that if the foreign enterprise is liable to tax in an EU State, the considered costs are always deductible.

[54] Paragraphs 7-*bis* and 7-*ter*, article 76, D.P.R. 817/86, introduced by L. 413/91. It was the first legislation of the Italian tax system for fighting tax planning which takes advantages of enterprises that are taxable in tax havens.

[55] The original legislation was modified by L. 342/2000, as well as by L. 448/2001 and finally by D.Lgs. 344/2003. This legislative *process* is shown in G. MARINO, *Paradisi fiscali: problemi*

State with a higher taxation level to a State with a lower one, independently from the fact that this avoidance behavior is adopted by enterprises that are included in the same company group, because the consequences for Italy are always the same: tax base erosion and loss of tax revenue. Moreover the removal of the control requirement has eased the application of the considered regime because proving the availability of the majority of the votes, as required the original legislation, was particularly difficult in cases of indirect control, realized through the interposition of a third person[56].

Coherently with the necessity to mitigate the State's tax revenue interest and the exercise of the economic freedom by privates, it is provided the possibility to deduct the considered costs, if the Italian enterprise demonstrates, with appropriate documentation, at least one of the two alternative circumstances, which operate like the valid commercial reasons of the article 37-*bis*, D.P.R. 600/73. Exactly the Italian enterprise can demonstrate the economic substance of the foreign enterprise or the economic substance of the considered transaction. In the first case it is necessary to prove that the foreign enterprise practices a predominant effective commercial activity in the tax haven, for example through the proof of the adequacy of the organizational structure in this State. In the second case, instead, it is necessary to prove that the transaction was effectively realized, for example through factures, and that it had an economic purpose other than the simply tax savings, for example proving the coherence of the considered transaction with others previously realized. It goes without saying that, for the

applicativi e proposte di modifica, in *Aspetti fiscali delle operazioni internazionali,* a cura di V. UCKMAR, C. GARBARINO, Milano, 1995, pp. 367 ss..

[56] In this regard, T. FUMAGALLI, *Il regime tributario delle operazioni con imprese domiciliate in paradisi fiscali*, in *Il Fisco,* 2004, n. 1, pp. 1-71.

Italian enterprise, proving the second circumstance is easier because the documents, which are necessary to demonstrate the economic-management coherence of the realized transaction, are in its availability.

Also the procedural aspects recall the article 37-*bis*, in fact it is provided that, before claiming the higher tax, the tax authority has to ask to the resident enterprise to prove the mentioned circumstances and, if it does not consider as sufficient the given proofs, it has to indicate the reasons in its claim tax act. Moreover in accordance to the Italian case law, the resident enterprise, which is not able to give sufficient proofs to avoid the application of the examined regime, not only has to pay the higher tax, but it is also punished. In fact there is an express clause which can be considered the required clear and unambiguous positive basis[57], the article 110, paragraphs 10 and 11, D.P.R. 917/86[58].

Despite of all these recalls to the most important Italian anti-avoidance rule, some authors assert the anti-evasion purpose of the considered regime[59] because it considers transactions as fictive, without an economic interest, and, for this reason, it does not attribute tax relief to their costs. For these characteristics, black-list costs' regime is different from transfer pricing one, which we are going to consider in the following paragraph of this chapter. In fact, according to the transfer pricing regime, the transactions are considered as effective and it is their contractual value which is criticized by the Italian tax authority.

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[57] About the necessity of a clear and unambiguous positive basis for the application of a punishment, see Cass., Sez. trib., 30th November 2011, n. 25537, in G*iust. civ. mass.*, 2011, XI, p. 1695 and Cass, Sez. II pen., 28th February 2012, n. 7739, in *Riv. it. dir. proc. pen.*, 2013, I, pp. 451-469.

[58] According to the article 110, paragraph 12-*bis*, D.P.R. 917/86, the same rules are applicable also to services made by a practitioner liable to tax in a tax haven.

[59] In this direction, R. CORDEIRO *GUERRA*, *Prime osservazioni sul regime fiscale delle operazioni concluse con società domiciliate in paesi o territori a bassa fiscalità*, in *Riv. dir. trib.*, 1992, I, pp. 277 ss..

2.2.2. CONTROLLED FOREIGN COMPANIES LEGISLATION

Switching to the CFC rules, we have to consider the articles 167 and 168 of the same D.P.R. 917/86[60].

As the black-list costs regime, also the Controlled Foreign Companies Legislation follows the purpose to avoid the profit shifting to tax havens and the consequential erosion of the tax base in Italy, but differently it is necessary the existence of a particular relation between the involved persons and the resident one can be also an individual.

The mentioned particular relation is identified through the reference to the article 2359 of the Italian Civil Code and a specific definition of linkage. According to the article 2359 there is a control relation when a person alternatively has the majority of the votes which are exercisable in the ordinary meeting of a company, a number of votes that permits to the first to exercise a dominant influence on the second or when the latter is exercised on the basis of particular contractual bonds. Only for the scope of CFCs, a linkage relation is identified, instead, when a person participates in the profits of a company at least for the 20% (10% if it is a quoted company).

So when a resident person has one of these particular connections with a foreign company, which has to be liable to tax in a tax haven, the profits realized by the latter are ascribed to the first and, consequentially, they are taxed in Italy. Therefore CFC Legislation is a kind of transparency taxation.

Also in this case the taxpayer has the possibility to demonstrate that the particular connection with an entity, which is liable to tax in a tax haven, is not an avoidance

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[60] For the analysis of the relative discipline, see F. TESAURO, *Istituzioni di diritto tributario*, cit., pp. 171-174 and G. INGRAO, *La riforma dell'IRES e la legislazione sulle Controlled Foreign Companies*, in *Saggi sulla riforma dell'IRES*, a cura di M. BEGHIN, Milano, 2008, pp. 255-290.

conduct, with the only aim to obtain a tax savings. Nevertheless there is a difference about procedural aspects, in fact, in this case, the taxpayer has to ask to the tax authority in advance, if the circumstances that avoid the application of the CFCs are realized in his specific real situation.

These circumstances work as exempting, like the valid commercial reasons of the article 37-*bis*, D.P.R. 600/73. They are two, but it is sufficient proving only one of them.

Firstly the Italian taxpayer can demonstrate that the foreign entity practices an effective commercial or industrial activity in the tax haven, as its principal business. Precisely, according to the reform of the CFC rules, operated by D.L. 78/2009[61], this circumstance is realized only if the practiced activity is also addressed to the market of the settlement tax haven[62]. Only in this case the activity can be considered effectively practiced in the tax haven. In this way, transposing a tax authority's practice[63], the operability of the exempting is limited. A part of this recent limitation, through this first circumstance, State's tax revenue interest and lawful exercise of the economic freedom are mitigated, also in this anti-avoidance discipline.

Alternatively, the Italian taxpayer can demonstrate that the particular connection with the tax haven does not involve the localization of incomes in it, for example because all the profits of the foreign entity derive from a permanent establishment that is taxable in a State with an ordinary tax system. In this case there is not an

[61] This Decree has been converted in law with L. 102/2009.

[62] In this way, not only the artificial constructions, but also the real structures, established in tax havens, are included in the scope of application of the CFCs, when their market is located elsewhere.

[63] See the Italian Tax Administration's Ris., 10th November 2008, n. 427, in *Il Fisco*, 2008, n. 44, I, p. 7935 and the Italian Tax Administration's Ris., 22nd June 2009, n. 165, in *Il Fisco*, 2009, n. 27, I, p. 4455.

abusive behavior, in fact the Italian taxpayer does not realize any tax savings. So there is no reason to apply the CFC legislation, which has an anti-avoidance purpose.

The mentioned reform, operated by D.L. 78/2009, has not only limited the operability of one of the two exempting, but it has also extended the application of the CFC rules to cases that do not involve tax havens. Precisely, the same transparency system of taxation has to be applied also when the foreign entity, which is in the mentioned particular relation with the Italian taxpayer, is subjected, in the settlement State, to a tax burden that is for more than 50% lower than the Italian one[64] and the same entity has realized profits that are constituted for more than 50% by passive income.

For these cases it is provided a special exempting: to avoid the application of the CFC rules, the Italian taxpayer has to demonstrate that the foreign entity is not an artificial construction, aimed to realize a tax savings. This exempting transposes the ECJ's judgment in the known case Cadbury Schweppes[65], so to clarify its meaning, we can refer to this judgment. According to the latter, to realize the exempting, the foreign entity has to be a real structure in order to exercise an effective economic activity in the settlement State and the Italian taxpayer has to prove so through objective and checkable elements, especially concerning entity's staff, locals and equipment. In this regard, authors clarify that the consistency of these elements is connected to the kind of activity that the foreign entity exercises. For example a holding cannot be qualified as an artificial construction in every

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[64] To ascertain this condition it is necessary to calculate the amount of the Italian tax burden, according to the Italian tax rules, and to compare this amount with that of the settlement State. The latter is calculated without considering the eventual foreign taxation, for example about profits deriving from a permanent establishment in another State.

[65] See ECJ, 12th September 2006, n. C-196/04, in *Riv. dir. fin. sc. fin.*, 2007, II, p. 3.

case, even if it usually does not need of staff and equipment. In this way it is assured that it is the economic operator to decide the necessary structure in order to exercise an activity and not the tax authority[66].

This exempting is a special one, so it can be applied only to the new cases and its existence should exclude the application of the others in the same cases. Nevertheless, while the article 167 expressly asserts the non-applicability to these new cases of the first original exempting, the application of the second original one is necessary. In fact, when a foreign investment in a tax haven has not a more advantageous tax treatment[67], there is not an abusive conduct because there is not a tax savings. So there is no reason to apply the ECJ's jurisprudence, which is directed to fight against abusive behaviors. In this way it is also avoided a discrimination between the two different categories of cases that involve the application of the CFC rules. In other words, if the foreign investment in a tax haven does not produce a tax savings, even if the foreign entity is an artificial construction, there is no reason to apply the CFC rules because there is not an abusive behavior and above all there is not the Italian taxpayer's purpose to use the artificial construction in order to not pay the due taxes.

Considering that the EU States are not included in the black list, it is just to extend the CFC Legislation to them that the reform was made. In this regard, it would have been better, if the legislator had clarified the relation with the Parents-Subsidiary Directive, according to which the profits of the participated company

[66] In this direction, S. GARUFI, *La nuova disciplina delle CFC*, in *Rass. trib.*, 2010, p. 619.

[67] As mentioned in the text, this situation can be realized, for example, if the profits of the foreign entity are taxed in a State with an ordinary tax system because they derive from a permanent establishment established therein or because they are passive incomes with a foreign source.

are taxable only in the source State[68]. Probably when the conditions to apply the parents-subsidiary regime recur, the application of the CFC rules is justified through the possibility to apply the anti-abuse or anti-fraud, national or conventional, rules, which is expressly provided by the directive[69].

The reform realizes a real derangement in the Italian CFCs' underlying logic. Indeed, while nowadays Italy follows both, the jurisdictional and the transnational approach, before the reform, Italy followed only the first.

According to the jurisdictional approach, the CFC rules are applicable to *all* income that are produced in a State which is included in a black *list* or not included in a white one. Differently, according to the transactional approach, the CFC rules are applicable only to certain categories of income, the *passive income*, and ascertaining, from time to time, the *effective taxation level* in the foreign source State, without referring to black or white lists.

As already said, after the reform, Italy follows both approaches at the same time. In fact the CFC rules are applicable to incomes which are produced in States included in the current black list, but also to incomes which are produced in States not included in this list, when the two mentioned conditions are realized in the real specific case.

Indeed the Italian transactional approach can be defined as hybrid[70] because when the required conditions recur in the real specific case, *all* incomes of the foreign entity are attributed to the Italian taxpayer, not only the passive incomes. In other words the fact that the passive income is the prevalent category of income of the

[68] About this issue see C. ROTONDARO, *Note minime in tema di compatibilità dei regimi CFC con il diritto comunitario. Alcune riflessioni sul caso italiano*, in *Riv. dir. trib.*, 2000, I, pp. 517-555.
[69] In this regard, S. GARUFI, *La nuova disciplina delle CFC*, cit., p. 619.
[70] In this respect, S. GARUFI, La nuova disciplina delle CFC, cit., p. 619.

foreign entity is an indication of the use of the same foreign entity in order to save taxes. For this aspect some authors consider the new CFC Legislation as an anti-evasion regime, which fights against the fictive interposition[71], like the article 37, paragraph 3, D.P.R. 600/73, according to which income is taxed on the real owner, when the tax authority demonstrates that the apparent owner is only an intermediary. As we can note, the difference is in the burden of proof.

After the analysis of the new CFC regime, we can make some critical reliefs about the reform.

First of all there is an intrinsic contradiction, connected to the procedural aspects, for the new cases that have been included in the CFCs' scope. As mentioned above, taxpayers have to demonstrate the circumstance that avoids the application of the CFC rules, consulting the tax authority in advance. In this way, if the tax authority denies the exempting in the real specific case, taxpayers can avoid the application of the CFC rules the same, for example doing so that passive income is not the prevalent income of the foreign entity. It is a clear invalidation of the regime[72].

Secondly we can note that, profiting of the international situation, where the OECD invites the States to strengthen their policy against tax havens, Italy has sharpened its CFC Legislation probably to try to solve its financial crisis, in fact the reform Decree is called the anti-crisis Decree. In reality the effects of the reform could worsen the Italian economic situation. Indeed, omitting applicative

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[71] In this direction, R. DOMINICI, *L'imputazione dei redditi prodotti da entità estere controllate e collegate (CFC)*, in *Diritto tributario delle società*, a cura di G. SCHIANO DI PEPE, Milano, 2005, pp. 355-380 and R. CORDEIRO GUERRA, *Riflessioni critiche e spunti sistematici sulla introducenda disciplina delle controlled foreign companies (art 127-bis TUIR)*, in *Rass. trib.*, 2000, I, pp. 1399 ss..

[72] In this regard, S. GARUFI, La nuova disciplina delle CFC, cit., p. 619.

doubts (e.g. market concept is not defined by the law) and compliance costs, which may discourage Italian economic operators to invest abroad, it is especially the modification of the exempting, which extends the applicability of the CFC rules through the reference to the market, that may discourage Italian enterprises to localize their industrial activities abroad for reasons other than saving taxes, for example for the lower labor costs[73]. Just to avoid these negative consequences, in the silence of the law, the bigger Italian companies understand the modified exempting as a reinforcement of the original version.

A clarification is necessary. It is possible that, in a specific real case, both the examined regimes are applicable. In this case the article 110, paragraph 12, D.P.R. 917/86[74] asserts that it has to be applied only the CFC Legislation because it is special than the black-list costs regime. In fact, besides the common elements, that is to say the anti-abuse purpose and the connection with tax havens, it has a specializing element: the particular relation that has to exist between the involved persons.

2.2.3. ASSUMPTION OF INDIVIDUALS' RESIDENCE

In order to complete the Italian tax provisions concerning tax havens, it is necessary to refer to the article 2, paragraph 2-*bis*, D.P.R. 817/26[75], introduced by L. 448/1998.

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[73] These negative effects are examined in S. GARUFI, *La nuova disciplina delle CFC*, cit., p. 619.

[74] According to the article 110, paragraph 12, D.P.R. 917/86, the provisions of the paragraphs 10 and 11 of the same article, that is to say the black-list costs rules, are not applicable to transactions with non-resident entities, if it is possible applying to them the articles 167 and 168, that is to say the CFC rules.

[75] According to the article 2, paragraph 2-*bis*, D.P.R. 917/86, Italian citizens, deleted from the registers of the resident population and emigrated in States or territories that are identified as tax havens, are still considered as residents for tax purposes, save the evidence to the contrary.

This article provides a relative assumption which has an anti-abuse purpose. In fact it fights against the common practice consisting in a fictive change of residence in a tax haven, in order to not pay the higher Italian taxes. For avoiding this practice, according to the considered article, Italian individuals, who establish their residence in one of the States included in the current black list, are still considered Italian resident, but they can demonstrate the effectiveness of their change of residence[76].

Therefore, when individuals transfer their residence in a tax haven, they have to prove that the residence transfer is effective and stable, differently, when individuals transfer their residence in a State with an ordinary taxation level, it is the tax authority that has to prove the fictive character of the residence transfer.

To fulfill the burden of proof, the relevant elements are various, for example, family ties, income remittances, availability of a permanent habitation, etc..

It is important to specify that this anti-abuse discipline has to be applied also when the residence change is realized passing through a third State with an ordinary taxation level.

2.3. OTHER ITALIAN DOMESTIC TAX MEASURES TO AVOID LOSS OF TAX REVENUE BECAUSE OF ABUSIVE TRANSACTIONS WITH AN INTERNATIONAL BREATH

The Italian tax system provides also measures aimed to avoid loss of tax revenue because of abusive transactions which are not connected with tax havens: exit tax,

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[76] See F. TESAURO, *Istituzioni di diritto tributario*, cit., p. 20 and G. MAISTO, *La residenza fiscale delle persone fisiche emigrate in Stati o territori aventi regime fiscale privilegiato*, in *Riv. di. trib.*, 1999, IV, pp. 55 ss..

transfer pricing regime, thin capitalization rules and taxation on foreign dividends at the level of domestic corporations.

2.3.1. EXIT TAX

Starting from the exit tax, we have to note that the residence transfer can cause a loss of tax revenue for the home State, not only about future incomes, but above all about unrealized gains. For avoiding abusive conducts consisting in the temporary transfer of the residence in order to pay a lower tax for the realization of the accrued gains, the Italian tax system provides an exit tax in the article 166, D.P.R. 917/86.

It is a limited exit tax because it is applicable only to the unrealized gains concerning certain categories of assets, that is to say firm or its components. Precisely, according to the article 166, individuals or companies, who transfer their residence[77] abroad, are liable to tax in Italy for the market value of the firm or its components which are not included in the assets of a permanent establishment, in case created in Italy. In order words, the transfer abroad of the mentioned assets is considered as the realization of their accrued gains. The spirit of this rule is clear: avoiding that the home State loses the revenue related to the taxes which it may levy on gains accrued under its tax sovereignty, at the moment of their realization. Indeed the considered rule is not applicable about the assets which are included in a permanent establishment in Italy, because the latter does not lose its power to levy tax on them[78].

[77] It is evident that this is the tax residence.
[78] For an analysis of the considered article see A. DRAGONETTI, V. PIACENTINI, A. SFONDRINI (a cura di), *Manuale di fiscalità internazionale*, Vicenza, 2008, pp. 312 ss..

As in every case of anti-avoidance measures, the State's tax interest has to be mitigated with the exercise of the privates' rights. In this case it is the freedom of establishment, attributed by the EU law, which is compromised. In fact, as the ECJ's jurisprudence has clarified, in order to assure this freedom, not only the host State has to provide for non-residents the same treatment of residents, but also the home State has not to hinder the possibility for its residents to settle in another EU State. In reality the exit tax can hinder the freedom of establishment, but, at the same time, it can avoid an abuse of this EU freedom, when it is exercised only to obtain a tax savings. So it is the proportionality principle that gives the solution: the EU States can provide, in their tax systems, exit taxes to avoid abusive behaviors and losses of tax revenue, but in a proportional way, that is to say that the freedom of establishment can be limited only to the extent which is strictly necessary[79].

According to these arguments, the article 166, D.P.R. 917/86, is not in accordance with the EU law. This statement is confirmed by the Hugues de Lasteyrie du Saillant judgment of the ECJ[80]. In this judgment the Court asserts the non-proportionality, so the non-compatibility with the EU law, of the French exit tax[81] because it is applicable to all taxpayers who transfer their tax residence abroad, even if this is an effective residence transfer, without any abusive purpose. Conversely, in order to be proportional, the applicability of an exit tax should be subordinated to the fictive character of the residence transfer, which is then only directed to obtain a tax savings in the specific real case. These arguments of the

[79] In this direction, C. ROMANO, *Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell'Unione Europea*, in *Rass. trib.*, 2004, n. 4, p. 1291.
[80] See ECJ, 11th March 2004, n. C-9/02, in *Riv. dir. trib.*, 2005, III, p. 23.
[81] The considered French exit tax relates to individuals, but the principles asserted by the ECJ are applicable also to the companies.

ECJ can be extended to the Italian exit tax because, as the French one, it has a general application to all cases of tax residence transfer by the Italian taxpayers. For this reason, it cannot be considered as compliant with the EU law because it limits the freedom of establishment also for the taxpayers who really want to transfer their residence for reasons other than tax ones[82].

Just for the incompatibility with the EU law of the Italian exit tax, recently the European Commission had started an infringement procedure against Italy, but it was interrupted because the Italian tax authority assured a modification of the article 166. This change was made with D.L. 1/12, which introduced the possibility to ask the suspension of the taxation, for the Italian taxpayers who transfer their tax residence in a member State of the EU or of the European Economic Area[83]. It was the Decree of the Minister of Economy and Finance of 2nd August 2013 which specified the application of this new provision. In particular this Decree provides that the taxation of the gains, which are accrued under the home State's tax sovereignty, can be deferred to the moment in which they are effectively realized, but it is otherwise based on the value that the gains have at the moment of the residence transfer[84]. Both, the moment of the gains' realization and the value of the same gains, are identified according to the Italian rules.

The Italian exit tax, reformed in this way, can be considered as compliant with the EU law because it reflects the principles that the ECJ asserted in a recent

[82] In this direction, C. ROMANO, *Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell'Unione Europea*, cit., p. 1291.

[83] From now on EEA.

[84] The suspension claim can be exercised by the taxpayer also for single assets.

judgment[85]. In this sentence, the Court confirms its previous jurisprudence, according to which an exit tax on the latent gains of the assets of a company which transfers its tax residence in another EU State is a violation of the freedom of establishment, but it finds the right compromise between this freedom and the home State's tax sovereignty. In fact the Court asserts the home State's right to tax the gains which are accrued in its territory and the proportionality of a rule, aimed to realize this right, which permits to the home State to determine the tax burden amount when its power to levy tax stops to exist, that is to say when the residence is transferred. Indeed the aim of an exit tax is taxing the gains which are accrued under the home State's sovereignty and, in this way, protecting the exercise of the home State's tax competence against abusive behaviors[86]. We can say that a rule like the current article 166, D.P.R. 917/86, is able to achieve these purposes, hindering the freedom of establishment insofar as it is strictly necessary. It is superfluous clarifying that this issue, connected with the freedom of establishment, concerns only the transfer of the residence in an EU State, not also the transfer outside the European Union. Differently, the exit tax can always cause double taxation problems, if the State in which the residence is transferred does not give relief to the taxation imposed by the home State. These problems can be

[85] ECJ, 25th April 2013, n. C-64/11, in *dejure.it*. This sentence particularly concerns the Spanish exit tax, but it contains principles which can be extended to the exit taxes of any EU State.
[86] A similar reform is necessary also for the residence transfers that are connected with restructuring transactions of the companies because also these transactions can have abusive purposes, but they can also be connected to effective restructuring needs. Therefore it needs a rule which mitigates the State's tax revenue interest and the freedom of establishment, if, for example, the residence transfer is connected to an intra-EU merger.

solved with the Double Taxation Conventions[87], but Italy usually does not include provisions about exit tax in its conventions [88].

The Italian tax system provides another exit clause that operates only for individuals[89]. This is the already analyzed article 2, paragraph 2-*bis*, D.P.R. 917/86. This is a particular kind of exit tax, which can be defined as a personal trailing tax, according to which the individual, who transfers his residence, is still considered as Italian resident for tax purposes[90]. This exit tax does not involve the examined issues concerning the freedom of establishment because it is applicable only when an Italian resident taxpayer transfers his tax residence in a State included in the current black-list and in this list no EU State is included. However also this kind of exit tax can cause double taxation problems, which can be solved through DTCs, as mentioned above.

2.3.2. TRANSFER PRICING REGIME

Another way to erode the taxable income is realizing transactions with a non-resident legal entity at a price that is determined in order to allocate income in the State with a lower tax rate. This purpose to realize the best allocation of income is achieved fixing a prince that is lower or higher than the market value. Precisely the transfer price will be lower than the market value, if it is the State with a higher tax rate to sell, so that a lower income will be realized in this State. Vice versa, if it is the State with a lower tax rate to sell, the transfer price will be higher

[87] From now on DTCs.
[88] The DTCs stipulated with Canada in 2003 contains an exit tax provision, according to which individuals can revalue their participation when an exit tax has been paid in the home State.
[89] Differently, the examined article 166, D.P.R. 917/86, is applicable to both, individuals and companies.
[90] See note n. 78.

than the market value, so that there will be an higher cost to deduct in the other State. Considering this common practice, it is easy to understand that the transfer pricing regime is an anti-avoidance legislation, aimed to avoid the consequent loss of State's tax revenue. The anti-avoidance purpose of the examined regime is asserted also by the Italian Supreme Court[91], according to which the transfer pricing legislation represents an assurance for the State's tax revenue interest against those transactions that shift abroad incomes in order to obtain a tax savings, as explained above.

In the Italian tax system, it is the article 110, paragraph 7, D.P.R. 917/86 which fights against this kind of abusive transactions[92]. According to this article, when the income, which is taxable in Italy, is eroded because of the considered transactions or, however, when a DTCs provides it, the Italian tax authority has the power to substitute the market value to the contractual price, if it considers the latter unsuitable. In this way it is achieved the right allocation of income because the abusive behaviors' effects are neutralized.

For the application of this regime, it is required that the suspected transactions are realized between an Italian enterprise and a non-resident one, linked by a control relation. Indeed the existence of a link between the involved enterprises is the necessary condition for an agreement about the transfer price that permits to achieve the avoidance purpose. For this reason transfer pricing is a phenomenon that involves above all companies of the same group. Precisely, the Italian enterprise has to control the foreign one or vice versa or both, the Italian and the

[91] See Cass., Sez. trib., 13th July 2012, n. 11949, in *Giust. civ. mass.*, 2012, VII-VIII, p. 913; Cass., Sez. trib., 27th February 2013, n. 4927, in *GT – Riv. giur. trib.*, 2013, IV, pp. 310- 16.

[92] For an analysis of the article 110, paragraph 7, D.P.R. 917/86, see F. TESAURO, *Istituzioni di diritto tributario*, cit., pp. 148-150.

foreign enterprise, have to be controlled by the same Italian or foreign enterprise. In order to extent the application scope of this anti-avoidance regime, it is adopted a notion of control that is wider than that which is defined in the Italian Civil Code and which is used for the CFCs. In fact, for the transfer pricing regime, it is enough that one of the involved enterprises exercises on the other an economic influence, deriving from the most disparate reasons, for example, exclusive sale, financial or technological dependence, family ties etc..

In order to identify the right price, the Italian tax authority has to follow the arm's length principle, that is to say that it has to consider the price that two independent enterprises would have contracted for a transaction with the same or a similar object and realized in the same conditions of space and time, in a free competition system[93]. It is the particular relation between the involved enterprises that requires to refer to the market value. Indeed the contractual price, which is usually used for tax purposes, is not reliable in this situation because the involved enterprises have the same purpose, considering that they belong to the same company group. Therefore it misses the condition which makes reliable the contractual price, that is to say the contrast between the purposes pursued by the involved legal entities[94].

As in every case of anti-avoidance measures, the State's tax revenue interest has to be mitigated with the exercise of the privates' rights and, in this case, it is the privates' contractual autonomy that is involved. For avoiding to excessively compromise the latter, it is provided the international ruling[95]. According to this

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[93] This is how the article 9 D.P.R. 917/86 defines the market value.

[94] In this regard, D. STEVANATO, *Il «transfer pricing» tra evasione ed elusione*, in *GT - Riv. giur. trib.*, 2013, n.4, p. 303.

[95] D.L. 30th September 2003, n. 269, art. 8.

procedure, the enterprises, which exercise an activity in an international area, can stipulate, with the Italian tax authority, an agreement, concerning the transfer prices that will be practiced in a limited period of time[96]. This agreement is sent also to the tax authority of the residence or settlement State of the counterpart enterprise. In fact the aim is preventing the tax authorities to revise the transfer prices that are fixed in the agreement[97].

Moreover, the Italian taxpayers can keep specific documents to demonstrate the rightness of the practiced transfer price to the tax authority. In this case, if the contractual price is still considered unsuitable, according to the market value, by the tax authority, the same taxpayers, who have shown the mentioned documents to the tax authority during its controls, avoid the punishments that are provided by the transfer price regime[98].

For completing the analysis of the transfer pricing regime, it is important to study in deep its anti-avoidance function.

Comparing the wording of the article 110, paragraph 7, D.P.R. 917/86 with the wording of the rules that discipline the black-list costs or the CFC legislations, it may seem that the transfer pricing regime has not an anti-avoidance purpose.

In order to explain this statement, we can note that, while for the application of the black-list costs or the CFC legislations, it is required the shifting of incomes in countries with a tax rate lower than the Italian one, the transfer pricing regime does not require so and it is applicable even if there is not a tax savings.

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[96] The agreement is binding for three tax periods, unless there is a change of the circumstances, which are the basis of the same agreement.
[97] For an analysis of this procedure see F. TESAURO, *Istituzioni di diritto tributario*, cit., p. 179.
[98] D.L. 31st May 2010, n. 78, art. 26.

Indeed it is aimed to determine the right amount of incomes that have to be taxed in Italy, on the basis of the market value of the exchanged goods or services. The reasons, according to which the transfer price has not been fixed in line with the market value, are not relevant. Therefore the transfer pricing regime is applicable even if the transfer price has been determined on the basis of reasons other than tax ones or unawares.

If, according to these arguments, it seems wrong considering the examined regime as an anti-avoidance one, it is also wrong attributing to it an anti-evasion purpose. Indeed it misses the main requirement of the evasive behaviors in the transactions that fall within the transfer pricing regime's scope, that is to say the hiding of the tax assumption. In fact, according to the transfer pricing regime, the involved transactions are considered as effective and they are declared to the tax authority, but the latter criticizes their contractual value. In this regard, we can find the main difference between transfer pricing and black-list costs regimes. In fact the latter considers the involved transactions as fictive, without an economic interest, and for this reason it denies tax relief to their costs. Therefore, while it can be considered correct the opinion of some authors, who qualify the black-list costs legislation as an anti-evasion one, the transfer pricing regime cannot be absolutely considered alike.

As mentioned above, also the Italian Supreme Court asserts the anti-avoidance purpose of the transfer pricing legislation. Coherently with this reconstruction, according to the Court, this regime is aimed to avoid the shifting of incomes within a company group through a manipulation of the transfer prices, in order to allocate incomes to the company that is settled in the State with a lower tax rate and to obtain the consequent tax savings for the group. So, for applying the transfer pricing rules, the Italian tax authority has to verify, first of all, if the Italian tax rate is higher than that of the States, where the other companies of the group are liable to tax[99].

In this context, it seems to exist a contradiction between the Supreme Court's jurisprudence and the wording of the article 110, paragraph 7, which does not give importance to the tax level of the involved States, as mentioned above. In order to reconcile this contradiction, we can note that the application of the transfer pricing regime always involves hard ratings for identifying the market value. For this reason, if, in the real specific case, there is not a difference between the tax rates of the involved States, which permits to the taxpayers to obtain a tax savings, these transactions are seen with minor suspect, even if they are not in line with the market value[100].

2.3.3. THIN CAPITALISATION RULES

In the Italian tax system, companies can erode their tax base also through a specific policy for financing their activity. Indeed for the Italian companies, using debt capital rather than capital of risk is tax cheaper because, while the remuneration of the first, that is to say the interests, is a deductible cost, the remuneration of the second, that is to say the dividends, is a taxable income (and it can cause also double taxation problems).

In order to fight against the common abusive practice, known as thin capitalization, consisting in the financing of the company's activity mainly

[99] See Cass., Sez. trib., 13th October 2006, n. 22023, in *Giust. civ. mass.*, 2006, p. 11; Cass., Sez. trib., 27th March 2007, n. 11226, in *Dir. prat. soc.*, 2008, I, p. 72.

[100] In this direction, D. STEVANATO, *Il «transfer pricing» tra evasione ed elusione*, cit., p. 303.

through debt capital, the tax law reform[101] introduced the thin capitalization rules[102], which were abrogated by L. 244/2007.

Analyzing the thin capitalization phenomenon, we have to note that, in the Italian tax system, there is not a rule, according to which the company's own capital has to be commensurate to its activity[103]. For this reason this phenomenon is very common.

We can distinguish two different kind of thin capitalization: the nominal and the material one. In the first case, company's own capital is not commensurate to its activity, but they are always the partners who finance company's activity through loans, acquiring, in this way, the status of creditor. In the second case, instead, the unsuitability of the company's own capital is not repaired through other financial contributions.

It is the first kind of thin capitalization that causes avoidance problems, for the mentioned different tax treatment of interests and dividends.

In reality the partners can decide to finance company's activity through a loan, rather than a conferment, for lawful reasons, for example because the company's financial needs are pressing and a loan is surely faster than the increase of the company's capital, but, above all, for following unlawful purposes: not being residual claimants, but having the same right of creditors to regain their money and, as mentioned above, eroding company's tax base to pay lower taxes.

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[101] D.Lgs. 344/2003 which has carried out the L. 80/2003.

[102] For an analysis of the thin capitalization rules, introduced by the tax law reform, see G. D'ABRUZZO, *Il contrasto all'utilizzo fiscale della sottocapitalizzazione nel Tuir riformato. Analisi delle scelte legislative ed inquadramento sistematico*, in *Rass. trib.*, 2004, n. 3, p. 828.

[103] See G. NICCOLINI, *Il capitale sociale minimo*, Milano, 1987, p. 19. According to the author, the indication of the object of the company's business in the Statute is not able to show the extension that the company's activity will have in the reality. Therefore an evaluation about the adequacy of the company's capital, based on the considered indication, in not reliable.

In order to fight against the first unlawful purpose, the commercial tax reform[104] introduced the article 2467 in the Italian Civil Code. According to this article, partners can regain their financings only after creditors and they have to return the eventual financings refund, if it was obtained in the year preceding the bankruptcy declaration. It is specified that the article is applicable only to the partners' financings that have been made in a situation of the company characterized by an excessive imbalance between debts and own financial resources or when it would have been reasonable a conferment. It is important to specify that these rules are provided only for a specific type of Italian company, the S.r.l., because it is characterized by a limited number of partners and the nominal thin capitalization is common in companies with a short shareholding. For this reason it is possible applying the considered rules also to other types of company, when, in the real specific case, they have not the usually large shareholding[105].

Switching to the tax purpose, the tax law reform had limited the possibility to deduct interests for the companies. In fact it was provided the requalification of interests in dividends, when the related financings had been made by a partner who participated to the company capital at least for 25% and who had financings at least four times greater than his portion of company's own resources[106]. This anti-cap rule received the arguments of some authors[107], who suggested the requalification when the loan had been made by a qualified partner and it was

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[104] D.Lgs. 6/2003 which has carried out the L. 366/2001.

[105] In this respect, A. BUSANI, *Il finanziamento dei soci conquista un posto nel "nuovo" Codice civile*, in *Dir. prat. soc.*, 2003, n. 8, p. 36.

[106] This rule was applicable also for interests connected to loans that were simply guaranteed by partners.

[107] E.g. G. B. PORTALE, *Capitale sociale e società per azioni sottocapitalizzata*, in *Riv. soc.*, 1991, pp. 108 ss..

abnormal, that is to say that the company could not have received a similar loan from an independent creditor.

These rules were able to fight the thin capitalization without compromising excessively the exercise of the economic freedom. Indeed in the common practice to finance the company's activity mainly through debt capital, in order to realize a reduction of the tax burden, we can find the characters of an abusive conduct, but the choice of the financing policy is a manifestation of the economic freedom. So, as in every case of tax avoidance behavior, it is necessary to mitigate the State's tax revenue interest with the exercise of the privates' rights and the examined rules were able to achieve this aim.

As mentioned above, although their functionality, these rules were abrogated in 2007 and substituted by a general limitation to the deduction of the paid interests. This is the article 96, D.P.R. 917/86[108], which permits the deduction of the paid interests only for the amount of the received interests and, for the eventual remaining part, within the 30% of the difference between costs and revenues of the characteristic activity of the company[109]. Probably the reason of this general limitation is denying the deduction of the interests that are negotiated for reasons other than the exercise of the characteristic activity of the company, even if it is not indicated what is the treatment when these interests are included within the provided limits.

For concluding, we can note that currently there is not a specific anti-thin capitalization regime, as in the past.

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[108] For an analysis of the paid interests' discipline, see F. TESARUO, *Istituzioni di diritto tributario*, cit., pp. 132-134.

[109] In the following years it is possible considering the paid interests that have not been deducted and the limits to the deduction that have not been used.

2.3.4. TAXATION ON FOREIGN DIVIDENDS AT THE LEVEL OF DOMESTIC CORPORATIONS

Dividends always generate economic double taxation problems because of their own nature. In fact they are taxed firstly as profit of the company and secondly as remuneration for the participation in the company by the partner. For this reason, States provide methods to eliminate this economic double taxation, choosing between the credit method and the exemption one.

As regards the compatibility with the EU law, the only important thing is adopting the same tax treatment for both, national and foreign dividends. Just to achieve this result, the Italian tax reform[110] substituted the credit method with the exemption one. Indeed the credit method assures the elimination of the economic double taxation, only if company and partner are resident in the same State, because the residence State of the partner usually does not grant a tax credit to dividends with a foreign source for the taxes that the company has paid in its residence State (save specific provisions in the DTCs)[111]. Therefore the credit method is not usually in accordance with the EU law because it hinders the free movement of capitals: making investments abroad usually involves an higher tax burden because the economic double taxation is not eliminated.

The ECJ expressly asserts the non-compatibility with the EU law of a national rule that assures, to its residents, the elimination of the economic double taxation on dividends, only if the company, which distributes dividends, is resident in its

[110] D.Lgs. 344/2003.

[111] See F. RASI, *La tassazione dei redditi societari in ambito UE: il nuovo modello italiano a confronto con i sistemi degli altri Paesi*, in *Rass. trib.*, 2009, n. 5, p. 1789.

State too. Moreover the Court underlines that the simply State's tax revenue interest is not enough to limit privates' freedoms[112].

According to these arguments, which are made by the prospective of the partners' residence State, the latter cannot discriminate the partners which receive dividends from a company which is resident in a different State. If we switch to the prospective of the company's residence State, we note that the same problems, concerning privates' freedoms and non-discrimination, are involved. Indeed this State cannot provide a worse tax treatment for dividends distributed by its company to partners which are resident in a different State. In other words, if the company's residence State provides a method to eliminate the economic double taxation for national dividends, the same tax treatment has to be provided for foreign dividends[113].

About that, until 2007, the Italian tax system assured the elimination of the economic double taxation on the national dividends through the exemption method, while for the dividends distributed by a resident company to a non-resident partner, it provided a withholding tax. This withholding expressed the Italian tax sovereignty, as source State, on incomes that the non-resident partner had produced in its territory, but it caused a discrimination against foreign dividends and a limitation of the basic freedoms. In fact the dividends paid to a non-resident partner could be subjected to a higher tax burden because of a juridical double taxation: the same income was taxed twice on the same person, the first time with the source State's withholding tax and the second time with the

[112] See ECJ, 6th June 2000, n. C-35/98, in *Rass. trib.*, 2000, p. 1347.

[113] In this direction, G. D'ANGELO, *La Corte di Giustizia conferma: le ritenute sui dividendi in uscita sono incompatibili con la libera circolazione dei capitali (a prescindere dal recupero nel paese di residenza del socio)*, in *Rass. trib.*, 2007, p. 1902.

residence State's income tax. It goes without saying that the free movement of capitals was hindered.

After the judgment of the ECJ about the important case known as Denkavit International case[114], where it is asserted the non-compatibility with the EU law of the French provision of a withholding tax only on dividends paid to non-resident partners, the EU Commission starts an infringement procedure against Italy[115] because of its article 27, paragraph 3, D.P.R. 600/73. This article provided a withholding tax of 27% for dividends paid to non-resident partners. This withholding could be reduced by a DTCs or not applied, if it was applicable the parents-subsidiary regime.

The considered article was modified by L. 244/2007[116], before the ECJ's judgment: the withholding tax's percentage was reduced to 1,375%, in order to achieve the purpose to provide the same tax treatment for both, foreign and national dividends, being the latter exempted from taxation for 95%, when they are distributed to parents that are companies too[117].

Considering the current article 27, D.P.R. 600/73, as modified by L. 244/2007, some doubts about its EU law conformity remain because the new percentage is provided only for dividends paid to non-resident companies and entities that are subjected to a company income tax in their residence State. In order to assure the EU law conformity, it must be considered that, if non-resident individuals or

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[114] See ECJ, Sez. I, 14th December 2006, n. C-170/05, in *Riv. dir. trib.*, 2007, IV, p. 109.

[115] This is the Procedure 2004/4350.

[116] For an explanation of the current discipline, resultant from L. 244/2007, see F. TESAURO, *Istituzioni di diritto tributario*, cit., pp. 181-182.

[117] Some authors deny the EU conformity of the new article 27, D.P.R. 600/73, because the quantitative equalization, between foreign and national dividends, is only apparent: paying a withholding tax is different than paying a company income tax. In this direction, G. INGRAO, *Brevi note sul persistente carattere discriminatorio della "nuova" ritenuta alla fonte sui "dividendi in uscita", ex art. 27, comma 3-ter, d.p.r. n. 600/1973*, in *Riv. dir. trib.*, 2010, IV, p. 153.

entities, like trusts, partnerships etc., that is to say those legal entities for which the new percentage is not applicable because they are not subjected to a company income tax in their resident State, have to pay a tax which is higher than the tax paid, on the same dividends, by a resident, they have to be able to obtain a refund for the surplus[118].

For our purposes, it is important to indicate that, in the process in front of the ECJ, Italy justified its higher tax burden on foreign dividends with an anti-avoidance aim. Precisely, according to the Italy's defensive arguments, considering the purpose of the Italian tax system to tax company's profits on the last individual beneficiary, the (old) article 27 wants to avoid that the last individual beneficiary uses a non-resident company as an artificial construction in order to pay lower taxes[119]. In this regard, the ECJ[120] asserts the non-proportionality of the anti-avoidance measure contained in the considered article because it provides a general application of the withholding tax, without any connection with the abusive character of the behavior. Moreover, according to the Court, Italy may fight against these abusive conducts through the mutual assistance among the Member States' tax authorities, assured by the EU Directive n. 799 of 1977.

It is just for the non-applicability of this Directive and for the lack of an appropriate exchange of informations among the member States of the EEA, that, in the same judgment, the ECJ asserts that the violation of the free movement of

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[118] 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, IV, p. 815.

[119] See D. STEVANATO, *La ritenuta sugli utili corrisposti a non residenti viola la libera circolazione dei capitali*, in *GT – Riv. giur. trib.*, 2010, p. 109. This author denies the believability of this abusive construction because, if the non-resident company is participated by individuals who are resident in Italy, the dividends distributed by the first to the second will be taxed in Italy the same.

[120] See ECJ, Sez. II, 19th November 2009, n. C-540/07, in *Riv. dir. trib*., 2010, IV, p. 135.

capitals among the same States, caused by the (old) article 27, is justified by the fight against the mentioned abusive behaviors, even if also the EEA Agreement assures this freedom.

The same argument can help to affirm the applicability of the ECJ's principles also to the dividends that are distributed outside the EU and the EEA. About that, we have to note that the EU Treaty assures the free movement of capitals also among member States and third States. For this reason, it is possible arguing that the (old) article 27 is not in accordance with the EU law also about dividends distributed to partners that are resident in a third State, when Italy has with this State an appropriate exchange of informations[121].

[121] A. DEL SOLE, *Riflessioni critiche sulla pronuncia di incompatibilità con il diritto comunitario della ritenuta italiana sui dividendi "in uscita" verso soggetti comunitari*, cit., p. 815.

CHAPTER 3

ANTI-AVOIDANCE MEASURES IN THE TAX TREATY LAW

3.1. THE TREATY SHOPPING PHENOMENON

In order to obtain otherwise undue tax benefits, taxpayers realize transactions aimed to abuse even of DTCs' provisions, not only of domestic or European ones. This phenomenon of treaties' provisions abuse is called treaty shopping[122] and it can be realized in two different ways. First of all, taxpayers can take advantage from the differences which exist among the several treaties that are stipulated by States. Moreover and above all, they can interpose, between the source State and the residence one, a person that is resident in a third State, when the latter has stipulated, with the other two countries, conventions which permit to the income's beneficiary to pay a tax that is lower than the one that he would have paid, if the third State had not been interposed.

Italy fights against the treaty shopping phenomenon mainly through the abstinence approach and the look-through approach. According to the first, Italy should not stipulate treaties with States with a tax system that is very advantageous for companies because, consequentially, taxpayers would constitute in this State artificial constructions, that is to say companies only aimed to profit of the better tax treatment. The second approach, instead, requires the capacity to go beyond the juridical scheme, which is adopted by taxpayers, in order to catch the economic transaction that they really want to realize, which is not equivalent of the used (because tax cheaper) juridical scheme.

[122] For a description of treaty shopping phenomenon see A. DRAGONETTI, A. SFONDRINI, V. PIACENTINI (a cura di), *Manuale di fiscalità internazionale*, cit., p. 128.

Generally DTCs contain anti-abusive measures. The aim of these measures is to not allow of profiting of tax benefits provided by the same Convention that contains the considered clauses, if these benefits are obtained through abusive transactions. Some of these clauses can be defined as classic because they are already provided by the first OECD Model Tax Convention[123], so that they can be considered as belonging to the international legal tradition; other, instead, are more recent. The beneficial ownership clause is a classic one, while the limitations on benefits clauses[124] are more recent[125].

Besides these conventional clauses, most of the States provides also domestic measures for avoiding this kind of tax avoidance concerning treaties' provision[126]. Indeed, in the following paragraphs, we are going to analyze, firstly, the anti-treaty shopping conventional clauses, that is to say the beneficial ownership and the LOB clauses, and, secondly, the issue concerning the possibility to use the Italian domestic anti-avoidance rules in order to contain the abuse of treaties.

3.2. LIMITATIONS ON BENEFITS CLAUSES (LOB CLAUSES)

This type of conventional clause is a recent tool, created by the American tax authority, for fighting the treaty shopping phenomenon[127]. Precisely, the effect of these clauses is denying all or some conventional tax benefits to subjects with certain characteristics or to subjects which do not pass the specific anti-treaty

[123] From now on OECD MTC.
[124] From now on LOB clauses.
[125] For a definition and a classification of the conventional anti-abuse clauses see G. CASERTANO, *Clausole anti-abuso nei trattati contro le doppie* imposizioni in *Rass. fisc. int.*, 1999, I.
[126] For an analysis of the various tools aimed at fighting the abuse of treaties see P. PISTONE, *L'abuso delle convenzioni internazionali in materia fiscale*, in V. UCKMAR (a cura di), *Corso di diritto tributario internazionale,* Padova, 2005, p. 813.
[127] For an explanation of this type of conventional clause see P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, Vicenza, 2012, pp. 100 ss..

shopping tests, provided by the same clauses. In this way, these anti-abuse measures reach their aim: reserving the conventional tax advantages only to the subjects that are resident of the Contacting States[128].

According to their U.S. origin, these clauses are based on Anglo-Saxon principles and precisely on the business purpose, which is linked to the substance over form, and on the step transaction doctrine.

According to the first two principles, for tax purposes, it is predominant what privates have really wanted to realize, not the juridical form of the transaction, and, in order to profit of the conventional benefits, this *effective* privates' will has to be characterized by genuine purposes. In fact tax authorities disclaim the tax conventional advantages if, through the application of the substance over form principle, it emerges that a specific transaction has been realized only for profiting of these advantages[129].

This same treatment of disclaimer is adopted also when the conventional benefits are obtained splitting an economic transaction in several acts, each of which is based on a valid commercial reason. It is the step transaction doctrine that allows to requalify this sequence of separate transactions as a single economic transaction, which has been split only for obtaining a tax savings.

While the United States Model Tax Convention[130] provides this type of clause, the OECD MTC merely suggests to introduce in the treaties similar provisions, if

[128] It is the taxpayer who has to demonstrate to have the required characteristics, if he wants to profit of the conventional benefits.
[129] See P. VALENTE, *Elusione fiscale internazionale: strumenti unilaterali di contrasto e disposizioni convenzionali in materia di Treaty Shopping*, in *Dir. prat. trib.*, 1998, III, pp. 11 ss..
[130] From now on U.S. MTC.

specific avoidance techniques have been identified or if the use of such techniques is especially problematic[131].

Italy seldom introduces LOB clauses in its Conventions, in fact, as mentioned above, it fights against treaty shopping mainly through the abstinence and the look-through approaches. However, we can find an example of these clauses in the Conventions with the United States, because LOB clauses are always included by the U.S. in their treaties, and in the Convention with Kazakhstan[132].

Italy has stipulated two conventions with the U.S., but only one is currently in force. Both contain a LOB clause in order to assure, even if in a different way, that the subject, who profits of the conventional tax benefits, is effectively resident in a Contracting State, like every LOB clause[133].

The LOB clause of the Convention of 1984 concerns only the benefits that are connected to certain categories of income, including dividends, royalties and interests. It is not applicable to individuals and it produces its effects only after the tax authority of the source State has ascertained that the constitution and the conservation of a company in the other Contracting State has the main purpose of obtaining the conventional benefits. It is not specified how verifying this abusive

[131] We can find this suggestion in the paragraph 9.6 of the OECD Commentary on Article 1: "*The potential application of general anti-abuse provisions does not mean that there is no need for the inclusion, in tax conventions, of specific provisions aimed at preventing particular forms of tax avoidance. Where specific avoidance techniques have been identified or where the use of such techniques is especially problematic, it will often be useful to add to the Convention provisions that focus directly on the relevant avoidance strategy. Also, this will be necessary where a State which adopts the view described in paragraph 9.2 above believes that its domestic law lacks the anti-avoidance rules or principles necessary to properly address such strategy*".

[132] That is only for examples, in fact Italy has introduced this type of conventional clause also in Conventions stipulated with other States.

[133] For a summary of the contents of these clauses see P. VALENTE, M. MAGENTA, *Analysis of Certain Anti-Abuse Clauses in the Tax Treaties Concluded by Italy*, in *IBFD Bulletin*, 2000, pp. 44 e ss.; P. VALENTE, M. MAGENTA, *The New Italy-US Tax Treaty*, in *IBFD Bulletin*, 2000, pp. 94 e ss..

behavior, but probably the exchange of informations between the involved tax authorities is quite appropriate.

Differently, the Convention of 1999, not yet implemented in the Italian legal system, contains a LOB clause that is more elaborated than the previous. It denies all the conventional tools aimed to eliminate double taxation, all the conventional limitations to the withholding taxes and all the non-discrimination guarantees. While the other LOB clause produces its effects only after a tax authority's action, this LOB clause operates automatically. In fact the mentioned conventional benefits are attributed to a subject, only if he demonstrates to pass the tests that are provided in the same clause.

In order to mitigate their rigor, both of these clauses provide that the otherwise denied conventional benefits are attributed if, in the real specific case, some conditions, expressly indicated in the same LOB clauses, recur. This provision is particularly important, especially in the second LOB clause, considering the mechanical character of its tests. Indeed it is possible that, in the real specific case, there is not an abusive conduct, even if the tests are not passed. Moreover, in the LOB clause of the Convention of 1999, it is provided that the otherwise denied benefits can be also granted, if the competent tax authority allows it.

Switching to the LOB clause of the Convention with Kazakhstan of 1994, it denies the conventional tax exemptions to a subject that is resident of a Contracting State, if this subject has had, as the only or principal purpose of its transaction, to obtain those conventional advantages. This LOB clause has an empiric approach, in fact, in order to deny the conventional tax benefits, tax authorities can consider some elements of the real specific case, including income's amount and nature, circumstances of income's production, intention of the transactions' parties. Moreover we can note that this LOB clause concerns "tax exemptions", not "tax benefits" as the other LOB clauses. This different wording causes some problems about the application scope of the clause, considering also that the Convention does not explain the used expression. In this situation, it needs to refer to the context or to the national rules, but it would be better having an official explanation.

3.3. BENEFICIAL OWNERSHIP CLAUSE

The beneficial ownership clause is one of the first conventional anti-abuse clauses, but, still today, it has not an univocal definition and a clear application scope[134].

Contrary to the LOB clauses, it is provided by the OECD MTC in the articles 10, 11 and 12. According to the articles 10 and 11, dividends and interests "may also be taxed" in the source State, but, if the beneficial owner is a resident of the other Contracting State, "the tax so charged shall not exceed" a certain amount. The article 12, instead, provides that royalties "shall be taxable only" in the Contracting State of which the beneficial owner is resident.

In other words, the beneficial ownership clause allows to benefit of the conventional limitations of the source State's taxation, only if the income's beneficial owner is resident of a Contracting State, having the considered income its source in the other Contracting State. Indeed the aim of this clause is fighting against the real interposition of a third person between the effective beneficiary

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[134] See G. CASERTANO, *Clausole anti-abuso nei trattati contro le doppie imposizioni*, cit..

and the payer, in order to take advantage from the more advantageous Convention that the source State has stipulated with the residence State of the third person[135].

Therefore it is clear that the beneficial ownership clause is not an anti-treaty shopping measure with a general application scope, but it refers only to specific cases of treaty shopping, that is to say those cases that involve the abusive real interposition of a third person. This limited application scope of the beneficial ownership clause is confirmed by the recent Italian trend to include in its DTCs also the new LOB clauses, besides the classic anti-abuse clause examined in this paragraph[136].

As we can easily note, the beneficial owner concept is not defined in the considered articles of the OECD MTC and this definition generally lacks also in the single Italian conventions, even if the most of them contain this clause[137]. For these reasons, in order to find the correct meaning of this conventional clause, we have to refer to the international rules about the interpretation of treaties[138].

Apart the general provision of the Vienna Convention, which underlines the importance of good faith, ordinary meaning and context of the terms, object and purpose of the treaty, as parameters to correctly interpret a treaty[139], we have to consider also the special provision of the article 3, paragraph 2, OECD MTC.

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[135] For an analysis of this type of conventional clause see P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, cit., pp. 472 ss..

[136] In this direction, about the limited application scope of the beneficial ownership clause, 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.

[137] Only the Conventions stipulated with Cyprus and Hungary do not contain this type of conventional clause.

[138] About this topic, see G. MELIS, *L'interpretazione delle convenzioni internazionali in materia di imposte sul reddito e sul patrimonio*, in *Rass. trib.*, 1995, n. 12, pp. 1966 ss.; G. MELIS, *L'interpretazione nel diritto tributario*, Padova, 2003, pp. 588 ss..

[139] See Article 31, paragraph 1, of the Vienna Convention of 23rd May 1969: "*A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*".

According to this article, the terms that are not defined by the Convention shall have the meaning that they have under the law of the Contracting State that applies the Convention, unless the context otherwise requires[140]. Therefore, before referring to the national definitions of beneficial owner, it is necessary to ascertain that the context does not require to use an autonomous conventional meaning.

First of all it is important to understand what the context is and which elements constitute it. About that, the international doctrine specifies that the context is constituted by all the tools that are able to identify the common will of the contracting parties.

Secondly, we can note that the Italian doctrine is divided because, while according to some authors, the context requires an autonomous conventional meaning[141], according to some others, it is possible referring to the national meanings of the clause[142].

Starting from the first opinion, it needs an autonomous conventional concept of beneficial owner at least for two reasons. Firstly, no State has a definition able to be automatically adopted in the tax conventions' context, in particular Italy has not any definition of beneficial owner[143]. Secondly, if it is possible to refer to the

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[140] OECD MTC, art. 3, p. 2 "*As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State*.".

[141] See A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano*, in *Rass. trib.*, 2006, I, p. 209. The necessity of an uniform interpretation of the provisions of the international law is asserted by S. BARATTI, *L'interpretazione delle convenzioni internazionali di diritto uniforme*, Padova, 1986, p. 92 and B. CONFORTI, *Diritto internazionale*, Napoli, 1997, p. 107.

[142] 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.14 and M. TENORE, *Taxation of Dividend: a Comparison of Selected Issues under Article 10 OECD MC and the Parent-Subsidiary Directive*, in *Intertax*, 2010, p. 235.

[143] Contrary, as we are going to say later in the text, some authors affirm the existence of two definitions of beneficial owner in the Italian tax system.

national concepts, it would cause strong discrepancies, especially if we consider that, while for the common law States the beneficial owner has to be identified on the basis of economic criteria, the civil law States give importance to juridical aspects.

In order to identify a possible autonomous conventional meaning of beneficial owner, it is important retracing the historical background of this clause[144].

The concept of beneficial owner has its origin in the equity case law of the United Kingdom, which, referring to the ownership, has always distinguished the legal owner and the beneficial owner, prevailing the formality in the first and the economic substance in the second. Although it had already been introduced in some conventions stipulated by some common law States, the beneficial ownership clause was introduced in the OECD MTC, for the first time, only in 1977. According to this first wording of the clause, in order to profit of the limitations of the source State's taxation, the income's material earner had to be also the beneficial owner. It was necessary a modification of the wording to clarify that, for obtaining the conventional benefits, the important thing is that the beneficial owner is a resident of the other Contracting State, even if he does not coincide with the material earner. This modification was made in 1995.

At the beginning, the OECD Commentary[145] individuated as examples of subjects that cannot obtain the conventional benefits, only the cases where an agent or a nominee are interposed. In the following years, the OECD found other cases

[144] For a reconstruction of the historical background of the beneficial ownership clause 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.14 and A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano*, cit., p. 209.

[145] From now on "Commentary" is for "OECD Commentary".

where the beneficial ownership clause can be applied. In fact, in 1987, with the OECD Report concerning the conduit companies, it was specified that the conventional benefits have to be denied also to a company that has powers so limited as to be a simply administrator on behalf of others, even if it is formally owner of certain goods. Then, in 1999, in the OECD Report about the partnerships, it was asserted that the beneficial owner is the subject to whom the income is allocated, according to the law of the residence State. It was in 2003 that the Commentary was modified and it was clarified that the expression "beneficial owner" is not a technical expression, but it has to be understood considering the context and the Convention's purposes, that is to say avoiding double taxation and preventing tax avoidance and evasion. According to this explanation, it is in contrast with the Convention's purposes, permitting to profit of the limitations of the source State's taxation to the agent or nominee who are resident in the other Contracting State because they are not liable to tax in this State, so there is not any double taxation problem. Moreover it is in contrast with the anti-abuse purposes of the Convention, permitting to profit of the same benefits to a resident of a Contracting State, if he is simply an intermediary of another non-resident person, who is, instead, the beneficial owner[146].

All these OECD's documents show that it is difficult finding an univocal definition of beneficial owner because there is not an unambiguous interpretation of this concept in the international scope.

[146] Recently, in the OECD Report about the vehicles for collective investments, it is specified that they can be considered as beneficial owners, if they have discretionary management powers on goods on behalf of the investors.

Nevertheless, the authors, who consider necessary an autonomous conventional meaning, try to find it through various reconstructions, but each of them is relative, so not appropriate.

Therefore, considering the real international circumstances, nowadays it seems more correct supporting the other opinion of the authors, according to which the context allows to refer to the national concepts of beneficial owner. In fact, as shown above, today it is not possible to find the searched univocal definition of beneficial owner, which is valid for all the Conventions stipulated by States. Moreover we have to note that, because of the wide spread of the avoidance phenomenon, by now all the States, with a common law or a civil law tradition, give importance to the economic aspects of a transaction, considering that it is common the practice to use certain juridical schemes only to obtain a better tax treatment and not because they are equivalent of the legal and economic effects that taxpayers really want.

So, switching to this second authors' opinion, we have to focus on the way to understand the beneficial owner concept in the Italian tax system, analyzing the reconstructions used by its tax authority, its Supreme Court and in its Conventions.

The Italian tax authority identifies the beneficial owner in those subjects to whom income is ascribed for tax purposes, according to the law of the residence State[147]. Some authors consider this definition not in accordance with the anti-abuse purposes of the examined clause because, so interpreted, it seems a subject-to-tax

[147] See the Italian Tax Administration's Ris., 21st April 2008, n. 167/E and the Italian Tax Administration's Ris., 12th July 2006, n. 86/E.

clause[148], according to which a person can profit of the conventional benefits, only if it is taxed on the income to which the mentioned benefits are connected[149]. Anyhow, the tax authority adopts a different definition of beneficial owner in relation to the EU Directive concerning interests and royalties: the company, which receives interests and royalties, can be considered beneficial owner, if it has the ownership and the availability on the received incomes, that is to say that it has to obtain an own economic benefit from the realized operation[150].

In the case law of the Italian Supreme Court there was a development. Indeed, initially, in order to profit of the conventional benefits, according to this Court, the earner had to prove the fulfillment of the tax burden connected to the received income, in his residence State[151]. Nowadays, instead, it is sufficient that the received income is liable to tax in the residence State of the earner[152]. In other words, nowadays the Italian Supreme Court adopts the same tax authority's definition of beneficial owner.

As mentioned above, in its tax conventions, Italy generally introduces the beneficial ownership clause, but usually it is not defined[153]. The only exceptions

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[148] For an analysis of this type of conventional clause, please refer to the paragraph 3.5 of this chapter.

[149] A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano*, cit., p. 209.

[150] See Circ., 2nd November 2005, n. 47/E.

[151] See Cass., Sez. trib., 29th March 2000, n. 3861, in *Giust. civ. mass*, 2000, p. 661.

[152] See Cass., 29th January 2001, n. 1231, in *Riv. dir. trib.*, 2001, III, pp. 40-47; Cass. Sez. trib., 21st February 2001, n. 2532, in *Dir. prat. trib.*, 2001, I, p. 530.

[153] In the most of the Italian Conventions, the beneficial ownership clause is formulated so as to require the coincidence of the beneficial owner with the income's material earner, which has to be resident in the other Contracting State. In other words, it is taken the first wording of the examined clause in the OECD MDC. Only the Conventions stipulated with Australia, Belgium and the United States contain the beneficial ownership clause formulated in accordance with its real spirit. In other words, in these Conventions, it is taken the wording of this clause, as reformed in 1995 in the OECD MTC: for profiting of the limitations of the source State's taxation, the important thing is that the beneficial owner is resident in the other Contracting State, even if it does not coincide with the income's material earner. Anyhow, this correct interpretation is endorsed by the Italian tax authority, so the beneficial ownership clause is applied in conformity with its real ratio, in all

are represented by the Convention with Germany of 1989 and the Convention with Turkey of 1990. In the first case, the earner of dividends, royalties and interests is considered beneficial owner, if he has the right to receive these incomes and if the same incomes have to be attributed to him for tax purposes, according to the tax rules of the Contracting States. In the second case, instead, the beneficial owner is identified on the basis of the residence in one of the Contracting States.

These definitions have to be considered for the application of the Conventions where they are contained, because according to the Vienna Convention "*A special meaning shall be given to a term if it is established that the parties so intended*"[154]. Differently, according to the mentioned article 3, paragraph 2, OECD MTC, for the other cases, where there is not a conventional definition of beneficial owner, it is possible referring to the national definitions[155]. About that, in the Italian tax law there are two definitions of beneficial owner, which have been introduced through the transposition of two EU Directives. Indeed also the national rules, deriving from the EU law, have to be considered for the interpretation of treaties because they are part of the national law, to which the article 3, paragraph 2, OECD MTC, refers[156].

Switching to a short analysis of these two definitions, according to the article 1, paragraph 1, D.Lgs. 84/2005, which transposes the Savings Directive, individuals are considered beneficial owners, if they receive payments as final beneficiary.

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the Italian Conventions. In this direction see the Italian Tax Administration's Ris., 7th May 1987, n. 12/431.

[154] This is the Article 31 paragraph 4 of the Vienna Convention of 1969.

[155] In fact, according to the opinion that is supported in the text, the context does not require an autonomous conventional meaning.

[156] Indeed some Italian authors assert that the Italian tax system has not a positive definition of the beneficial owner concept.

Similarly, the article 26-quarter, paragraph 4, D.P.R. 600/73, which transposes the Interests and Royalties Directive, companies are considered beneficial owners, if they receive payments as final beneficiary and not as intermediary. In order to attribute the correct meaning to the expression "final beneficiary", it is necessary to consider that it is opposed to the other expression "intermediary". This means that the final beneficiary is the subject who receives incomes on its own[157].

In conclusion it is not difficult to understand that the beneficial ownership clause is not an efficacious tool for fighting the treaty shopping phenomenon because of the indefiniteness of the concept and the consequential uncertainties about its application scope. For these reasons the OECD suggests to adopt more accurate anti-abuse measures for avoiding the interposition of a third person aimed to profit of the conventional benefits[158].

3.4. OTHER ANTI-AVOIDANCE MEASURES IN THE ITALIAN TAX TREATIES

3.4.1. THE LOOK-THROUGH APPROACH FOR REAL ESTATE INVESTMENT ENTITIES

As we have already said, Italy tries to fight against the treaty shopping phenomenon also adopting a look-through approach.

In the OECD MTC this approach is the basis of the paragraph 4 of the article 13, according to which "*Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or*

[157] In this regard, F. AVELLA, *Il beneficiario effettivo nelle convenzioni contro le doppie imposizioni: prime pronunce nella giurisprudenza di merito e nuovi spunti di discussione*, cit., p.14.

[158] See paragraphs 13 ss. of the OECD Commentary on Article 1.

indirectly from immovable property situated in the other Contracting State may be taxed in that other State".

This paragraph was introduced in 2003, that is to say when it was adopted a general anti-abuse approach within in the OECD, while in the past this approach was admitted only if the single convention provided so[159].

Indeed the new paragraph has a clear anti-avoidance purpose[160]. In order to understand its function, we have to consider the paragraph 1 of the same article, according to which "*Gains derived by a resident of a Contracting State from the alienation of immovable property […] situated in the other Contracting State may be taxed in that other State*". When the paragraph 4 was missing, it was simple for the taxpayer avoiding the taxation of the State where the alienated immovable property was situated, that is to say the source State's taxation, because it was sufficient realizing an indirect alienation of the immovable property through the alienation of the shares of a company, which had, as its only assets, the immovable property that the taxpayer wanted to alienate. In fact, in this case, it would have been applicable the paragraph 5 of the article 13, according to which "*Gains from the alienation of any property, other than that referred to in paragraph 1,2,3 (and 4), shall be taxable only in the Contracting State of which the alienator is a resident*".

In other words, the current paragraph 4 fights against the abusive behavior aimed to avoid the source State's taxation through the use of legal entities, which are

[159] For this change of perspective 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.14

[160] For a complete analysis of the Article 13(4) OECD MTC see the OECD Commentary.

interposed as owners of the immovable property that the taxpayer wants to alienate.

The new paragraph of the article 13 of the OECD MTC can be regarded as a provision that is parallel to the paragraph 1 of the same article because it makes equal the treaty regime for the direct and indirect alienation of immovable property.

It is important to clarify that, despite its anti-avoidance aim, in order to apply the article 13(4), it is not necessary to demonstrate the abusive character of the considered transaction, but this provision is always applicable when a taxpayer alienates shares deriving more than 50 per cent of their value from immovable property situated in a Contracting State other than its residence State. Probably for this reason, the Commentary specifies that the 50% threshold can be either increased or reduced by the Contracting States during their bilateral negotiations, in accordance with the general transactions intervening among their citizens.

Nevertheless a confirmation of the anti-avoidance function of the article 13(4) can be found in the Commentary's provision according to which the Contracting States can exclude the applicability of the examined paragraph when "*the immoveable property from which the shares derive their value is immovable property in which a business is carried on*". This possibility underlines that an abusive intention can miss in the real specific case, when the company is not simply interposed for avoiding the source State's taxation in the alienation of immovable property, but there is the real intention to alienate this company's shares. Even if the wording of this exception provided by the Commentary seems to cover only the cases where more than 50% of the value of the shares is derived from the sole immovable property in which the business is carried on, it can be alternatively provided that the immovable property in which the business is carried on does not have to be considered for purpose of the 50% test for applying art. 13(4)[161].

In order to strengthen the anti-abuse purpose, it is provided the same tax treatment when the alienated shares derive the required portion of their value either directly or indirectly from immovable property. While in the first case the shares relate to the capital of the company owning the property, in the second case they relate to the capital of a company that in turn owns a participation in other companies owning the property. In this way it is avoided the possibility to dodge the article 13(4) through the interposition of a company between the shareholder and the company owning the immovable property.

Moreover, always in order to avoid that the examined paragraph is dodged, the Commentary provides that the Contracting States can extend the application scope also to gains deriving from the alienation of interests in entities other than companies, such as partnerships or trusts.

Analyzing the effects of its application, we can note that the article 13(4) can cause some unfairness problems, which show the necessity of a reform. Precisely, when it is verified that more than 50% of the value of the shares derives from immovable property[162], the *entire* gain attributable to the shares may be taxed in

[161] In this regard, S. SIMONTACCHI, *Immovable Property Companies as Defined in Article 13(4) of the OECD Model*, in *Bulletin*, 2006, p. 32.

[162] According to the Commentary, in order to verify if the alienated shares derive more than 50% of their value from immovable property, it is necessary to compare "*the value of such immovable property to the value of all the property owned by the company without taking into account debts or other liabilities of the company*". This latter limitation can be explained considering that in order to apply the article 13(4), it does not need the value of the company as such, but the contribution of the relevant immovable property to determine that value. Moreover, according to the economic principles, the financial resources of an enterprise pertain to the whole enterprise and

the source State, that is to say also the part of the value of the shares deriving from property other than immovable property located in that State. This means that the application of the article 13(4) leads to an allocation of taxing rights between the involved States that differs from the ordinary allocation of them that would be, if the article 13(1) is directly applicable. Therefore it is clear that the article 13(4) can cause an allocation of taxing rights that is inconsistent with its ratio because the source State may tax not only the gains that have their source in its territory, but also the gains that should be taxed in the residence State. In this way it is not assured the same tax treatment for the direct and indirect alienation of immovable property, although this is the goal pursued by the article 13 (4). In other words, in its application, the article 13(4) goes beyond its anti-abuse purpose. In order to assure a fair distribution of taxing rights between the residence and the source States, it needs a reform of the wording of the article 13(4) aimed to attribute to the source State taxing rights to the extent of the unrealized gains on immovable property situated in its territory, that is to say those taxing rights that are attributed to it by the article 13(1), when the same immovable property is alienated directly[163].

Considering the Italian tax treaty policy, we can note that not all the Conventions stipulated by Italy contain the provision of the article 13(4). For example it is provided by the Conventions with China, Algeria, Saudi Arabia, while it is absent in the Conventions with France, Germany, U.S., Spain, U.K., Russia and many other. Probably the reason of this different Italian behavior is connected to the fact

cannot be specifically attributed to its various assets. In this direction, S. SIMONTACCHI, Immovable Property Companies as Defined in Article 13(4) of the OECD Model, cit., p. 33.

[163] About the necessity of this reform see S. SIMONTACCHI, *Immovable Property Companies as Defined in Article 13(4) of the OECD Model*, cit., p. 37.

that treaties do not give taxing rights to the Contracting States, but simply distribute the already existing taxing rights between source and residence States, in order to avoid double taxation problems. In other words, if a tax treaty allows to the source State to tax a certain income, like the article 13(4) OECD MTC, this State can effectively do it, only if that income is taxable according to its domestic tax legislation. Generally, States have not the right to tax, as source States, non-resident sellers deriving income from the sale of shares in companies that are resident in these same States and, except for the sale of shares in immovable property companies, neither the OECD provides for a taxing right in the source State in such cases, save the application of the anti-avoidance measures[164].

Regarding the Italian tax legislation about the provision of the right to tax incomes attributed to a non-resident seller for the alienation of shares of a resident immovable property company, we can note that, in these cases, it is detectable the same avoidance plan of those abusive behaviors that use the artificial construction known as Special Purpose Vehicle (SPV). Indeed in the latter cases, in order to obtain a tax savings, taxpayers who want to alienate, for example, immovable property, do not alienate it directly, but they confer it to a company, obtaining the related shares, and then they sell these received shares. The possibility to obtain the pursued tax savings is connected to the Participation Exemption regime (PEX) provided by the Italian tax legislation, according to which incomes deriving from the alienation of shares are exempted from taxation[165]. It is not difficult to note

[164] About this observation see J.J.P. DE GOEDE, *Allocation of Taxing Rights on Income from Cross-Border (Indirect) Sale of Shares*, in *Asia-Pacific Tax Bulletin*, 2012, p. 215.

[165] The PEX regime is connected to the Italian tax regime on dividends. Indeed, in order to assure the same tax treatment for both incomes that can derive from shares, as it is provided a tax exemption for dividends, aimed to avoid the economic double taxation, so it is provided a tax

how these abusive behaviors have the same logic of the conduct which the article 13(4) OECD MTC tries to prevent: in both cases there is a company that is used as a vehicle, in order to avoid a higher tax burden. Just because it is detectable the same ratio, we can affirm that the Italian tax law should cope to the abusive issues connected to the article 13(4) OECD MTC, as well as it faces to the abusive behaviors realized through the SPVs. In this regard, it is important to understand if the domestic anti-avoidance rules can be applied also to international abusive schemes[166].

3.4.2. THE LOOK-THROUGH APPROACH FOR ARTISTE-COMPANIES

Also the paragraph 2 of the article 17 OECD MTC is based on the look-through approach. In particular, as the Commentary specifies, this provision is very important for those States that do not have "*the statutory right to look through the person receiving the income to tax it as income of the performer*"[167].

In order to understand this statement, we have to refer also to the paragraph 1 of the same article.

According to the article 17(1) OECD MTC, "*income derived by a resident of a Contracting State as an entertainer […] or as a sportsman, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.*". This means that the country of the performance has the primary right to tax incomes of non-resident artistes or sportsmen deriving from their activities as such exercised in its territory. Therefore the general rules of the

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exemption for capital gains. About this connection see F. RASI, *La tassazione dei redditi societari in ambito UE: il nuovo modello italiano a confronto con i sistemi degli altri* Paesi, cit., p. 1789.

[166] For this issue please refer to the last paragraph of this article.

[167] For an analysis about the ratio of the Article 17 (2) OECD MTC see the OECD Commentary on Article 17.

articles 7 and 15 of the OECD MTC, according to which income is taxable in a country other than the residence one, only if it is attributable to a permanent establishment established in that other country or after a presence of 183 days in that other country, are derogated for an anti-avoidance purpose: avoiding that highly remunerated and mobile artistes and sportsmen do not pay tax in any country, neither in the source nor residence countries.

In this context the paragraph 2 of the same article strengthens this anti-avoidance purpose because it prevents that entertainers and the sportsmen avoid the source State's taxation through the interposition of a third person, who receives incomes deriving from their performances. In fact the article 17(2) OECD MTC provides that, in these cases of interposition, the source State still holds the right to tax the considered incomes[168]. In other words, it is an additional measure to counter tax avoidance.

The specific tax avoidance device, which the paragraph 2 tries to prevent, is expressly provided by the Commentary, according to which the relative provision is applicable in cases "*where remuneration for the performance of an artiste or sportsman is not paid to the artiste or sportsman himself but to another person, e.g. a so-called artiste company, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the artiste or sportsman nor as profits of the enterprise, in the absence of a permanent establishment.*"

[168] Art. 17(2) OECD MTC "*Where income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may […] be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised*".

Now we can understand the initial statement. Some States are able to tax entertainers and sportsmen for the performances that they realize in their territory only through the paragraph 1 of the article 17 because they have domestic legal tools which, expressing the look-through approach, allow to bring incomes received by the third person back to the real owner[169]. Other States, instead, do not have these national legal tools, so it is necessary the paragraph 2 of the article 17 for allowing to these States to prevent the examined abusive behaviors, which are aimed to avoid the source State's taxation through the interposition of a third person, as explained above.

About that Italy has domestic rules which express the look-through approach[170], but more or less all its Conventions contain the paragraph 2 of the article 17 OECD MTC, maybe for the problematic issue concerning the possibility to apply domestic rules to international schemes[171].

Although its important anti-avoidance function, there are many authors who suggest to remove the article 17 OECD MTC or at least to modify it. The reasons of these proposals can be found considering the problems caused by the application of the examined article. While some of these problems are practical, others involve the fairness of the taxation[172].

Starting from the practical problems, we can indicate how it is difficult to attribute the right portion of the performance's remuneration to the different States to

[169] See the OECD Commentary on Article 17 at paragraph 11.2, according to which "*[…] the Convention would not prevent the application of general anti-avoidance rules of the domestic law of the State of source which would allow that State to tax either the entertainer/sportsman or the star-company in abusive cases, as is recognized in paragraph 24 of the Commentary on Article 1*".
[170] They will be examined in the last paragraph of this chapter.
[171] For an analysis of this issue please refer to the last paragraph of this chapter.
[172] All the problems caused by the application of the Article 17 OCED MTC are analyzed, through a casuistic approach, in D. MOLENAAR, M. TENORE, R. VANN, *Red Card Article 17?*, in *Bulletin for international taxation*, 2012, pp. 127 ss..

which the same performance is related and to individuate the right application scope of the examined article.

About the latter issue, it is common that entertainers and sportsmen earn incomes related to their celebrity and not to their activity as sports star or entertainer, for example we can think to the remuneration related to sponsors. About that the OECD, in 2010, published a Discussion Draft for changes in the Commentary on Article 17. In the first place, through the reference to the term “entertainer” instead of “artiste”, it clarifies what falls under the article 17, such as the prize money of an amateur and advertisements and interviews directly related to entertainment and sports events, but also what falls outside the scope of the same article, such as the reporting or commenting by an entertainer or sportsman in broadcasting who does not participate in the match or tournament. Moreover the Discussion Draft makes it clear that preparation and training come under the personal activities as such of entertainers and sportsmen.

Switching to the fairness problems, we can note that the article 17 does not specify the taxation method that has to be adopted in the country of the performance, so it is possible also a gross taxation. In this way the tax base there is very often much higher than the tax base in the residence country because of the non-possibility to deduct the expenses that are connected to the income’s production. In order to avoid the excessive taxation so realized, in 2008, the OECD has added the option for net taxation.

Another source of taxation’s unfairness can be represented by the possible double taxation. In this regard, the OECD recommends to use the tax credit method to eliminate double taxation because, if the residence State applies the exemption method and the performance State does not use its taxing right or restricts this to a low-tax rate on net income, the result would be double non-taxation or a very low taxation. Nevertheless, the adoption of the credit method may not eliminate double taxation caused by the article 17 OECD MTC when both, the residence and the performance States, exercise their taxing right. Indeed there may be problems linked to the assurance of the tax credit in the residence State in respect of taxes paid in another State, the State of the performance. In these cases double taxation continues and, consequentially, also the unfairness of the taxation.

Finally we have to note that the application of the examined article produces administrative and compliance costs that may be higher than the tax revenue derived from the taxation of artistes and sportsmen, especially when taxes in the source State and tax credits in the residence State are balanced.

3.5. SUBJECT-TO-TAX CLAUSE: TOOL FOR AVOIDING DOUBLE NON-TAXATION

Another clause that can be introduced in tax treaties is the subject-to-tax clause. Also this clause has a function that contributes to achieve fairness in the international taxation. Precisely this clause has the purpose to avoid double non-taxation, that is to say the situation where the same income of the same person is not subject to tax neither in the source nor residence States[173].

It is easy to understand that double non-taxation causes unfairness of the international taxation, alike the opposite phenomenon of double taxation. Nevertheless, while the general aim of tax treaties seems to be, undisputedly, the

[173] For an analysis of this type of tax treaties clause see E. BURGSTALLER, M. SCHILCHER, *Subject-to-Tax Clauses in Tax* Treaties, in *International Bureau of Fiscal Documentation*, 2004, pp. 266 ss..

avoidance of international double taxation, the avoidance of double non-taxation as a general goal or as a rule of interpretation of tax treaties cannot be inferred from treaties themselves. In other words, generally tax treaties do not aim at avoiding double non-taxation and, if the Contracting States want to ensure the avoidance of this phenomenon, they have to agree on a subject-to-tax clause in their treaty[174].

Even when countries agree on such provisions, their scope is limited and not all the cases of double non-taxation are covered by it because the reason of non-taxation is the decisive factor for the application of such clause and the possible reasons are several.

The first cause of double non-taxation is connected with the fact that tax treaties do not create States' taxing rights, but they simply divide the taxing rights that States already have. Therefore double non-taxation can occur when the State that has the taxing right, according to treaty provisions, cannot exercise it because in its domestic tax law is not provided that taxing right.

Double non-taxation can arise also because of negative characterization conflicts, that is to say when both Contracting States conclude that they do not have the taxing right on a certain income because both of them apply different distributive rules to that income.

Moreover it can result from allocating income to a taxpayer which must not be taxed according to treaty provisions under domestic law.

Finally double non-taxation can obviously occur if the taxpayer does not declare income or other tax-relevant facts, even if in this case it does not derive from the

[174] In this regard, E. BURGSTALLER, M. SCHILCHER, *Subject-To-Tax Clauses in Tax Treaties*, cit., pp. 266 ss..

application of a tax treaty, but it is the result of the taxpayer ignoring tax obligations, as in pure domestic situations[175].

Just for the variety of the double non-taxation's reasons, although the subject-to-tax clause always has the same function, its wording is as diverse as the form in which the international double non-taxation appears. Likewise it is difficult to individuate a general definition of this clause.

Sometimes the examined clause is defined as the rule that makes treaty benefits dependent on actual taxation, usually of a specific type of income[176], but it is the definition of the German Federal Tax Court that seems to be the most adequate to cover all the possible applications of the clause. According to this definition, the subject-to-tax clause is such clause that limits the general prohibitions of virtual double taxation. In other words, through a subject-to-tax clause, it is avoided the application of the methods aimed to avoid double taxation, when in the real specific case a double taxation does not occur because the State that has the taxing right, according to treaty provisions, does not use it. Consequentially, for residence States that adopt the exemption method, it might be reasonable to combine this method with a general subject-to-tax clause, in order to avoid situations of double non-taxation. In fact making the exemption of foreign incomes from taxation dependent on actual taxation in the source State permits to prevent double non-taxation.

About the OECD policy, it does not generally recommend to include subject-to-tax provisions in tax treaties, but in the Commentary it is asserted that such

[175] For an analysis of the double non-taxation phenomenon and of its causes see M. LANG, *Avoidance of Double Non-Taxation*, Vienna, 2003, p. 489.

[176] In this direction, M. H. LAMPE, *General Subject-To-Tax Clauses in Recent Tax Treaties*, in *European Taxation*, 1999, IV/V, p. 184.

provisions might be adopted for typical conduit situations. Some of these situations are individuated in the "*case where no tax on specific items of income or capital is provided under the domestic laws of the State of source or tax is not effectively collected owing to special circumstances such as the set-off of losses, a mistake, or the statutory time limit having expired*."[177] This general statement gives only limited clues on how the bilateral subject-to-tax provisions have to be interpreted and also the OCED MTC does not give a larger aid. In fact it contains only an example of subject-to-tax clause in the Article 23A(4), which seems to be applicable to certain cases of characterization conflicts. Indeed this article provides that the residence State has not to apply the exemption method under art. 23A(1) to income derived or capital owned by a resident, if the source State "*applies the provisions of the Convention to exempt such income or capital from tax or*" to reduce its taxation when the beneficial owner of interests or dividends is a resident of the other Contracting State[178].

In this context, considering that States cannot refer to models contained in the OECD MTC, the subject-to-tax clauses, which are stipulated by States in their bilateral treaties, are very different in their form and very difficult to interpret because each clause has to be interpreted separately and in consideration of the interaction of the tax legislation in two countries and the historical reasons for the clause[179].

[177] See the OECD Commentary on Article 23A OECD MTC at paragraph 35.
[178] See S. B. LAW, *Anti-Avoidance Rules in Recent Tax Treaties*, in *Bulletin for international taxation*, 2012, p. 320. This author underlines that this conventional clause is only relevant for States using the exemption method to provide double taxation relief. In fact under this provision these States may apply the credit method, thereby being allowed to tax income in cases where the source State has refrained from taxing it. Nevertheless not all the countries using the exemption method actually adopt this provision in their tax treaties.
[179] In this regard, E. BURGSTALLER, M. SCHILCHER, *Subject-To-Tax Clauses in Tax Treaties*, cit., pp. 266 ss..

About Italian tax treaties, examples of subject-to-tax clause are contained in the Conventions with United Kingdom and Azerbaijan.

In the first case it concerns dividends and precisely the article 10, paragraph 3, of the Convention with UK provides that tax credit is not granted when the person who receives dividends is not subject to tax in Italy.

In the second case, instead, the subject-to-tax clause relates pensions. Precisely the point 6 of the additional protocol to the Convention with Azerbaijan provides that when the pension's beneficiary is not subject to tax in his residence State, the considered income is taxed in the source State, not applying the provided exemption.

In both cases the clauses concern a specific type of income and they prevent the application of the methods to eliminate double taxation when the State to which the treaty attributes the taxing right does not use it. Therefore in these clauses we can find all the elements that characterize a subject-to-tax clause according to the definition formulated by the German Federal Tax Court.

3.6. POSSIBILITY TO USE THE ITALIAN DOMESTIC ANTI-ABUSE CLAUSES FOR FIGHTING TREATY SHOPPING

The relation between DTCs and domestic anti-avoidance clauses is not clear[180]. About that the Commentary on Article 1 indicates two opposite views shared by the OECD Member States divided in two different groups: on one side States with the monistic system and on the other States with the dualistic one[181].

[180] In general about the relation between conventional and national laws see B. CONFORTI, *Diritto internazionale*, cit., pp. 299 ss..
[181] For a complete analysis of these two different views see the OECD Commentary on Article 1.

In the first States DTCs are directly included within the domestic legal system once they have been ratified and properly promulgated and they take, at least prima facie, precedence over domestic law. These States share the view according to which the taxpayers' behaviors, which constitute abuse of DTCs, can be disregard by tax authorities and judges of the Contracting States simply interpreting DTCs in good faith, as required by the Vienna Convention.

Differently, in the second group of States, DTCs are not existent for national authorities and judges, unless they are transposed into domestic legal system through a Parliament Bill. When this happens, DTCs provisions are considered as nothing more than domestic laws and, for this reason, tax authorities and judges are able to apply domestic anti-abuse measures at treaties level. Therefore these States share the other view indicated by the OECD Commentary, according to which the application of domestic anti-avoidance rules to economic activities that are regulated by DTCs is part of the application of the basic domestic tax rules for determining which facts give rise to a tax liability, consequentially their application is not affected by DTCs.

Anyhow it is important to clarify that there is a principle of public international law that has to be respected when the domestic anti-abuse rules are applied contrary to treaties' provisions. This is the principle according to which no State can justify a breach of the international obligations with the mere reference to the domestic law requirements[182].

Anyway, in order to assure legal certainty, it would be desirable to lay down international rules for autonomously preventing tax avoidance at level of public

[182] In this regard, A. ZALASIŃSKI, *Some basic Aspects of the Concept of Abuse in the Tax Case Law of the European Court of Justice*, in *Intertax*, 2008, v. 36, IV, p. 163.

international law, by including general or specific anti-abuse provisions in DTCs themselves.

Meanwhile contracting parties may include in their DTCs a provision that permits the application of domestic anti-abuse rules for avoiding the abuse of the concerned DTC[183].

About this issue, Italy seems to be in the second group of States, so it recognizes the possibility to apply domestic anti-avoidance measures at treaty level. Apart the internationally accepted principles, the only limitation relates the application scope of the domestic rules[184].

Among the various Italian anti-abuse rules that express the look-through approach[185], we have to consider two articles of D.P.R. 600/73, the article 37, paragraph 3, and the article 37-*bis*, for their wider application scope.

According to the first article, tax authority attributes income to the effective owner when it is demonstrated that the apparent owner is only an interposed person. This article is not able to fight against treaty shopping because the latter always involves a *real interposition of person*. This means that the third person is the effective juridical contractor, so that the juridical effects of the realized transaction involves his juridical sphere, thus they have to be transferred to the person on whose behalf the third person has been interposed. Differently, the article 37, D.P.R. 600/73 concerns the *fictive interposition of person*, that is to say that the third person is only fictitiously income's owner, in order to hide the real juridical owner. In other words, in this type of interposition the juridical effects

[183] In this direction, A. ZALASIŃSKI, *Some basic Aspects of the Concept of Abuse in the Tax Case Law of the European Court of Justice*, cit., p. 163.
[184] In this respect, J.J.P. DE GOEDE, *Allocation of Taxing Rights on Income from Cross-Border (Indirect) Sale of Shares*, cit., p. 216.
[185] For example we can think to the CFC rules, to the transfer pricing regime etc..

involves directly the juridical sphere of the real owner, thus it is not necessary a following transfer of them[186].

Switching to the article 37-*bis*, it seems correct to assert its capacity to fight treaty shopping. According to this article, in fact, tax authority has the power to disclaim tax advantages realized through transactions that have not valid commercial reasons and that are directed to dodge tax obligations or prohibition and to obtain an otherwise undue tax savings, if the taxpayer has realized one or more operations expressly indicated in the paragraph 3 of the same article. Therefore, if the taxpayer uses one or more of these operations in order to realize the interposition of a third person, the Italian tax authority can disclaim the obtained conventional benefits through the application of this domestic anti-abuse rule, in cases where Italy is the source State. Naturally the tax savings will be constituted by the more advantageous conventional tax treatment provided by the treaty concluded between Italy and the residence State of the interposed person than that concluded with the residence State of the real income's owner. It goes without saying that the application of a national rule to an international transaction involves a lot of difficulties for tax authority because of the transnational character of the abusive conduct[187].

Finally, considering that, according to the current Italian case law, a general unwritten anti-abuse principle exists in the Italian tax system, it is possible fighting the treaty shopping phenomenon also through it. In fact it has a general

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[186] About the capacity of the article 37, D.P.R. 600/73 to fight only against the fictive interposition of person see S. MARCHESE, *A margine di un caso di "esterovestizione", fra società di comodo, interposizione nel possesso di reddito e divieto della doppia imposizione*, in *Dir. prat. trib.*, 1995, II, pp. 702 ss..

[187] These conclusions about the articles 37 and 37-*bis*, D.P.R. 600/73, are shared by A. BALLANCIN, *La nozione di "beneficiario effettivo" nelle Convenzioni internazionali e nell'ordinamento tributario italiano*, cit., p. 209.

application scope, so it can be used to fight against both, fictive and real interposition of person[188].

[188] In this direction, F. AVELLA, *Il beneficiario effettivo nelle convenzioni contro le doppie imposizioni: prime pronunce nella giurisprudenza di merito e nuovi spunti di discussione*, cit., p.14.

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Fairness in procedural tax law

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Chapter 1

1.1.Tax return and tax assessment[1]

The tax return is a fundamental act, thanks to which the taxpayer shows the tax assumption to tax Administration. In Italy there are taxes that do not need a return because they have instant nature, as in the case of registration tax in which the relevant items for tax Administration are contained in the act to be recorded itself. Other taxes include a specific return to be presented sometimes, or in case of a single operation (e.g. for customs operations), or periodically (e.g. for the purposes of income tax and VAT). Then, there are hypotheses in which the return obligation belongs to non-taxpayers, such as withholding tax.

The tax return is instrumental to the tribute implementation and to the exercise of tax Administration’s control powers. Its aim is to represent the relevant economic events for the tribute implementation after a first evaluation of legal relevance made by the same taxpayer. The tax return also contains the due sum based on the declared taxable income. In the case of partnerships the tax return contains only the tax base assessment and income shares that are attributable to each partner and will feed into his tax return. The tax return may also contain useful elements for investigation purposes. The VAT return has a purely different content because it shows periodic settlements and payments.

[1] G. MELIS, *Lezioni di diritto tributario*, Torino, 2013, pag. 271; D.lgs 74 of 2000 and article 1 and 2 of d.lgs 471 of 1997 in G. FALSITTA, A. FANTOZZI, G. MARONGIU, F. MOSCHETTI, *Commentario breve alle leggi tributarie*, Padova, 2011, Tomo II, p. 525 e 681.

The tax return is the object of financial Administration's subsequent control activities, which, however, are only possible. The tax return can be useful to tax return and collecting or as evidence.

Anyone who owns taxable income produced in Italy, even if living abroad, is required to declare it to the Italian revenue Agency, using a paper model, unless expressly provided for exclusions. Each year, the single model is different. The single model, with instructions for the tax return completion, can also be collected from the Agency's website. A special section is dedicated to non-residents.

Taxpayers have to pay taxes resulting from tax return using a specific model, within certain time limits, which vary depending on the type of taxpayer (natural person, partnerships, corporations and assimilates institutions). In general, income tax payments (Irpef or Ires) take place in two phases: the balance for the year covered by the tax return and the payment for the next year, which is paid in one or in two installments, depending on the amount.

Natural persons must pay the balance and the first installment no later than 16^{th} June of the year in which the tax return occurs or within the next 30 days by paying a premium of 0.40%. The deadline for any second or only installment is 30^{th} November. The personal income tax advance is due if the declared tax in that year (refer to the previous year), net of deductions, tax credits, deductions and surplus, is higher than 51.65 euro. The advance shall be equal to 100% of the declared tax in the year (D.l 76/2013) and must be paid in one or two installments, depending on the amount: single payment, no later than 30th November, if the advance does not exceed 257.52 euro; two installments, if the advance is equal to or greater than 257.52 euro; the first one is equal to 40% by 16th June (along with the balance), the second – the remaining 60% - by 30th November. The balance and the first partial payment can be done in monthly installments (the November amount must be paid in a lump-sum payment). In any case, the installment payment must be made within the month of November.

Partnerships and assimilated institutions are bound to pay only the Irap and VAT. The personal income tax is paid directly by the members, to which incomes are allocated by transparency (regardless of perception).

Ires payments and any first balance must be performed by the 16th of the sixth month following that of the tax year's closing, or no later than the thirtieth following day, by increasing the amounts of 0.40 percent by way of interest payment. The Ires advance is fixed at 102.5% for the tax year in progress at December 31, 2013 and at 101.5% for the tax year in progress at December 31, 2014 (D.L 76 and 133/2013). Afterwards, it will be equal to 100%. The balance is paid in two installments, unless the payment to be executed upon expiration of the first does not exceed 103 euro. In this case, the 40% due balance is paid upon the first installment expiry and the remaining amount at the end of the second. Ires subjects may divide payments in no more than six installments.

Vat taxable person must liquidate and pay the fee periodically on a monthly basis or, in some cases, on a quarterly basis, using the specific model according to article 1 of D.P.R. 100 of 1998. The terms of payment vary depending on the type of taxpayer. Therefore, we must distinguish:

monthly taxpayers: the liquidation and payment must be made within the 16th day of the following month;

quarterly taxpayers: the tax payment is made by the 16th day of the second month following each of the first three quarters (16 may, 16 August and 16 November). The payment for the last quarter is made in the annual adjustment by 16th March of the next year.

The 27th of December is the balance deadline for paying the tax due for the periodic closing of the liquidation of the last month or of the last quarter of the year. Payment can be made using the specific model. It is possible to compensate the balance with any taxpayer's tax credits or contributions. Unlike the provisions for periodic settlements, quarterly and ordinary taxpayers do not have to apply the increase of interest of 1%. The deposit must be subtracted to VAT payable for the month of December (for monthly payers), during the annual Vat return (for quarterly payers) or the amount due to the liquidation of the fourth quarter (quarterly special taxpayers).

Taxpayers who are subject to VAT payment (i.e., companies and self-employed persons), presenting the annual declaration, must make tax payment no later than 16th March. Payment must be made using the specific model, exclusively in electronic form, provided that the due amount exceeds 10.33 euro. If the taxpayer is obliged to present the model for VAT and Irpef/Ires, the VAT payment may be deferred to the end of the payment period, according to the VAT return.

Tax Administration's control on tax return is absolutely possible and differs depending on whether is carried out a deep control of the tax assumption (substantial control) or a mechanical task aimed to verify the taxpayer's due amount (formal control, articles 36 bis and 36 ter of d.p.r 600 of 1973). Errors and omissions detected during formal controls lead to a penalty equal to 30% of the due tax, further reduced to one third or two thirds of the penalty in case of payment made within 30 days from notification. If tax obligation violations are found during other controls, tax Administration imposes a penalty that can be administrative, if the infringement constitutes an administrative offence, or criminal, if the violation constitutes a crime. According to article 20 of d.lgs 472 of 1997, the imposition act must be notified no later than 31st December of the fifth year following that in which the violation occurred (the verification notice must be notified within the same deadline, as established by article 43 of d.p.r. 600 of 1973). The tax violators may present their defensive arguments by the appeal deadline.

The d.lgs 472 of 1997 is the regulatory text for administrative penalties. In particular, the first part of the first title deals with penalties related to direct taxes. In cases of non-submission of tax return and void tax return, administrative penalty from 120 to 240% of the due tax amount is applied, with a minimum of euro 258. This can be increased up to twice towards the people responsible for the keeping of the accounting books. In the case of unfaithful tax return, administrative penalty from 100 to 200% of the tax or credit is applied. The penalty is increased by 10% in the case of omitted or unfaithful reasons about sector studies that do not exist. In the case of omitted or unfaithful tax return related to investments and assets illicitly held in privileged taxation States, the penalty does not apply if, during the inspection or audit, the taxpayer communicates and delivers to financial Administration some documents indicated in a special decision of the Italian revenue Agency's Director; these documents may enable the confirmation of the normal value of the transfer prices applied. Article 2 contains similar provisions that are addressed to tax substitutes, instead.

Finally, article 3 provides for a penalty when changes in rising incomes are not reported; the amount varies between a minimum of 258 and a maximum of 2065 euro. The third part contains provisions that are common to direct taxes and VAT. In particular, we can find violations regarding the tax return content and documentation; violations connected to accounting obligations; violations related to financial actors' obligations; ancillary penalties.

The d.lgs 74 of 2000, instead, is about penal tax system and regulates the types of offence in accordance with the principle of offensiveness, providing for serious crimes punishable with harsh penalties. In particular, article 2 makes provisions for the crime of fraudulent misrepresentation by using invoices or other documents to non-existent operations and establishes that anyone who, for the purpose of evading income taxes or value added tax by using invoices or other documents to non-existent operations, indicates fictitious tax losses in an annual tax return, shall be punished by imprisonment from one year and six months to six years.

Article 3 provides for the crime of fraudulent misrepresentation by other artifices and establishes that anyone who, in order to evade income taxes or value added on the basis of a misrepresentation in the mandatory accounting and using fraudulent means to hinder the investigation, indicates active elements for an amount less than the actual one or fictitious losses, is punished with imprisonment from one year and six months to six years. However, two conditions must be fulfilled:

– the evaded tax is higher than 30,000 euro (with reference to each of the individual tax);

– the total amount of the stolen to the taxation elements, including fictitious losses, exceeds 5% of the total amount of active elements, or more than 1 million euros.

Article 4 provides for the crime of unfaithful tax return and establishes that anyone who, in order to evade direct taxes or VAT (without a fraudulent system, but nevertheless knowingly and willfully), indicates in an annual tax return active elements for an amount less than the actual one or fictitious losses, is punished with imprisonment from 1 to 3 years. However, two conditions must be met:

a) the evaded tax exceeds 50,000 euro, with reference to each of the individual taxes;

b) the total amount of the subtracted active elements is more than 10% of the total amount of active elements or, however, is greater than 2 million.

Article 5 provides for the crime of failure to submit tax return and establishes that anyone who, in order to evade the income tax or VAT, does not present an annual tax return, is punished by imprisonment from 1 to 3 years if the evaded tax is superior to 30,000 euro, with reference to each of the individual taxes.

1.1.1. Withholding taxes[2]

Withholding tax is the amount that certain subjects must withhold when remitting certain fees and, then, at a later stage, pay it to the revenue Agency. These subjects are called tax substitutes because they act as tax collectors on behalf of the tax office. In Italy, there are two types of withholding taxes: withholding tax in advance, when it constitutes an advance on the overall tax burden; final withholding tax, if it completes tax substitute's function over an income[3].

A first type of income subject to withholding is income from dependent employment and similar incomes. Withholding computation is done by applying the IRPEF rate to taxable income on the base of income brackets that correspond to a pay period. In this way, a gross deduction is determined, from which subtractions are made to obtain the net payable withholding tax. Within two months of the end of the year or of the employment relationship, the balance between single payments and the due tax on the annual remuneration amount must be determined. However, arrears and severance pay are subject to separate taxation.

[2] M. CODONI, *Ritenute alla fonte e sostituti d'imposta*, Trieste, 1991.

[3] Article 1 of d.p.r. 602 of 1973 fixes that one of the ways in which income taxes are levied is the direct withdrawal; articles from 23 to 30 of d.p.r. 600 of 1973, however, set out the types of taxes that were affected by the application of withholding and income categories to which withholding taxes are applied.

Income from self-employment includes several cases (the most important is that of professionals) subject to withholding tax. The withholding tax application with obligation of compensation is the common element in all cases. Withholding tax shall apply as advance, except in cases of fees paid to non-residents for which a final withholding tax is applied. The withholding measure varies according to the different situations.

Agency revenues are subject to withholding tax under obligation of compensation, even though they are included among business incomes, which are not usually subject to withholding tax. There is a significant difference within the category: a withholding tax as balance is applied to commissions, while a final withholding tax is applied to home workers.

Capital revenues consist of a vast number of cases that, generally speaking, can be distinguished into two groups, interests and dividends. They are usually subject to withholding tax as balance.

Other incomes include various situations that have different withholding rates. Life insurance policies, for example, are characterized by various hypotheses that can be taxed as final withholding tax or withholding tax as balance; compensation for goodwill losses is subject to a 15% withholding tax as balance.

1.2. Principles of tax proceedings

Taxpayer's rights (as well as obligations) obviously refer both to resident and to non-resident taxpayer. There is no reason that could justify an exclusion of non-residents from the application of these principles. Such a difference could not be justified, on the one hand, by the principles of equality and reasonableness found under article 3 of the Italian Constitution and, on the other hand, by the principle of non-discrimination.

First of all, the private participation to tax assessment is a very important principle that has increased its importance over time, thanks to the undertaking of a relationship based on mutual respect between tax Administration and taxpayer as a parameter of the legislative activities. The participation of the private citizen to tax inspection is divided into several institutes that convey the temporary needs that have inspired their introduction. The result is a disorganized system with different sources[4].

A very important form of participation is regulated by the articles 36bis and 36ter of d.p.r. 600 of 1973. In the case of article 36bis, when differences with tax return emerge from automatic controls, the outcome shall be communicated to the taxpayers to allow them to regularize the formal aspects and provide clarification within 30 days. In the case of formal control dealt with in article 36ter, the taxpayer is asked to provide information or to send the additional documents not previously attached to the tax return. The outcome of the control is then communicated to the taxpayer in order to allow the reporting of information or issues not previously mentioned or wrongly assessed. A similar provision is contained in article 110 of the 917 d.p.r of 1986 that formalizes contradictory assumptions (although they still seem to address the financial Administration's interest in fair controls) regarding the negative income components disclaimer

[4] A. FANTOZZI, *Diritto tributario*, Torino, 2012, p. 544.

arising from transactions between resident companies and companies domiciled in privileged taxation States.

Article 6 of the taxpayer's Statute[5] appears to be more effective; it states that, before proceeding with the tax roll subscription, when there are uncertainties on relevant aspects of tax return, the tax Authority must call upon the taxpayer to provide explanations or documents within a reasonable period, not less than 30 days from the request. This is an important case of obliged contradictory to which law reconnects invalidity to contrasting measures.

Article 12 of the Statute also provides that, in accordance with the principle of cooperation between the Administration and the taxpayer, after the release of the copy of the document that states the closure of the inspection operations, the taxpayer can present his remarks and requests within 60 days. The notice of assessment cannot be made before the expiry of this term, except in cases of particular or motivated urgency. The jurisprudence has been divided about this article, but, generally, it considered that the notice served before the expiry of the term is to be considered null and void. In 2013, the application range of article 12, paragraph 7, of law 212/2000 was definitively clarified with the 18184 judgment of the Joined Chambers of the Court of Cassation. The Court of Cassation claims, in fact, that it is a rule that guarantees the joint consultation of administration and taxpayer, to allow a more effective tax exercise; the verification notice issued without waiting for the outcome of that term is null; the

[5] L. 27.7.2000, n. 212.

anticipated emission can be justified only if there are specific reasons of urgency which, if not indicated in the act, should be proved in court.

Verification with acceptance[6] is the most structured taxpayer's contribution to the investigation. In this case, the private participation ends with a formal act, therefore, is likely to establish subjective situations which are immediately subject to legal protection. The participation is once again considered by law as being aimed at protecting the Administration's interests.

Another important principle is that of good faith and cooperation in the relations between taxpayers and tax Authorities, contained in the first paragraph of article 10 of the taxpayer's Statute[7]. After reading it, you might wonder if there was the need of such a rule, given that invokes article 97 of Italian Constitution which states that public offices are organized according to the provisions of law, so that the Administration's good performance and impartiality are assured. The choice of a specific rule is probably due to the fact that there was an opposite principle in tax matters; actually, the relationship between tax Administration and taxpayers was strongly antagonistic and characterized by mutual mistrust. The collaboration between the Administration and the taxpayer constituted only an aspiration.

This situation began to change in the early 1990s with the transposition of important institutions such as self-defense, borrowed from the administrative law, and the tax assessment settlement. The taxpayer's Statute enacts the principle of cooperation that today have a strong influence on all tax matters, just thinking

[6] Chapter 5.
[7] D. STEVANATO, *Buona fede e collaborazione nei rapporti tra fisco e contribuente*, in *Lo Statuto dei diritti del contribuente*, a cura di G. MARONGIU, Torino, 2004, p. 149.

about public tax rulings or the penalties inapplicability, in case of violations that depend on objective conditions of uncertainty about tax rule applicability.

Article 12 of the law 212 of 2000 regulates the rights and guarantees of the taxpayer that is subject to tax audits[8]. The provisions of this article constitute general principles with innovative content, as expressly stated by the Court of Cassation[9]. On a first analysis, it can be established that the scope of these principles is limited to tax audits, in the broadest sense, that take place in an available place for the taxpayer. However, the taxpayer's Statute content and the fact that the investigation activities can also take place in other locations belonging to other people suggest that the taxpayer's rights and guarantees compete even on the others. The guarantees are expressed in terms of restriction on the exercise of tax Administration's investigating powers. Article 12 sets the principles concerning relations between the tax office and the single taxpayer. While, normally, tax rules impose obligations at the expense of the taxpayer and give the Administration the power to impose financial penalties for the infringement of those rules, article 12 imposes certain behaviors on the tax Administration in the taxpayer's interest. The taxpayer's legal situation, compromised by violations committed by the tax office or by its collaborators, will be reconstructed by the judge.

In particular, article 12 envisages that access must only be made when there is a real need for survey and control over the site. In addition, the verification

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[8] S. SAMMARTINO, *I diritti del contribuente nella fase delle verifiche fiscali*, in *Lo Statuto dei diritti del contribuente*, a cura di G. MARONGIU, cit., p.125.

[9] Cass., 10 dicembre 2002, n. 17576.

activities shall be carried out, except in cases of exceptional circumstances, during the normal working hours of the taxpayer and in such a way as to cause the least possible disruption to his activities, as well as to commercial or professional relationships. The taxpayer has the right to be informed of the reasons which justify the verification and its subject and to determine the location where the inspection will take place. The verification activities cannot continue more than 30 working days, extendable for another 30 days in cases of particular complexity. The taxpayer may contact the taxpayer’s defender if he considers that auditors do not act in conformity with the law. At the end of the audit, an official record of findings is drawn up.

Finally, it is worth mentioning article 68 of Decree 600 of 1973, entitled professional secrecy. It deals with the treatment of information gathered through the investigation. In particular, any information or communication on the assessment given, without the judge's order and in other cases than the ones stated by law, to people outside the Administration, other than the taxpayer or his attorney, by the Italian finance police, members of municipal councils and staff of communes participating in the investigation is considered breach of professional secrecy.

1.3. Exchange of information[10]

Traditionally, an attitude of non-cooperation between the various States with regard to the assessment and collection of tax credits abroad has spread. More recently, the trend seems to have reversed in favor of mutual assistance. The

[10] P. BORIA, *Diritto tributario europeo*, Milano, 2010, p. 365.

European Union has spread the belief that administrative cooperation is a key factor to ensure the pursuit of the principles of economic freedom.

Therefore, there were various regulatory actions at European level (most recently, directive/16/2011/EU about direct taxation and Regulation (EC) no 904/2010, October 7, 2010, on administrative cooperation and the fight against fraud in the field of value added tax) that Italy has readily complied with. In this regard, article 31bis of the 1973 d.p.r 600, called support for the exchange of information between the competent authorities of the Member States of the European Union, has a remarkable relevance as it provides the contents of the directive concerning direct taxes.

A significant problem in this field is that of the protection of single-payer in tax assessment activities that is not regulated in the EU. This is what emerges from a recent judgment of the Court of Justice of the European Union on the case of October 22, 2013 Jiří Sabou (C276/12). The Court says that the European Union law does not confer to a EU Member State taxpayer the right to be informed about the request for assistance submitted by his State to another, nor the right to participate in the formulation of the request submitted, nor the right to participate in the hearings of witnesses. In fact, the directive does not regulate the issue of the conditions under which a taxpayer may question the accuracy of the information transmitted by the State and does not impose any particular requirements regarding the content of the latter.

At the most, it can be applied the principle of proportionality; in this particular case, one must refer to internal discipline to find the forms of protection of the personal sphere. In principle, therefore, the taxpayer lacks safeguards. Italian jurisprudence[11], therefore, intervened to define some elements for the validity of tax inquiries from foreign Governments: the document containing the request must be attributable to foreign administration; applicability of the rules of the requesting State for the formal validity of the request; assessment of the compatibility of the request with the internal discipline. These are formal elements that define a minimum level of protection for the taxpayer against administrative acts lacking the minimum requirements of legitimacy and competence to proceed.

1.4. Preliminary activity[12]

After the period for declarative obligations has expired, the phase of tax Administration's control can begin. The tax Administration's activity, in fact, does not conclude with the control of the determination of the assumption, but extends to all the formalities and to fact-finding surveys. This activity has the function of prevention and supervision. The final document resulting from the investigation does not necessarily require a formal meeting with the taxpayer. In addition, the investigation may affect individual freedoms because it ends with an act that requires the taxpayer to sustain or perform a certain behavior.

Concerning the addressees, formal controls are carried out in a generalized way on all taxpayers, while this not happens in the case of fundamental controls. For the latter, in fact, the principle of possible assessment is implemented, which results in the need for a selection of taxpayers that reduces the tax

[11] Cass., 3 marzo 2000, n. 2390.
[12] G. MELIS, *Lezioni di diritto tributario*, cit., pag. 297.

Administration's discretion. Article 37 of the 600 d.p.r of 1973 states that the tax return selection to be checked is based on selective lists. This does not mean that the Financial Administration and the Italian finance police cannot proceed by own initiative, controlling subjects or categories that are not included in the lists. More precisely, the recipients are selected on the basis of selective criteria established annually by the Minister of finance. The d.l. 16 of 2012 establishes that the Revenue Agency and the Italian finance police could consider non-anonymous reports of tax violations when proceeding with inspections. For larger parties, on the other hand, there is a legislative trend to consider systematic control activities at predetermined intervals.

The powers of investigation can be classified into two categories depending on their different intensity. First, there is the power to ask information to the taxpayer or third parties. This power can be further subdivided into power to require the transmission of data or information, the power to require the production and transmission of documents and the power to summon the taxpayer to appear in person to provide information or clarification. There is also the power to carry out checks and inspections and to access the taxpayer's or third parties' premises.

However, the investigation could be conducted in a way that is not legitimate, as in the case of a disproportionate or unreasonable limitation of a fundamental taxpayer's right or of the use of a non-statutory power.

In regard to the consequences for the final act of a flawed procedure, the doctrine swings between the argument that the committed offence causes the contested act invalidity (derived invalidity) and the argument that the material, acquired in the course of the illegitimate access, cannot be used and that the claim is groundless, unless supported by additional evidence. In particular, in the first case, the inquiry irregularities give rise to an inherent flaw, namely, of the contested act; in the second case, the flaws of the activity lead to an extrinsic evidential shortage and would lead to baselessness, unless the fairness of the formulated observation is otherwise demonstrated. The doctrine is now uniquely oriented in the sense of an unusable act, so, when an act is based on illegally obtained evidence, it should be regarded as unlawful because unfounded. This conclusion is based also on the fact that article 60 of the 600 d.p.r. of 1973 refers to the penal code and to the criminal procedure code, including article 191 c.p.p that disposes unlawfully evidences as inoperable. The jurisprudence, however, asserts that the act becomes unusable, only where the vices involve the infringement of a right directly protected by the Constitution.

1.4.1. Italian finance police

Tax Administration's employees are the owners of preliminary powers, but the Italian finance police also plays an important role. This is a special police force governed directly by the Minister of Economy and Finance. It is organized as a military structure and is an integral part of the armed forces of the State and of the public force.

The Italian finance police's tasks are envisaged by the law 189 of 1959 and consist in the prevention, investigation and exposure of tax evasion and violations, in financial supervision over the compliance with the provisions of political-economic interest and at-sea monitoring for financial police purposes.

In addition, the Italian finance police contributes to the maintenance of order and public security and political and military defense of the borders.

For carrying out the tasks assigned, some titles are given to the soldiers:

-officers and judicial police agents;

-officers and tax police agents;

-public safety officers.

In reference to the institutional tasks of the above-mentioned finance police body, annually the Ministry of economy and Finance issued a general directive for administrative action and management.

The finance police acts both as criminal police and as tax police. The criminal police role concerns, in particular, the criminal activities that have a prevalent financial component. In fact, thanks to its particular professional qualification and specific skills, the body is the main representative of the judicial authority able to examine in depth the complex issues of corporate law, tax law and financial law normally related to such crimes.

This function, performed even within criminal police sections in law courts, enables the body to develop an important and effective investigative activity for the establishment of the offences. Within this function, the finance police operates according to the rules of the code of criminal procedure and the data are covered by judicial secrecy. The documents and data collected during the criminal proceedings may be transmitted to the financial offices with the judicial authority's license that will have to assess the interest of maintaining the secrecy of criminal investigations and the financial officers' interest to gather the relevant information. The law considers that the lack of authorization, acting in defense of the secrecy of the investigations, does not undermine the evidential effectiveness of any data transmitted, nor the validity of the notice of assessment based on it.

The need to conduct criminal investigations on taxpayer's behavior justifies a doubling of the terms to issue assessment notices. If the finance police, acting as administrative police, becomes aware of facts with potential criminal implications, it must notify without delay the Prosecutor's Office and each subsequent trial stage will be carried out by applying the penal procedure code.

In its capacity as tax police, the finance police develops mainly administrative activity aimed at safeguarding the public interests. The powers of research and investigation exercised by the soldiers have a legitimacy source in specific legal provisions. For the fulfillment of its tasks of monitoring and verification of the correct tax obligations on the part of taxpayers, the body has wide powers of investigation, the use of which is instrumental in the timely tax function exercise. These powers are analytically contained in single tax laws. In this sense, articles 32 and 33 of d.p.r. 600 of 1973 are very important. These articles state that finance police can initiate to perform inspections, tests and audits; summon the taxpayer to appear in person to provide data or information; invite contributors to submit acts or documents; send questionnaires on taxpayer’s data or relevant information for the investigation; request information to public administration, banks and companies. In addition, the finance police cooperates with the tax authorities for the acquisition and retrieval of elements relevant to the income assessment and for the prevention of law violations on direct taxation, proceeding on its own initiative or at the request of the offices. In order to coordinate the action between the finance police and the tax offices, agreements will be taken both periodically and in cases when systematic investigations need to be carried out.

Chapter 2

2.1.Public tax rulings[13]

The tax ruling is a procedure through which the taxpayer requests to the tax Administration to express an opinion on the taxation of an act or case intending to engage in or which has already put in place in order to know the opinion and not suffer the consequences of possible errors. The taxpayer here operates without a previous activity of the tax Administration. The Administration's legal advice activity is essential in a legal system like the Italian one based on spontaneous fulfillment of the taxpayer. The consultancy may be general in nature if expressed primarily through circular letters prepared by central Directorates and addressed to all taxpayers, practitioners and offices, or specific if expressed in resolutions, opinions and agreements relating to particular cases of application.

There are four main types of rulings joined by the aim to know the opinion of the Administration, but that differ in subject, procedure and result of the response. The ruling is never binding for the taxpayer.

- Ordinary ruling (article 11, L. 212/2000);

- Preventive anti-elusive ruling (article 21, L. 413/1991);

- Ruling for the non-application of anti-elusive rules (article 37bis, D.P.R 600/1973);

-International ruling (article 8, D.L. 269/2003).

[13] G. MELIS, *Lezioni di diritto tributario*, cit.; I. MANZON I- G. VANZ, *Il diritto tributario*, Torino, 2008.

2.1.1. Ordinary ruling

The taxpayer may appeal to the ordinary ruling to obtain the opinion of the tax Administration upon the interpretation of every objectively uncertain tax rule with regard to a concrete or personal case that concerns him. The request must deal with the interpretation of any primary or secondary tax rule governing procedural or fundamental aspects of tax case. When the taxpayer presents the application, he shall indicate all relevant elements for the definition of the case. The application shall be submitted before the taxpayer carries out the actions mentioned in the request or before the uncertain rule is implemented. The ruling can be proposed in objective conditions of uncertainty that does not occur when the Administration has already provided clarification on the same rules or has been provided the solution to similar cases through circular letters, resolution, note or statement, brought to the taxpayer's attention.

The Administration must reply within 120 days from the presentation of the request. In case of silence, the tacit approval on the taxpayer's solution is admitted, if previously proposed. The answer is valid only for the taxpayer in question and for the specific case. The subsequent actions of the taxpayer are effective if attributable to the case, except for rectification of the Administration's interpretative solution. The opinion is binding only on the offices of financial Administration. Documents other than the reply or the interpretation proposed by the taxpayer on which the silent consent has been expressed are to be considered invalid..

If the request is made by many taxpayers and concerns the same question or similar questions, the Administration may provide collective response through circular letters or resolution to be published on the website of the Ministry of economy and finance. Notwithstanding, the ruling will be applied to the individual cases because the fact that many people have made the request simultaneously is merely fortuitous.

2.1.2. Preventive anti-elusive ruling

This ruling is aimed at obtaining an opinion on the elusive nature of some operations, on the correct classification of expenditures incurred by the taxpayer and on cases of interposition. The same request can be made to get the deductibility of costs and other negative contributions to income that derive from transactions with people resident or domiciled in different states from those in the white list and also for the system of taxation applicable in the case of parent companies and subsidiaries of different Member States. The application shall contain a detailed exposure of the specific case and the interpretative solution envisaged by the taxpayer.

After 120 days from the request, the taxpayer may prompt to respond the Administration, if he did not get an answer; after further 60 days, silent consent is given to the interpretative solution presented by the taxpayer.

Ruling functions are different and depend on the matter. In the case of tax avoidance, the rule interpretation is not the subject of the proceedings because the taxpayer is interested in knowing whether the proceeding or the purposes are elusive or not.

In the case of interposition, doctrine and jurisprudence traditionally believe that the ruling applies to cases of fictitious interposition, but recent jurisprudence[14] extends the ruling to cases of actual interposition, based on the principle of abuse of rights.

In the case of the classification of expenditure, legal interpretation is assumed; the taxpayer is interested in seeing how a particular expense is qualified in the case. Factual or strictly economic matters are also involved in the case of disapplication of rules relating to the deductibility of costs related to transactions with residents of the tax havens.

The effects of the ruling are much discussed. Part of the doctrine sustains that the legislator wanted to limit the relevance of the response to evidence (burden of proof borne by the party who has disregarded the instructions); the other part argues that the answer creates a mandatory qualification for the financial Administration.

2.1.3. Ruling for the non-application of anti-elusive rules

The taxpayer may request the non-application of tax rules that limit deductions, tax deductions, tax credits or other subjective positions to counteract elusive behavior. The same ruling can be applied even in case of instances about regulations regarding non-operating companies.

[14] Cass., 10 giugno 2011, n. 12788

Before submitting the tax return, the taxpayer presents an instance on a concrete case demonstrating that in that case the elusive effects the rule wants to preclude do not occur. The request is addressed to the regional Director of revenue that is responsible for the area and sent to the financial office, responsible for investigation because of the fiscal domicile of the taxpayer. The Director's definitive answer must be notified to the taxpayer within 90 days from the presentation of the request.

In case of positive answer, nothing is said about the effectiveness of such a binding opinion for the financial Administration. However, it can be concluded that the instance has a binding effect as in the case of preventive anti-elusive ruling. In case of refusal, the taxpayer is entitled to contest the negative response and he has also the ability to enforce its claim against the next assessment act or the refusal of reimbursement. This means that the taxpayer may independently apply the rule despite the negative opinion of financial Administration, appealing against the next assessment act or the refusal of reimbursement and asking the Court to ascertain the elusive nature of the operation. The Court of Cassation, recently, issued an important judgment[15] on the matter, stating that the regional Director's decisions on taxpayer's instance pursuant to and in accordance with the article 37 bis, eighth paragraph, of d.p.r. 600 of 1973, are not comparable to a refusal of tax concession because this constitutes a preferential treatment generally recognized, under certain conditions, to achieve non-tax interests. Instead, the taxpayer does not want to apply an anti-elusive rule in order to remove rules that aim to limit their benefits; in particular, the judge's examination

[15] Cass., 5 ottobre 2012, n. 17010.

excluded the elusive purpose, and as a result the fair tax regime can be restored. Therefore, the act in question cannot be clearly connected to one of the categories listed in article 19 of the decree on the tax process (which lists acts which taxpayers may appeal) and, therefore, cannot be considered necessarily actionable.

The taxpayer can appeal the Director's refusal only optionally because the recipient taxpayer has an interest to invoke judicial review on the act's legality. Therefore, even if the act is not appealed, the taxpayer is not affected and, without different explicit provisions, the act has no binding effect. However, the ruling answer does not prevent the same Administration from re-evaluating (in the examination of the tax return or refund instance) the negative opinion previously expressed or the taxpayer from bringing full legal protection against the typical act, proving the existence of the conditions that enable him to avail of the non-application of the anti-elusive rule. The positive Director's answer, instead, prevents the tax Administration from applying the anti-elusive rule, in accordance with the principle of protection of entrustment, which is effective also in tax matters.

2.1.4. International ruling

This ruling is governed by article 8 of Decree 269 of 2003 and by the decision of the Director of the income revenue Authority of 2004 and is intended to achieve further forms of cooperation between tax authorities and taxpayers.

The ruling may be used for the determination of normal value of intra-group transactions (advanced pricing agreement), of the tax treatment of dividends, interests and royalties incoming or outgoing from the territory of the State, of the tax treatment of other income and the allocation of profits or losses of the permanent establishment. In addition, article 7 of Decree 145 of 2013 extends the possibility to use an international ruling to get preventive assessment on whether a permanent establishment of a non-resident enterprise is in Italy or not.

Companies, both residents and non-residents in the territory of the State, with international activities can use the ruling. The ruling is permitted to those resident enterprises that perform transactions with non-resident companies that directly or indirectly control the company, subsidiaries or subjects controlled by the same company that controls the other company. Companies whose assets, capital or fund is participated by non-resident individuals or companies involved in the capital, assets or fund of non-resident individuals and companies that have paid to non-residents or who have perceived dividends, interest or royalties are also included. Non-resident companies enabled, however, are those who have a permanent establishment in the territory of the State.

An agreement between the financial Administration and the international enterprise can be concluded; this agreement deals with the nature of settlement in Italy of foreign company that ties both sides for the tax year in which it was concluded and for the subsequent four, except amendments are made to the factual situation. The procedure is always ruled by article 8 of Decree 269 of 2003 and by the decision of the Director of the income revenue Authority of 2004.

The taxpayer sends an instance in which he explains the controversial case and describes the solution he intends to adopt. Afterwards, there is a phase that requires the presence of the parties at the end of which they draw up a written deed of their activities in order to use it as evidence. The procedure concludes with an agreement between the income revenue Authority and the taxpayer which is binding for the tax period in which it is concluded and for the following two periods, unless there are changes in the situations of fact or of law. The agreement has merely a declaratory effect. The tax authority shall send a copy of the outcome of the procedure to the competent authorities of the States involved so that they can take it into account in order to avoid double taxation. The deal is secret and is not published for commercial reasons; as a matter of fact, this is strongly conditioned by the specific cases and its disclosure might pose problems of violation of free competition on the market.

Tax Administration ensures that the agreement is respected or if the assumptions are changed. In case of violation of the agreement, the Administration calls on the company to provide any defense briefs of their work within 30 days. If the company does not answer or not argue, the agreement is terminated.

The agreement may be renewed on request within 90 days from the expiration date. The income revenue Authority communicates at least 15 days before the expiration of the agreement if the renewal is permitted.

Chapter 3

3.1. Verification with acceptance[16]

Verification with acceptance is a procedure that allows a definition of the assessment agreed upon during the discussion of the matter under dispute and in the presence of the taxpayer and the financial Administration, which usually entails a reduction of revenue claims. The joined discussion is certainly one of the most important features. At the end of the procedure, it is possible to reach an agreed definition, but it cannot be inferred that the taxpayer and the tax authorities work together in a non-adversarial manner in this venue because there is already an act of investigation with some remarks at the base and, then, two opposing interests related to the parties. Nevertheless, we can conclude that some form of collaboration is involved in the process.

The institute is governed by articles 1 to 13 of Decree 218 of 1997. The definition can cover any aspect of the act and violations relating to the principal taxes of the Italian system. Verification with acceptance can be activated on the initiative of the tax office after the notification of the verification notice, or on request by the taxpayer, upon prior notification of the verification notice, not preceded by an invitation of the office in the investigation stage or when inspections or checks were made. The taxpayer may start the procedure even when access, inspections and verifications were made against him both on the part of tax Administration and by the Italian finance police, which ended with an official tax assessment

[16] L. MONTECAMOZZO, *Gli istituti deflattivi del contenzioso tributario*, Milano, 2013, p.52.

report. In this case, the tax office will invite the taxpayer to appear in person only if deemed appropriate.

The office sends an invitation to appear to the taxpayer or the taxpayer discloses an instance to the office that issued the document or to the office responsible for the investigation, indicating all necessary information. Within 15 days from the reception of the request, the office shall call upon the taxpayer to appear.

The adversarial phase begins when the taxpayer accepts the invitation sent by the office and shows up at the place and time indicated.

The discussion can have different outcomes: closure of the procedure and renunciation of the office to its claims when the conditions to proceed with the investigation are missing; signing of the acceptance act, in case an agreement is reached; conclusion of the procedure if no agreement is reached.

If the parties reach an agreement, a motivated acceptance act is drafted in duplicate; this must be signed by both parties. The acceptance is finalized with the payment of the only one installment or of the first one, due within 20 days after the drafting of the act.

In case of agreement, the penalties for violations, relating to the taxes object of the acceptance, committed in the tax year, as well as for infringements relating to the content of the declarations concerning the same period, apply to the extent of 1/3 of the minimum that may be imposed. Additional penalties are not applied. The violations are not important for recidivism. Generally, the verification once defined cannot be integrated or modified.

3.2. Cooperative compliance programme

The Italian Revenue Agency is launching a pilot project aimed at setting an agreed upon framework in light of possible implementations of a cooperative compliance programme for Large Business Taxpayers.

The project falls within similar frameworks adopted by other foreign tax administrations, in consistency with the recent OECD recommendations.

The project aims at identifying the main features of a new form of relationship between Large Business Taxpayers and the Italian Tax Administration, in order to make the current risk management monitoring activity (section 27, paragraphs from 9 to 12, of decree-law no. 185/2008, as converted by section 1 of law 2/2009) evolve into a more advanced programme in compliance with the recent recommendations of the OECD.

The new regime implies a commitment for taxpayers to adopt compliant behaviors based on transparency and disclosure in dealing with the Tax Administration.

In exchange of a higher level of transparency, the Agency should be prepared to meet taxpayers' needs and to resolve relevant issues in a timely and effective manner.

In brief, the underlying purpose of this new approach is to implement ex ante rather than traditional ex-post approaches, with related benefits in terms of taxpayers' compliance and aimed at providing certainty and predictability in advance.

The Large Business Taxpayers that will be admitted to the pilot project will engage with the Italian Revenue Agency (more specifically, with the Large Business Taxpayers Division of the Central Directorate for Tax Assessment) in ad-hoc technical tables to examine several issues jointly, e.g. features of their internal tax control framework, features of the new approach, obligations or incentives for the taxpayers, responsibilities for the Agency, and so forth.

In general, once this testing phase is concluded and, the regime implemented through appropriate legislative measures, the entrance in the programme should enable taxpayers to reduce fulfillments, to obtain several advantages and to take benefit, as much as possible, of advance legal certainty on specific transactions performed.

The project and its implementation are in line with the Agency's strategies and, in particular, with the mission of the organizational structures competent for the Large Business Taxpayers' treatment, whose main purpose is to establish a relationship based on mutual cooperation and on open and transparent dialogue intended to promote voluntary compliance.

However, we must remember that the Parliament adopted an enabling act on the tax system last February. This law authorizes the Government to rewrite the tax system to make it more equitable, transparent and growth-oriented. The

Government will have one year to change the tax system, therefore, it is logical to expect various modifications in the matter in question.

3.3. Active amendment[17]

The active amendment is an institute that represents an incentive for taxpayers to reveal their tax situation and, as a result, to regularize it. It is governed by article 13 of legislative-Decree 472 of 1997 and gives a bonus effect either because the offender acknowledges its conduct as unlawful or because there is a saving of administrative activity in the investigation of offences. The rule makes it clear that inspections, audits or other administrative tasks of ascertaining (that the infringer has had knowledge through formal notification) have not started yet.

The institute provides for a reduction of the penalty when the violation has not been contested and inspections, audits or other administrative tasks are not started. In particular, it is expected to reduce the penalty to one tenth of the minimum in case of non-payment of the tax or deposit, if it occurs within 30 days from the expiry of the deadline; a reduction to one-eighth of the minimum, if the regularization of errors and omissions, although incidents on the determination or payment of tribute, takes place within the time-limit for the submission of the tax return of the year in which the infringement was committed or when no tax return is required, within a year from the omission or mistake; the reduction for a tenth of the minimum of the penalty intended for the omission of the presentation of the tax return, if it is presented with a delay of no more than 90 days.

[17] G. MELIS, *Lezioni di diritto tributario*, cit., p. 411.

The payment of the reduced penalty shall be made at the same time as the payment of tribute and the payment of default interest, calculated at the legal rate.

Article 23, paragraph 31 of Decree 98 of 2011 works in the same way; it has introduced a new measure of penalty that is applicable to payments made within 15 days of the normal due date. The penalty is further reduced to one-fifteenth for each day of delay. The amendment serves the purpose of making the penalty system more gradual, strengthening the compliance of the penalty with the gravity of the infringement. An explicit regulatory provision states that this reduction is added to the one of article 13 of the Decree 472 of 1997[18].

3.4. Voluntary disclosure[19]

Recently, the simplified procedure for the return of capital in Italy was implemented. It is based on the voluntary disclosure, provided for in Decree 4 of 2014[20]. However, at the moment, it does not appear that the Government is going to change the Decree into law.

The motivation to spontaneous regularization is entrusted to all the risks of the investigation of hidden fees made by the Italian revenue Agency. The taxpayers' choice to comply with tax rules or not depends on their assessment of the risks of irregularities, i.e. on the concrete possibility to see investigated their forms of tax

[18] It is right to remember that in our tax system we have also other institutions to reduce trials as the complaint and mediation (article 17bis of the 546 1992 Decree), the judicial conciliation (article 48 of the 546 1992 Decree), the self-defense (article 2 c. d.l. 564 of 1994) and the acquiescence (article 15 of 218 d.lgs of 1997).

[19] www.agenziaentrate.gov.it

[20] Decree 4 of 2014 will probably be changed in Law within 30 March 2014.

evasion in comparison to the tax savings that are consequence of the illicit conduct.

Taxpayers who have held activities in violation of the legislation on fiscal monitoring can make use of voluntary disclosure procedure to bring out financial and patrimonial activities constituted or possessed outside the territory of the State[21]. The procedure is reserved for violations committed until December 31, 2013 - in relation to relevant foreign assets held at December 31, 2012 or before this date - and can be activated until September 30, 2015.

A taxpayer who intends to activate the voluntary disclosure procedure must:

• present a request with all investments and all financial activities, constituted or held abroad (even indirectly or through an intermediary), providing documents and information for the reconstruction of the incomes which served to set them up, buying them or deriving from their disposal or use in any way, in relation to all tax periods for which, at the date of submission of the request, are not expired the conditions for the establishment or contestation of violation of the obligations of tax return.

• pay lump sums pursuant to the notice of assessment within the closing date for the appeal, otherwise those due on the basis of tax assessment settlement within

[21] Article 1 and 2 of d.l. 167 of 1990 indicates the subjects that the legislator wants to monitor about operations that they do to transfer money and securities abroad. In fact, financial intermediaries are obliged to transmit to the Italian revenue Agency data concerning these operations, limited to operations that are performed on behalf of or in favor of individuals, non-commercial corporations, partnerships and related associations. In addition, intermediaries can be required to communicate the operations conducted with foreign countries for masses of taxpayers and with reference to a specific time period.

20 days from the issuance of the act, in addition to the amounts required by the act or the decision challenged by the imposition of penalties for the violation of obligations on foreign assets.

Voluntary disclosure is not allowed if the request is submitted after the infringer has been formally informed about inspections, audits or any other administrative activity or criminal proceeding, related to undeclared activities. The voluntary disclosure request cannot be submitted more than once, even indirectly or through an intermediary.

In relation to taxable assets, established or held abroad, the crimes of unfaithful and omitted statement are to be considered non-punishable (Legislative-Decree 74/2000, articles 4 and 5) for the taxpayer who activates the voluntary disclosure procedure. Moreover, penalties in cases of fraudulent statement by using invoices or other documents for nonexistent transactions (Legislative-Decree 74/2000, article 2), or by other mechanisms (Legislative-Decree 74/2000, article 3) are reduced by up to half.

Administrative penalties for the breach of the obligation of the fiscal monitoring submission, concerning investments and financial activities abroad, are reduced to half of the minimum, if the activities are transferred to Italy or European Union Member States and to States part of the agreement on the European economic area that enable an effective exchange of information with Italy; if the activities transferred to Italy or the States mentioned above were held there; if the person who breaks the law allows a foreign financial intermediary where activities are held to transmit to Italian tax authorities all data concerning activities concerning voluntary disclosure.

In the other cases, the penalty will be equal to the minimum that may be imposed reduced by a quarter.

The procedure to impose penalties for infringements concerning fiscal monitoring is defined in accordance with article 16 of Legislative-Decree 472 of 1997.

If the taxpayer does not pay the due amount within the time limits provided for, the voluntary disclosure procedure cannot be put into practice. The Italian revenue Agency notifies a new act containing the restatement of the penalty.

Anyone who, within the procedure of voluntary disclosure, exhibits or sends false documents in whole or in part, in other words provides data and information not corresponding to the truth, is punished with imprisonment from one year and six months to six years.

The Italian revenue Agency circular 38/e of 2013 addresses the issue of penalties with regard to fiscal monitoring. The 2013 European law has modified article 5 of Decree-Law 167 of 1990 and has significantly reduced the penalties for violations of the obligations of monitoring the stocks of assets held abroad.

In particular, the pecuniary administrative penalty – originally envisaged for the missed declaration of outstanding amounts of investments abroad and foreign financial activities which are considered as taxable income in Italy, from 10 to 50 per cent of the sum of the undeclared amounts – is now established by article 5, paragraph 2, of the Decree between 3 and 15 percent of the total of the undeclared amounts.

The penalty is applied in the highest degree, between 6 and 30 percent of the total of the undeclared amounts, when the violation concerns investments abroad or foreign financial assets held in the States or territories with a preferential tax regime. The sanction of confiscation of property has also been abolished.

A specific hypothesis of penalty is also envisaged when the tax return relating to investment abroad or to foreign financial activities is presented with a delay of no more than 90 days after the end of the term. In this case, there is a pecuniary administrative penalty of 258 euro.

Chapter 4

4.1. Forced collection procedure[22]

In principle, the collection activities should follow the assessment ones, but this does not always happen. In fact, tax collection begins before the assessment and is completed by applying provisional payments that change during investigations. The collection procedure gradually approaches the due tax, even by means of tax refund; this is a consequence of the gradual adaptation of the collected amount to the determined amount. The d.p.r. 602 of 1973 governs this particular case and the collection phases.

In the past, the levying taxes authority was responsible for tax collection. By 2006, however, a special body Equitalia S.p.a. took over the authority. Equitalia is a public company that deals with the Italian taxes collection. Equitalia is 51% owned by the Italian Revenue Agency and 49% belongs to Inps.

In the absence of voluntary payment, the Italian revenue Agency proceeds to tax collection with Equitalia through tax roll, tax form or directly executive tax assessment. Whatever procedure is performed, from July 1st, 2012 offices fail to tax assessment, the tax roll registration and the credit collection, relating to regional and local taxes, when the due amount does not exceed 30 euro for each credit and for each tax period. This limit does not apply if the claim arises from many violations of the obligations to pay the same tribute.

[22] G. PUOTI, B. CUCCHI, F. SIMONCELLI, *La nuova riscossione tributaria*, Padova, 2012, pag. 33.

The collection by tax roll can be forced, when it is a result of registration deriving from taxpayer's non-compliance; spontaneous, when it is a result of registration that does not derive from non-compliance.

Tax rolls are lists where financial Administration registers taxpayer-debtors and their due amounts. They are compiled so that Equitalia can proceed to collection and are used to collect taxes, penalties and interests. Taxes resulting from definitive investigations, taxpayers' tax returns and those arising from definitive judgments are recorded outright. Taxes and penalties resulting from non-definitive investigations are registered provisionally. When collection is in danger, two extraordinary tax rolls are issued: taxes, interests and penalties are enrolled for the full amount resulting from the notice of assessment, even if not final. In any case, the roll is not listed if it is less than 16.53 euro for each tax period or 10.33 euro for each entry. In each roll, taxpayer's due sums and some other data set by DM 321 of 1999 are listed.

The tax form is used so that the collection agent can bring to the taxpayer's attention the tax roll. The form is a writ of execution and, in general, it is a collection act of taxes that have been already ensured with other acts, but, in some cases, it is the first measure to notify a violation to the taxpayer. The tax form shall be notified within certain terms that vary depending on the income tax or VAT debt. It contains the intimation to fulfill the obligation that results from the roll within 60 days from notification; there is also the warning that, failing to do so, Equitalia will proceed to levy.

The taxpayer must pay the required amount within 60 days from notification. Under certain conditions prescribed by law, the taxpayer may compensate debts and credits for revenue taxes (e.g. income tax credits, Ires, VAT etc.).

The d.l. 78 of 2010 envisages the set-off prohibition between claims and debts if there are registered debts with an exceeding amount of 1500 euro whose payment deadline has expired. Over 1500 euro, therefore, taxpayers must first pay off any registered and expired tax debts, after which they can use the remaining credit to set off. After the 60 days period after notification, interests of arrears are applied on the sums entered in the roll.

Tax assessment notices issued from October 1st, 2011 and related to VAT and income taxes and to tax periods that are in progress at December 31st, 2007 and onward, are executive, therefore tax form is not required for forced collection. Tax assessment should also contain the order to fulfill the payment obligation. The taxpayer who receives tax assessment must pay within 60 days from notification. After 60 days without payment, the assessment becomes executive; after further 30 days without payment, the required amounts are entrusted to Equitalia for collection. The taxpayer is informed that the sums are taken over by the collection agent.

In the case of temporary situation of difficulty, the taxpayer can request the collection agent to divide the tax payment into up to 72 monthly installments, fixed or increasing amounts, without giving any guarantee. The temporary situation of difficulty is that when the taxpayer who is unable to pay the debt in a single solution, however, is able to withstand the financial burden resulting from the allocation of debt in a number of installments which is reasonable in relation to its financial condition. In any case, for rescheduled amounts up to 20,000 euro, the installment plan may be granted upon ordinary request of the taxpayer. In order to be eligible for this kind of plan the taxpayer should submit a request to the concerned collecting agent. If the plan is granted, a task form with the debt allocation shall be notified to the taxpayer. In case of refusal or revocation, the collection agent shall notify its reasoned decision; this can be appealed in front of Provincial Tax Commission.

The executive tax assessment, when the 60 days term for payment is expired, may be a useful act to begin the levy only when, after further 30 days, the sums are entrusted to the collection agent.

The tax roll, notified with the tax form, may be a levy assumption only when the 60 days term for payment is expired. Levy begins with the seizure of the debtor's assets; this takes different forms depending on whether it relates to movable or immovable property. In particular, the real estate confiscation cannot be carried out if the property has all the following features:

• it is designed for residential use and the debtor resides in;

• it is the only property owned by the debtor;

• it is not a luxury estate or it is a mansion, a castle or a historical or artistic building of great value.

In other cases, the real estate seizure can be made only if:

• the debt amount which is registered in the tax roll is higher than 120,000 euro;

• six months have passed from the mortgage registration and the debtor has not paid.

The salary/pension and other amounts related to employment seizure is less severe towards people with lower economic means:

• if the monthly salary does not exceed 2,500 euros, the value is one-tenth seizable;

• monthly sums between 2,500 and 5,000 euros are one-seventh seizable;

• if the monthly salary exceeds 5,000 euros, the maximum amount that can be seized is one-fifth.

Seizure may not include the latest salary/pension deposited on the debtor's bank account, which remains in its full availability. Besides the immovable property, the so-called "essential" goods will be not seizable; they must be identified by the Minister of economy together with Italian Revenue Agency and Istat through the "basket of goods" statistical formula.

The tax roll and tax form are peacefully appealed in front of the Provincial Tax Commission because they appear in the list provided for by article 19 of the decree on the tax trial[23]. The reason range that can be complained varies according to how the taxpayer can be involved by each act. In any case, the collection acts must meet the conditions set by law for the taxation exercise and the formal

[23] M. BASILAVECCHIA, *Funzione impositiva e forme di tutela,* Torino, 2013, p. 248.

requirements that affect their validity. The trial takes slightly different features because there are more acts subject to appeal that are adopted by two different tax authorities.

4.2. Tax refund[24]

The graduality of the tax collection and the simultaneous proceeding with the assessment involve the rise of credit situations on the taxpayer who, in general, has the obligation to make use of them by disclosing requests.

There is an automatic obligation of reimbursement in the case of material errors or duplications which are attributable to the financial Administration, or when the outcome of the process makes the collections made on the basis of provisional acts withdrawn by the tax Commissions undue.

We can distinguish three hypotheses of tax refunds that have common features and, above all, common procedural profiles.

First of all, there are tax refunds resulted from undue payments, namely those that result in errors made by the taxpayer when giving spontaneous implementation to the tribute. These refunds can be caused by tax collection mistakes or can include errors made in the assessment documents during investigation. If the undue payment results from malfunctions, we must challenge the tax act otherwise the refund is unacceptable. In the other cases, the reimbursement must be made within a variable period that typically begins on the date of payment. In the absence of specific rules, we must assume that the instance should be submitted within two

[24] M. BASILAVECCHIA, *Funzione impositiva e forme di tutela*, cit., p. 242.

years from the payment or following the date when the payment has become undue.

Secondly, there are tax refunds that consist in credit positions that imply an undue payment. Procedural rules vary from case to case, but the appeal of any act that may claim a no longer due tax payment is assumed, as well as an administrative instance.

Finally, there are tax refunds from declaration that have some features in common with both the first and the second group of refunds. They derive from the physiological mechanism of tax application and can be treated as refunds from undue payments, but with a procedural autonomy. The refund shall be incorporated in the tax return and the assumption emerges from the tax return and linked documents. The refund request is alternative to other forms of utilization of credit; the financial Administration's answer merges the liquidation procedures.

Once the refund request is submitted, three situations may occur:

1. the application is accepted;

2. the application is rejected (in this case, the taxpayer may appeal to the competent Provincial tax Commission within 60 days from the notification of the decision).

3. the Administration does not answer (in this case, the claim must be rejected, because there is an implied decision of refusal. After at least 90 days from submission of the application and within the limitation period, usually 10 years, the interested party may appeal to the tax Commission).

Various ministerial decrees have been changed from time to time the amount of the applicable interest rate, but the problem of unequal treatment on the application of interest has not been solved yet. In fact, it is still uncertain on the base on what criteria and in accordance with what law we can establish a rule that determines a difference between the interests owed to tax Administration and interests due to the taxpayer.

In fact, on sums owed by taxpayers or by the tax Administration accrue interests in favor of one or the other party according to the different situations.

On the contrary, it is fair to say that this difference does not exist on local taxes because there is a law provision that expressly establishes the amount of interest on delayed payments and those on delayed refunds to the same extent.

In fact, for the delayed payments the taxpayer will have to pay interest on the amounts ascertained at the rate of 4% a year; the interests for delay of the payment at the rate of 4.5% a year; default interests for delay in payment of the enrolled amounts at the rate determined annually by Decree of the Minister of finance in accordance with the average of the bank interest rates (which from 1 may 2013 amount to 5.2233%).

In cases of delayed refunds from tax Administration concerning undue sums paid by the taxpayer, article 1, paragraph 1, of the Italian Ministerial Decree of May 21, 2009 establishes that the interests for delayed refund are due to the extent of 2% a year and the 1% every six months, with effect from 1 January 2010.

Chapter 5

5.1. Tax advisors

In Italy, we cannot talk about a profession of tax consultant, as provided for and protected by law. In fact, there are many subjects that the taxpayer may contact especially lawyers, performing tax adviser's tasks, but not a separate profession.

First of all, in addition to lawyers, the taxpayer can apply to chartered accountants registered in the public registry of chartered accountants and expert bookkeepers. They are professionals with the highest expertise, to whom the law recognizes specifically a role within the business and corporate law and in matters of economic, financial, corporate, tax and administrative provisions. Then, there is the expert accountant registered in the public register of chartered accountants and expert bookkeepers in another section who is a professional registered in the same register, but with fewer powers than the latter. A three-year Bachelor's degree is required to become an expert bookkeeper; after a three-year training period, they have to sit a State examination in order to be listed in the registry. In addition, there is the possibility to turn to consultants or tax accountants, enrolled in registers or rolls.

Then there are the welfare agencies and trade associations, formed by experts in the field of tax consulting and tax authorities, which give assistance to local companies (such as Confesercenti, Confartigianato...). Finally, subjects that are not obliged to the keeping of the records may contact a local revenue agency office or can avail itself of the assistance of Authorized Tax Assistance Offices [25] (so-called CAF). These organizations have obtained permission to subscribe to a national register of CAF held at the Ministry of finance. They assist employees and employers in the compilation and submission of tax declarations of all kinds and take care of electronic data transmissions.

On the other hand, the profile of technical assistance is very different. Many individuals are qualified to represent the taxpayer and are punctually indicated in article 12 of the Decree 546/1992. There you can read about lawyers, accountants, business appraisers, consultants, engineers, architects, surveyors, agronomists and many others. This is due both to the social relevance of tax litigation, which for its possible occurrence in people's lives is likely to cause substantial and repeated costs, and to the complexity of the technical issues that are treated.

The defense reserve to forensic class returns fully operating in the third degree of judgment before the Court of Cassation. However, article 12, paragraph 5, states that disputes of a value of less than 2582.28 euro can be proposed directly by interested parties and that they can be prosecuted even without technical assistance.

However, the Chairman of the Tax Commission may order the part to obtain technical assistance fixing a deadline by which the same shall be bound to appoint an enabled defender. In consequence, there are cases when the taxpayer can defend himself without appealing to special figures.

[25] Governed by L. 413/1991

5.1.1. Legal defense of have-nots

Article 24 of the Constitution reads: "*are insured to the have-nots, with appropriate institutions, the means to act and defend themselves before any jurisdiction*". The equality of the parties before the judge is not realized if some of them do not have the economic means to provide a defender. The legislator has the duty to provide special educational establishments to ensure judicial protection of those who cannot afford to pay a lawyer.

These requirements are satisfied by the Presidential Decree 115/2002 (consolidated law on court costs) that gives a general discipline for have-nots in all processes. There is an income limit above which people are not entitled to benefit of free legal defense. The application is submitted to the lawyers' Council whose offices in the same place where the Office of the court having jurisdiction to hear the matter is. The Council evaluates the absence of the unfounded claims and admits the person for the free legal aid. The acceptance has effect for all grades of the process if the person qualified for the aid is victorious; otherwise, a new instance is necessary. The Defender is chosen by the part and is remunerated by the State. In addition, the admission determines exemption from charges and taxes inherent to the process.

5.2. Role of the tax consultants

Tax consultants assist taxpayers in the formalities which are required by law, when they are in contradiction with the tax Administration and during the whole tax trial. Generally speaking it is not an obligation for the taxpayer to use these specialized figures, but rather an option. Given the complexity of the issues, taxpayers often rely on professionals to keep accounting records and then prepare their tax return. In light of this, it is provided that accountants, business appraisers, consultants, lawyers and auditors are enabled to send the tax return in electronic form. Tax assistance centers provide for taxpayers that are not required the drafting of accounting as mentioned in the previous paragraph.

Taxpayers may also be assisted in the cross-examination developed by the Financial Administration as a result of the checks that have been carried out. We find traces of this in the verification with acceptance framework where it is said that the taxpayer can be represented by an attorney, even with a special assignment related only to the tax assessment settlement. In this case, a proxy must be issued and the signature must be authenticated.

The matter becomes more complex when it comes to compulsory or non-compulsory of the applicant's technical assistance in legal proceedings. The regulatory scheme is ambiguous.

In fact, article 12 of 546/1992 decree talks about technical assistance while article 18 requires the presence of a defender, except for disputes of limited value, from the commencement of the action that under penalty of inadmissibility must contain the signature of the defender. If the defender had functions of counselor, as the article 18 seems to confer, it would be anomalous that non-professionals could perform those functions. After various uncertainties, the Court of cassation[26] has qualified the defender as technical assistant on the grounds that the judgment is always admissible even in person; the provision of article 12 on the

[26] Cass., 2 dicembre 2004, n. 22601

causes of lower value to a certain extent has become of general character. It allows the Court to order the part that is in court in person to obtain a penalty enabled inadmissibility of the action, when the defense is considered too complex. It is settled that the part that has the titles to be enabled to defend in front of tax commissions can stand in judgment for itself, without any further assistance. The judgment of the third degree in front of the Court of Cassation, however, requires the presence of an attorney qualified to provide legal assistance in front of the Court of Cassation.

The relationship between taxpayer and tax consultant is protected by professional secrecy as it concerns sensitive data. The law allows for this as readily emerges from the discipline of fiscal access in professional offices. Tax consultants, in fact, because of their work, are aware of personal facts about third parties and, therefore, they have an ethical obligation to maintain; the secret allows the professional to refuse to present client's documents without fiscal significance and that might result in an additional tax in respect of the investigation itself. Access is governed by article 52 of the decree of the President of the Republic 633/1972 and, on the one hand, if it can be done without authorization of the public prosecutor, on the other hand, there are two precautionary measures. First of all, the regulation requires the necessary presence of the holder of the professional studio or his delegate. Access in the absence of the owner is illegitimate; the people in charge of investigations must therefore carry out investigations to identify in advance the timetable in which the owner is present[27]. In the absence of the professional, the person who replaces him in the office at that moment

[27] Circolare del Ministero delle Finanze 8 ottobre 1993 n.15762

cannot be considered his delegate. Therefore, it is necessary to contact the owner of the studio in advance in order for him to appoint another person specifically delegated to attend to tasks that will be carried out by verifiers. In the case of non-compliance with these conditions of access, and then the subsequent research and document inspection, the results of operations performed illegally shall not be eligible for subsequent proceedings. Secondly, during the inspection, the professional, in the case of documents containing personal information of a customer and, therefore, their revelation would involve the violation of professional secrecy, could deny the examination thereof: in this case, in accordance with the third paragraph of article 52, in order to overcome the secrecy raised, verifiers are required to apply to the judicial authorities in order to conduct their research legitimately, but always without prejudice to the limits imposed by article 103 of the code of criminal procedure concerning guarantees of the defender[28]. This regulatory framework indicates that the acquisition of documents and information, covered by the obligation of professional secrecy, without the prior authorization of the judicial authority, can be regarded as unlawful if there has been opposition in his professional capacity as custodian and guardian of the specific secret.

[28] This article describes the rules that have to be followed in the case of inspections and searches at the office of the defender (for example the activities can be held by the judge or the public prosecutor authorized or it is forbidden to proceed with the seizure of papers or documents unless they constitute the body of the crime). The last paragraph says also that it is not allowed the interception of conversations or communications submitted by defenders of the private investigators licensed and charged in connection with the proceedings, technical consultants and their assistants, or as between them and the people they cared for.

Chapter 6

6.1. Appeal procedures[29]

After the 1992 reform, tax justice is characterized by three stages of litigation; the first two are assigned to special jurisdiction agencies (tax commissions), which are part of the Ministry of economy and finance. The Tax Commissions of the first instance are, as a rule, provincial; those of the second one are regional. All disputes concerning taxes of every kind and species, no matter how denominated, are attributed to Tax Commissions jurisdiction.

Generally, the tax process is started by the individual recipient of an act or an activity of the financial authorities and the action is pointed towards that act or activity. Article 19 of the decree 546 of 1992 has a central role because it incorporates the definition of tax jurisdiction. Indeed, article 19 paragraph 1 provides for acts subject to autonomous appeal: the legislator considers these adequate to allow direct access to the tax court. The protection is also given to different acts; however, the recipients of these have no immediate protection, but rather connected to other acts which are independently actionable.

In addition, article 19 paragraph 3 says that every independently actionable act can be challenged only for their own vices. This implies that failure to appeal of the act compromises the ability to lift the vices that pertain to that act and that there is a precise moment for action: the taxpayer cannot choose to postpone the legal action at the moment when he receives subsequent acts.

[29] D.lgs 31 dicembre 1992 n°546.

The taxpayer may appeal within 60 days from the notification of the act, under penalty of inadmissibility. The appearance before the court of the appellant and the respondent part follows the notification of the appeal. Subsequently, the applicant's dossier is set up and then assigned to one of the sections of the Provincial Tax Commission.

The structure of the tax trial is much concise than the civil or criminal one. First of all, we can distinguish a number of stages which we can define necessary from other ones that may not be in the trial. These stages precede the judgment of first instance.

In the trial there is certainly a preliminary examination of the appeal followed by a conciliation hearing that may be preceded by the transmission of documents and pleadings of the parties within twenty and ten days from the date fixed. The conciliation hearing takes place, generally, in the room of the Council, even if one of the parties can ask that the discussion take place in public hearing. At this point, we have the decision and the ruling on the determination of costs. Sometimes, however, the process is quite complicated. In fact, there may be an interruption or suspension of the process, the request for an interim injunction or an adversarial integration request.

Another important possible phase in the tax trial is the one aimed at evidentiary inquiry. The distinguishing feature is that of a written trial in which documentary evidence has a predominant role. Neither the oath nor testimonial evidence is allowed. The testimonial evidence ban involves a lack of balance between the parties; it acts mainly to the detriment of the appellant. It may be possible to remedy by giving the applicant the opportunity to submit to the Court written documents containing third-party statements but also by encouraging the Commission to adopt such means[30]. The Constitutional Court in its judgment (number 18 of 2000) has stated not founded the question of the constitutionality of the ban precisely because of the admissibility of these compromises.

In Italian law, it is possible to appeal against the decision of a tax Commission and therefore proceed to a second degree of judgment. This is only possible if you are the losing party, i.e. you are in a prejudicial situation because of the judgment. The loss can be determined depending on the interest gathered from the judgment, wondering whether the outcome of the appeal may have a practical utility or not.

Proceedings are to be started with the Regional Tax Commission whose expertise is mandatory and fixed according to its administrative district: decisions delivered by the provincial commissions located in that area must all be open to appeal before the regional tax commission.

The second degree is conducted almost identically to the first instance because the judgment of second instance should strive to replace the contested one. The notice of appeal takes the place of the application initiating proceedings, submitted by notification and then registered. The bailiff or the appellant is responsible for the registration of a copy of the appeal at the Secretary of the provincial Commission that delivered the judgment under appeal. The act is deposited at the Secretariat of the Regional Commission that asks the Provincial

[30] Cass., 15 febbraio 2008, n. 9958.

one the transmission of the file containing the judgment in authentic copy. The act of counterclaims fulfills the appearance of the parties, other than the appellant, before the court. Supplementary grounds of appeal may be proposed if new elements not known previously are acquired.

The appeal is an act subject to free review: it does not exist a predetermined model of objections. This does not mean that you can have access to the second degree with a generic grievance of injustice of the ruling. In fact, the act of appeal must contain specific reasons of challenge. In Italy, therefore, there is a principle that excludes a general and automatic review by the Court of appeal in order to restrain the duration of the trials; therefore, the parties must expressly indicate the subject matter of the dispute. Any question or exception that is not upheld in the judgment must be proposed again or it cannot be submitted anymore; new exceptions are not allowed. The purpose of the appeal proceedings is to reach a decision on the merits of the judgment and therefore to the action proposed by the applicant. The review of the judgment of first instance is essential but still functional to a decision that has effects on the legal position relied upon in court. The appeal has a reformatory function whose purpose is not only to cancel but also to replace the first judgment with the final judgment.

The Regional Tax Commission may exercise its powers of investigation in a limited manner during appeal and even more than during first instance. Article 58 of the decree on tax trial lays down a ban on new evidence unless necessary for decision or intended to make up for the burden of a part that has not been able to provide evidence for his guilt. However, it is possible to produce new documents in contrast with the mechanism that tends to create exceptions to the parties[31].

Everything indicates that the judgment can have very different outcomes. It is possible that the appeal is declared inadmissible, that there is a remittal to first instance or that the appeal has a real replacement judgment that can take the most diverse content. Surely, there will be a double pronunciation on the matter, but it is said that there is a split decision on the issue. In addition, it can be excluded a prohibition of reformatio in peius, that is a limit to the control of the judge; as a matter of fact, at the end of the second grade of judgment he can also decide a measure for the taxpayer which is worse than the one previously applied.

In the Italian system, there is a further means of appeal that may be exercised against the judgment of the Regional Tax Commission. This is an appeal in front of the Court of Cassation that, unlike the appeal, admits only objections that comply with the article 360 of the civil procedure code (which is invoked by article 62 of the Decree on tax process). In particular, it is possible to have recourse to one of the five reasons listed in article 360, namely on reasons relating to the jurisdiction, for infringements of the rules on competence, for infringement or misapplication of rules of law and contracts and national collective agreements, for nullity of the judgment or the proceedings, for omitted examination about a fact that is decisive for the judgment that has been the subject of discussion between the parties[32]. That appeal has the function of third degree of legitimacy in

[31] M. BASILAVECCHIA, *Funzione impositiva e forme di tutela*, cit., p.178.

[32] Today it is very important the question of applicability of amending provisions of the code of civil procedure to appeals in front of the Court of Cassation against decisions of Tax Commissions

the fiscal process similar to what the Supreme Court has in civil trial. However, there is no full coincidence between the rules applicable to the tax process and that applicable to the civil trial.

6.2. Extraordinary measures

When the final decision is pronounced, it may be questioned only by tax Administration in self-defense (the power of Public Administration to withdraw their spoiled or judged unfit acts), and only for reasons other than those considered in the course of the trial. Article 2-quater of decree 564 of 1994 is, today, the key provision for the discipline of the self-defense institution. On the basis of that provision it was, then, issued a special decree (D.M. n. 37 of 1997) which regulates the exercise of the self-defense right by the bodies of financial Administration.

The limit of the merit of the final judgment is expressly provided for, in respect of the current provision of article 2-quater, paragraph 2 of article 2 of d.m. 37 of 1997 that states: there is not automatic revocation, or surrender to the imposition in case of tax assessment, for reasons on which the final judgment intervened in favor of tax Administration. The provision operates in the broad debate on the nature of the tax trial and with regard to the possibility that a merit final judgment may form in that trial, having regard to decisions rejecting the taxpayer's appeal. On the subject, there are essentially three theories: tax trial is a trial of appeal-annulment (subject of judgment is the act's annulment); tax trial, instead, is a trial

(D.L 83 of 2012) so that the ordinance of the Court of Cassation 23273 of 2013 has referred the matter to the United sections.

of appeal-merit (subject of judgment is the relationship proof); finally, a mixed-theory according to which tax trial is aimed at the act's annulment and to the relationship establishment[33]. The Court of Cassation has constantly argued that tax trial is formally constructed as appeal-judgment of the tax act, which is the vehicle for access to the judgment on the merits[34]. In any case, it does not appear that some authors' opinion can be shared: this assigns a different value to tax court's judgment depending on their annulment or rejection nature. Indeed, the tax court always makes the same assessment, consequently, also in the case of rejecting judgments, it cannot be possible to recognize the value of judged, at least regarding to taxpayer's complaints examined by the judge.

The rule is, however, very clear: the self-defense cannot be exercised for the same reasons (as set out in the appeal) that have been rejected by the judge and evaluated with favorable final judgment to the financial Administration. Conversely, however, it should be pointed out that the tax self-defense, instead, is exercisable for different reasons or for vices not assessed by the judge. In this field, therefore, it has not been transposed the civil procedural principle according to which the sentence covers the inferred and the deductible, retaining, however, a strong correlation with the reasons underlying the decision: the exercise of the self-defense power is allowed for legitimate and not examined profiles, while referring to the same tax measure, if there are the formal and essential requirements.

[33] A. COLLI VIGNARELLI, *Aspetti essenziali del processo tributario*, in Rass. Trib., 1997, p. 614; M. FORNACIARI, *L'oggetto del processo tributario*, in Giust. Civ., 1999, II, p. 91; G. SETTIMIO TOTO, *Giudicato tributario e autotutela*, in Tributi, 2001, n. 11/12.
[34] Cass., 23 luglio 1999, n. 7964.

There is also the remedy of revision, regulated from article 64 to 67, (culminating in a judgment of merit) available both from the taxpayer and the Financial Administration. We must refer here to the code of civil procedure, in particular to article 395 as article 64 of Decree says. In fact, it is possible to have a review for one of five reasons listed there. The assumptions identified under numbers 4 and 5 of article 395 (the judgment is the effect of an error of fact resulting from the acts or documents of the case; the judgment is contrary to another before having res judicata authority between the parties, provided it has not pronounced on its exception) being immediately detectable, impose an immediate appeal although they recede in front of the second degree appeal. The other reasons (a judgment which is the effect of willful misconduct of either party against the other; it is judged on the basis of recognized tests or otherwise declared to be false after the judgment; that the losing party was unaware of being recognized or designated as such before the judgment, if after the judgment were found one or more crucial documents that the party had not been able to produce in court for reasons of force majeure or the opponent or if the judgment is a result of willful misconduct proven by court with a res judicata authority judgment) does not emerge from reading the judgment and may occur even after a time, so they do not preclude becoming definitive if the discovery of the defect that caused the revocation is not possible within the time limit of normal terms of appeal. There are also other conditions for the revision of the judgment: this must involve investigations in fact and on the point that comes into consideration is not actionable or has not been challenged. The judgment takes place as a normal judgment before the tax commission and the judge is called upon to replace the ruling revoked deciding the cause and dictating further action.

6.3. Burden of proof[35]

The principle of the proof is the principle according to which the parties wishing to support a theory in the case must give evidence, and the judge, between different versions, must choose the most convincing. Therefore, the evidence are the elements on the basis of which each party believes that its own version of the facts in dispute is more convincing than the one provided by the other party.

With respect to these elements, the judge asks a dual verification: firstly, the eligibility.

The Court must determine whether that evidence is admissible, i.e. in accordance with the law (it is not permissible a proof provided by a person who has a direct interest in the cause). Secondly, the relevance: the judge must verify whether the facts adduced are inherent in the subject matter of the case.

Article 2697 of the Civil Code speaks about burden of proof for the hypothesis in which the legislator requires one of the two parties to demonstrate to the judge the truthfulness of some question. Therefore, if the party fails to satisfy the burden, the Court shall consider that fact as certain. Conversely, it should automatically be considered prevalent the part on which no burden weighs on. The fundamental difference compared to normal proof is that the outcome here is decided solely by

[35] M. BASILAVECCHIA, *Funzione impositiva e forme di tutela*, cit., p. 220; FRANCESCO P. LUISO, *Diritto processuale civile*, I, Milano, 2011, p. 253.

the demonstrations given by one part: if it offers compelling demonstrations the part has absolved the burden, otherwise the position of the other side prevails (though this had no means to support his position).

The burden of proof, generally, falls on the person who wants to assert a right in his/her favor, or contests the existence of a fact in his/her disfavor. However, the parties may enter into conventional inversion of the burden of proof in establishing that this lies on one of them, which is not necessarily the one who must prove the existence of a right or contest it. The reversal is not permitted for legal rights (e.g. demonstration of legitimate child status) or when the reversal makes it excessively difficult to offer proof.

In the tax trial, in particular, there is a general principle according to which the tax Administration cannot issue any act without having first procured the evidence of the facts contained in that act. Then, when the taxpayer appeals the act, the tax Administration has to prove its legality and validity and only after such evidence has been provided to; the taxpayer has to prove the existence of the facts, or something that paralyze or extinguish the act. Therefore, it is the tax Administration that has to provide the evidence of the constitutive fact, and then it will be the taxpayer to prove that the fact is ineffective or that the counterpart's right is modified or extinguished. According to general principles, in the end, the evidence, once taken, explains its effectiveness for the benefit or to the detriment of both sides of the process, without distinction between the one who produced it and the other parts.

In fact, however, it is the taxpayer that has to fulfill the burden of proof in court because the Financial Administration shows evidence in the process that should have collected before thanks to its powers of investigation. Nevertheless, the law often provides for administrative obligations over the taxpayer so that he can advance evidence to merge in the process. We can say that jurisprudence is misleading when it shares the burden of proof depending on the item assessed: in this way, the positive and negative elements would be borne only by the taxpayer. Actually, an operation that gives the right to deduction and that is entered in the accounts has virtually all the formal requirements necessary for inferring and the Administration has to provide evidence of the contrary. Only if this appears doubtful the burden falls on the taxpayer. The law often grants the tax Administrations the possibility to proceed from assumptions: so the burden of proof is circumscribed to certain facts from which we can deduce the existence of additional facts or relevant elements for the purposes of taxation.

At this point, if we consider the main tax disputes, we can clarify that, in disputes concerning reimbursement, the plaintiff's burden of proof is much more prevalent because this must also refer to the correct establishment of the quarrel. However, if the burden is too onerous for the taxpayer, the tax Commission may exercise powers of investigation the facts the applicant annexes. In disputes about tax breaks, the taxpayer has the burden of proving the constituent elements of the tax break because he asserts a fact favorable to him. This happens independently from the structure that the dispute takes in concrete terms: the proof must be given both in case of refund and in case of appeal of an act. The Administration then will have to prove that its refusal is correct mainly if it has not insured to taxpayer an active participation in the proceedings.

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Fairness in Allocating Taxation Rights between Source State and Residence State

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1. The meaning of the term "Fairness"

1.1. The ability to pay

"Everybody must contribute to the public expenses because of his ability to pay. Tax system is based on criteria of progression" ([1]).

This rule, contained in the article 53 of the Italian Constitution, expresses the principle of "ability to pay", which can be regarded as a mean to realize fairness within Italian tax system. The article 53 is intended to establish, by requesting a financial benefit, the roots of a distributive justice on the social; this follows from the rule that all members of the community must participate to public expenses without any distinction of class or category and the extent of such obligation must be based on the criteria of progressivity. By this precept, the Italian legislator aims to "constitutionalise" the principle of social justice linked to that of solidarity.

The ability to pay is also the cause and the extent of tax; in fact, it represents a substantial limit to the legislative discretion in tax matters. The constitutional principle, therefore, plays a dual role: a solidarity function, according to which every individual must contribute to public expenses not to achieve personal benefits but for the interest of the community; a guarantee function, according to which taxpayer is only who has an ability to pay, considered as an attitude to demonstrate the existence of an economic capacity or to bear the sacrifice of a patrimonial request by the tax authority.

Tax burden should therefore aim for a reasonable balancing of rights based on the principle of ability to pay, understood as a projection of the principle of equality, that is, a way to reduce diversity in terms of social welfare; indeed, article 53 of the Italian Constitution may not be considered as isolated but in its relation with other constitutional principles, such as those expressed in articles 2 and 3 of Constitution.

Article 2 of the Constitution requires to members of the social community the fulfillment of the mandatory duties of politic, economic and social solidarity. This rule gives relevance to the solidarity criterion of the principle of ability to pay, where the tributary duty becomes expression of the mandatory duties of solidarity,

[1] M. Procopio, *Il sistema tributario italiano. Principi istituzional*i, Padova, 2013, p.78 e ss..

arising a provision direct both to the allocation of the tax burden of public services among all taxpayers, and to finance the social benefits addressed not to the generality, but to a restricted circle of people ([2]).

Article 3 states, instead, the principle of equality, distinct in formal and substantial equality. The principle of formal equality does not allow discrimination based on sex, race, language, religion, political opinion, social and personal conditions. The principle of substantial equality, instead, clarifies that it is a duty of the State to remove the economic and social obstacles that prevent the full development of the human person. Article 53 contains both principles.

About principle of formal equality, it requires applying the same financial request to identical situations and a different taxation to different situations. In other words, it is legitimate a greater tax levy on a larger ability to pay and a smaller one on a lower ability to pay.

About principle of substantial equality, the State may use tax leverage to promote and to improve the situation of its own associates, correcting the social imbalances due to not equal starting situations ("positive actions"). So the State has the obligation to take into account the different situations existing between members of the social community in order to promote their growth, their improvement also from the economic point of view, in the interests of distributive justice.

The principle of equality expresses, therefore, the relative limit to the principle of ability to pay, as a justification for the different contribution imposed to certain associates compared to other and rationally deriving from different symptoms of ability to pay. This involves, also, the principle of tax justice or distributive justice.

Ability to pay is the ability to contribute to public expenditure and it can be deduced from indexes not necessarily economic. Consequences are:

(a) holders of a minimum income (minimum subsistence) are not subject to any financial obligation;

[2] G. Melis, *Il principio di capacità contributiva*, in educational material distributed during Tax Law class, p.9 e ss..

(b) progressivity of taxation cannot deprive the taxpayer of the essential means for his maintenance and that of his family;

(c) ability to pay is the only reference to evaluate whether a law complies with the principle of equality ([3]).

Another criterion, linked to ability to pay and used to guarantee fairness in the internal tax system, is represented by the principle of progressivity that, understood as the increase of the rate with increasing income, assumes a direct relationship between tax and individual income of every subject. For this reason, it is applicable only to personal taxes.

Progressivity, as an instrument to redistribute income, means that legislator has to consider the subjective situations of taxpayers in the application of tax and, consequently, that tax burden must be slighter towards poorer classes. Moreover, this is one of the ways to realize economic solidarity allowing to individuals with a limited ability to pay to benefit from indivisible services, thanks to the highest contribution of wealthy individuals.

At the end of these considerations, it is possible to state that ability to pay is included in that catalogue of constitutional principles which express fundamental values for the life of the community and it pursues "fairness" in the tax system.

1.2. "Fairness" in allocation of income between States

In the Italian tax system, constitutional rules do not specify the procedures to be followed for the taxation of income earned by taxpayers.

Article 53 of Constitution does not suggest anything about these procedures ([4]).

This article only states that "Everyone" must contribute to public expenditure: citizens and foreign, residents and non-residents.

The majority doctrine says that the expression "ability to pay" is direct to value the taxpayer's overall wealth and all of the income that the taxpayer has earned. This statement is questioned by a part of the minority doctrine, affirming that there are not, in the text of the rule, elements that allow to say that the rule has

[3] M. Procopio, *Il sistema tributario italiano. Principi istituzionali*., cit., p.118 e ss..

[4] M. Pellecchia, *Principio di territorialità e reddito d'impresa*, PhD thesis, in eprints.luiss.it, LUISS Library, p. 194 e ss..

expressed an undoubted preference for a taxation based on the worldwide principle.

Article 3 of Constitution, to which a part of the doctrine links the principle of ability to pay referred to in article 53 of Constitution, only states that the adopted criteria have not to create discriminations between similar situations.

The majority doctrine believes that the right procedure to interpret this article is that taxpayers who are in the same condition should be subject to taxation in the same way. According to this interpretation of the principle of equality, the factor determining the equality of treatment is represented by the taxpayer’s budget, regardless of whether such income were earned in Italy or abroad. This means that two taxpayers, considered as residents in Italy, will be treated in the same way, although one of the two has produced, in whole or in part, his income abroad, under the principle of worldwide taxation.

Another part of the doctrine, recently, has affirmed the possibility that the constitutional rule can be read in a different way. This means that the rule provides certainly a similar treatment for similar situations, but the comparison between situations has not to cover two residents but rather a resident and a non-resident. In this case, treatment established for non-residents, that is the only taxation of income produced within the State, creates a discrimination towards residents because, contrary to that provided for non-residents, income produced outside the territory of the State by the resident is too taxed.

This second interpretation of the rule, although a minority, is confirmed by the tax law, considering that the legislator both historically and currently adopted the principle of territoriality in relation to some tributes.

The first example is represented by the Tax of Movable Wealth that, although introduced into law before the enactment of the Constitution, was suppressed only at the beginning of the seventies. This tax was characterized to subject to taxation income produced by resident taxpayers on the basis of the principle of territoriality and, however, for this reason it has never been the subject of constitutional scrutiny.

After suppressing this tax and introducing the personal income tax (IRPEF), legislator however introduced into law taxes providing for the taxation on the territorial basis.

Another example is represented by IRAP. This tax, indeed, establishes a general principle of taxation of the tax base on territorial basis. This provides for a tax base to which contributes also that part of resources made abroad.

About IRES, it is possible to see that:

- the delegating legislator established a constraint for the delegated legislator represented by the observance of the international, conventional and EU principles;
- the tax has not real nature;
- the assumption of taxation is based on the concept of residence, which acts as a catalyst of taxpayer's income wherever they are produced;
- in order to eliminate international double taxation, legislator opted to recognize to the taxpayer a limited tax credit for taxes paid abroad;
- permanent establishment represents theoretically a solution to problems of allocation of tax rights.

This close examination of the Italian tax system allows to affirm that actually the Constitution does not pose a constraint to legislator in the identification of the policy to be adopted for taxation of income earned by taxpayer.

The constraint, about IRES, was introduced by the delegating legislator when he imposed to the delegated legislator to comply, in formulating the new tax, with international, conventional and EU principles. The delegated legislator complied with this obligation, according to the traditional model of the personal tax, leaving intact the residence criterion and associating to this latter the worldwide principle about income produced by taxpayer.

So the Italian legislator does not meet any constitutional obstacle in the adoption of the principle of territoriality. On different occasions, indeed, he used this principle to determine the structure of taxes.

However, this legislator's freedom is limited in two aspects. On one hand, conventional law is a strong limit to the possibility for the legislator to adopt a principle different from that inspirer of the conventions. Indeed, on the contrary, there would be a conflict between rules in which the conventional rule would prevail according to the provision of article 117 of Constitution and to the consolidated jurisprudence that establishes the prevalence of the special rule in the conflict with the ordinary rule.

On the other hand the abandonment of the worldwide principle for the adoption of the principle of territoriality could be also a limit in conventional terms and a violation of the Convention when the domestic rule prevails over the conventional one, with the consequence that State would be subject to international sanctions.

About EU law, it is possible to underline that principles expressed by the EU legislator and by the Court of Justice seem coherent with the international practice, that is with the possibility of the EU judges of discriminating taxpayers in residents and non-residents and of applying to the first the worldwide principle and to the second that of territoriality.

However, there is also a jurisprudence that, in its most recent ruling, stated that the non-resident and the resident can be compared and that principle of territoriality is secondary to the principle of ability to pay.

This latter principle would complement the meaning of the principle of equality of article 3 of Constitution. So the non-resident, in the case considered by the Court of Justice, would be entitled to receive the tax treatment provided for the resident taxpayer, that is the taxation according to the worldwide principle.

If this circumstance is confirmed, there will be a reverse discrimination, because while to the non-resident taxpayer producing almost the entire income in Italy would be given the possibility to determine his tax, alternately, through the worldwide principle or that of territoriality, the resident determining almost the entire income abroad is subject to the worldwide principle.

The question involves two problems:

(a) if the taxpayer resident in Italy determines almost the entire income abroad and he opts for the application of the worldwide principle there is a problem for which between the two States has to grant the tax credit or the exemption;
(b) discrimination that this situation would generate between resident and non-resident.

A remedy could be to abandon the worldwide principle and to adopt that of territoriality. However, this change would lead to many problems as regards the relationship between domestic rule and the international one.

Conclusively another remedy could be to extend to both residents and non-residents the right to opt for a regime or for another.

2. *The OECD Model Tax Convention on Income and on Capital*

2.1. Structure and functionality

The OECD Model Tax Convention on Income and on Capital consists of seven chapters. Chapters 3, 4 and 5 represent the essential part.

Chapter 1 indicates the scope of the convention: people subject to this model and taxes covered by the same.

Chapter 2 provides definitions of some terms used in the convention. Other terms such immovable property, dividends, interests and royalties are defined in their respective articles.

Chapter 3 shows the different income categories and determines whether the source State, the residence State or both have the right to tax (allocation rules).

The fundamental expressions used in establishing these rules are:

(a) "may be taxed", referred to the right limited or less of the source State to tax certain income categories;

(b) "shall be taxable only", reported to the exclusive right of the residence State to tax certain income categories, including business profits, shipping, inland waterways transport and air transports, royalties, capital gains, income from employment, pensions, government services and other income;

(c) "may not be taxed", for example, in the case of dividends and interests both the residence State and the source State can tax this income, but the taxing power of the second is limited to a certain tax rate ([5]).

Chapter 4 deals with the taxation of capital. Immovable property and movable property of the permanent establishment can be taxed in the State where they are located. Other goods can be levied only in the residence State of the owner.

Chapter 5 establishes the two main methods to eliminate double taxation, the exemption method and the credit method.

Chapter 6 consists of some special rules about non-discrimination, mutual agreement procedure, exchange of information, assistance in the collection of

[5] A. Dragonetti, V. Piacentini, A. Sfondrini, *Manuale di fiscalità internazionale*, Milano, 2012, p.62 e ss..

taxes, members of diplomatic missions and consular posts and territorial extension.

Chapter 7 illustrates the rules about entry to force and termination of treaty.

The purposes of the OECD Model Tax Convention can be divided into three main:

a. to eliminate international double taxation and double not taxation;

b. to solve disputes;

c. to prevent and to fight tax avoidance ([6]).

The first purpose is realized by negotiating, bilaterally, treaties containing:

- rules about distribution of the tax power between the Contracting States;
- rules designed to avoid double taxations resulting from the imperfect work of the internal rules.

The second purpose is to find solution to the interpretation and to the application problems of the Convention. In this respect, the OECD Model provides the Mutual agreement procedure, that is defined by agreement for the application of treaties on taxation.

A mean to reach the third purpose is the exchange of information between the competent authorities of the Contracting States, but there are also other forms of cooperation as assistance in the collection of taxes.

2.2. The double non-taxation

Italian experience shows only a few legal cases addressing the theme of *double non-taxation.*

In general these themes related to the implementation of the Double Tax Conventions have been the object of the attention of jurisprudence, of the scholars and, and more marginally, of the Tax Authorities solely over the past ten years. This explains why the decisions which address interpretation and the problems relating to the implementation of the DTCs ([7]) are still a few, and, in a broad

[6] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, p.160 e ss..

[7] DTCs stands for Double Tax Conventions.

sense, based on the enunciation of institutional principles concerning the problems of international double taxation.

Save a few exceptions, they do not expressly take into consideration the themes relating to the attribution of the DTCs discipline also for the purpose of avoiding double non-taxation ([8]).

According to the version of the Commentaries to the OECD Model 2000, the wording “in accordance with the provisions of the Convention, may be taxed” put in Article 23 of the OECD Model must also be interpreted “in connection to the possible cases of double non-taxation”, to avoid that the waiver of the taxation power by the residence State may actually imply the non-taxation of the income specifically considered. So the double non-taxation can be avoided by applying Article 23, paragraph 4 of the OECD Model.

To our knowledge, no Convention entered by Italy has utilized the exemption method under article 23A of the OECD Model, and therefore the Italian regulations do not provide cases in connection with which an interpretation orientation consistent with the last OECD indications has surfaced. Therefore, there is no provision modeled after Article 23A of the OECD Model that has already been incorporated in new or revised bilateral tax treaties. As a consequence, there are no examples that said provision has been applied or interpreted by Italian Tax Authorities or courts; neither have they applied similar approaches in the absence of such a provision.

Another method to avoid double non-taxation is to apply specific bilateral provisions. Like many treaties concluded by other States, also some tax treaties signed by Italy require:

(i) the taxation in the source State for the application of the Convention;

(ii) or the taxation in the residence State for the exclusive taxing right of this State;

(iii) or non taxation in the source State for the taxation in the residence State.

[8] A. Pozzo, *The avoidance of double non taxation in the Italian double taxation conventions' framework*, in *Dir. prat. tribut. internaz.*, 2003, I, p. 84 e ss..

This theme can be connected to some interesting problems concerning the procedural point of view, even though, as far as it known, there was neither any document issued by the Tax Administration with respect to this topic in the Italian experience. Some DTCs concluded by Italy, like, for example, Australia-Italy DTC or Albania-Italy DTC provide for the exemption of an item of income in the source State and its taxation in the residence State on conditions that taxes are levied out in the last one.

This being said, we can wonder what would happen in Italian tax law if a professor, for example, resident in Australia, receives an income from his teaching activity in Italy:

- and then, at first, he is not taxed in this State because he produces a certificate issued by the Australian Tax Administration stating his residence in Australia and his subjection to taxation and then, at the same time, a second certificate stating his identification data, the existence of the conditions provided for in the DTC to get the benefits and the lack of a permanent establishment or a permanent establishment base in Italy,
- but subsequently he is not taxed in Australia because, before the payment, there is a modification of the law or, after the payment, there is a definitive judgment of an Australian tax court (in consequence of a law-suit brought by the professor).

In such a case, Italy should be able to assert its right to tax the item of income received by the Australian professor, as the DTC subordinates the right of levying taxes of the residence State to the effective taxation in this last one.

Obviously, in order to succeed in this end, it would be necessary an exchange of information according to the Article 26 of Australia-Italy Tax Treaty between the Tax Authorities of both States because otherwise the Italian Tax Administration could never known the taxpayer was not taxed in Australia.

Besides, it should be considered that in Italian tax law, the right of the Italian Tax Authorities to assert their power to tax is conditional upon particular periods of expiration which, in these cases, would not be easy to apply ([9]).

On the other hand, if Australia:

- at first does not exercise its right to tax and Italy levies taxes on the item of income,
- but then asserts its power to tax and consequently denies the right of Italy,

the taxpayer would be subjected to a double taxation.

It would be a perfect case to apply Article 25 of Australia-Italy Tax Treaty about Mutual Agreement Procedure, even if, as for Italy, examples of the application of the above mentioned provision are not known.

In any event, the taxpayer could claim the reimbursement of the taxes he paid in Italy from the Italian Tax Authorities.

Nevertheless, he would have to prove the right to tax of Australia and the claim should be deposited within an expiration time of 48 months from payment.

2.3. Distributive rules of the OECD-MTC for allocating income between resident and source State

The criteria used in distributive rules in the OECD-MTC are the following:

a. the *permanent establishment*, used in the article 7, about business profits;

b. the *place of effective management* of the enterprise, used in the article 4 as tie-breaker rule and in the article 8 about profits from shipping, inland waterways and air transport;

c. the *place where the recipient is resident*, used about dividends, interests and royalties;

d. the *location of assets*, used about capital gains;

e. the *place of exercise of the employment* ([10]).

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[9] A. Pozzo, *The avoidance of double non taxation in the Italian double taxation conventions' framework*, cit., p.111e ss..

[10] The basic rules are:

- article 7, according to which *"profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein"*;

These basic distributive rules are justified with the principle of equivalence in order to guarantee a right allocation of income and a correct distribution of the tax power between residence and source States and they rest on formal elements.

Deviations from basic distributive rules concern:

a. dividends, interest and royalties, because the provisions of the paragraphs 1 and 2 of the respective articles ([11]) shall not apply if the beneficial owner of dividends or interest or royalties, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the holding or the debt-claim or the right of property in respect of which dividends, interest and royalties are paid is effectively connected with such permanent establishment. In these cases provisions of article 7 shall apply;

b. income from employment, because it is established ([12]) the exemption in the State where employment is exercised and the taxation only in the residence State if the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or

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- article 8, under which *"profits from the operation of ships or aircraft in international traffic" and "profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated"*;
- articles 10, 11 and 12, according to which *"dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State", "interest arising in a Contracting State and paid to a resident of the other Contracting State" and "royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State" "shall be taxable only in that other State"*;
- article 13, under which *"gains derived by a resident of a Contracting State from the alienation of immovable property and situated in the other Contracting State may be taxed in that other State"*;
- article 15, according to which *"salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State"*.

[11] Articles 10, 11 and 12 of the OECD Model Tax Convention.
[12] Article 15, paragraph 2 of the OECD Model Tax Convention.

ending in the fiscal year concerned, the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State and the remuneration is not borne by a permanent establishment which the employer has in the other State. Moreover, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated;

c. directors' fees, because notwithstanding articles 7 and 15, income derived by a resident of a Contracting State as an artist or a sportsman may be taxed in the State where activity is exercised and not in the residence State of the percipient ([13]);

d. government service, because instead of the exclusive tax power of the State that makes payments ([14]), it is established that the beneficiary State can tax remunerations paid to certain categories of staff of diplomatic and consular foreign missions who are resident permanently or national of this State ([15]). These provisions are not applicable when services are provided in connection with a business carried on by the State or a political subdivision or a local authority ([16]). In such case articles applied are 15, 16 and 18.

This deviations are justified by the principle of effectiveness or objectivity because they consider important not the formal elements, such as place of incorporation or where the registered office is situated, but the concrete aspects like place where key-management and commercial decisions that are necessary for the conduct of the entity's business are in substance made, or entity or subject who effectively exercises business and determines the company policy. A weakness is that many of these rules suppose subjective definitions that change from State to State, depending from relative judges.

Principles playing an important role in the interpretation of these rules are feasibility and legal certainty. These aspects can be in conflict because of the stability over time and the rigidity of the rules, the predictability of the legal

[13] Article 16 of the OECD Model Tax Convention.
[14] Article 19, paragraphs 1 and 2, subparagraph a) of the OECD Model Tax Convention.
[15] Article 19, paragraphs 1 and 2, subparagraph b)of the OECD Model Tax Convention.
[16] Article 19, paragraph 3 of the OECD Model Tax Convention.

consequences of the conduct, the non-retroactivity of the law, although they represent values important to protect individual freedom and equality of people before the law, they could be sacrificed or forced in order to make effective certain provisions and to reach other purposes worthy of protection, such as flexible rules, evolutionary interpretation, prohibition of non-discrimination.

2.4. An example of the Italian treaty policy: the Convention Italy-U.S. against double taxation on income

Italy does not present new trends in double tax conventions, but the treaty signed with U.S. is a clear example of the most recent guidelines followed by its treaty policy.

2.4.1. Subjective scope of application

The Convention is very complex because provides a number of limitations and restrictions based on the American policy. These limitations, called "limitations on benefits - LOB" have not only the purpose of contrasting abusive uses of treaties but also that of guaranteeing a fundamental principle of every Convention: benefits of a Convention, because normally involve a renunciation of taxation by the source State, should be reserved only to those deserving of these benefits according to the purpose and spirit of the Convention.

This problem can occur whenever a person does not act directly as an individual but by a vehicle (company or entity) to which may also participate members resident in a State other than that in which this vehicle is resident for tax purposes ([17]).

For the corporations, for example, the application of the conventional benefits is satisfied if it is listed or if it is owned directly or indirectly by listed companies. If the Italian listed companies, or companies owned by Italian listed companies, pass the test of the above mentioned requirements (publicly traded tests), they can benefit from the Treaty Italy-U.S., even if there are members who are not resident in Italy. If a company does not meet the test described above, it must pass another

[17] S. Mayr, *La nuova Convenzione Italia-USA contro le doppie imposizioni sul reddito*, in *Boll. Trib.*, XI, 2009, p.853 e ss..

test to benefit of the Convention. In fact, there are two cumulative tests, the so-called “ownership test” and the “base erosion test”.

The first test is passed if at least the 50% of each class of shares or stock is owned, directly or indirectly, for at least half the days of the tax days of the tax period, by people who are entitled to benefit of the treaty pursuant the article 2.

For the overcoming of the second test, the gross income of the company or an entity, in a tax period, shall not be affected negatively, by 50% or more, by payments or debts in favour of people who are not resident in a Contracting State and that are deductible for tax purposes of the company or of the entity.

2.4.2. The tax residence

The Convention does not contain its own definition of residence but basically refers, to the definition of this concept, to the unlimited imposition of the subject in one or both States based on a criterion of personal connection with the land. Given that the Convention refers to the tax residence on the basis of the national law of the two States, it is possible that the person is a resident of both Contracting States according to their respective national laws. While the OECD-MTC has its own discipline to solve the problem of dual residence both for individuals and for legal persons, the Convention Italy-U.S. contains, in the paragraph 2 of the article 4, the same rules (the famous tie-breaker rules) for individuals, while for people other than an individual, on the third paragraph of article 4 there is not the same solution adopted by the OECD model, but it is established that “where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavour to settle the question and to determine the mode of application of the Convention to such person” ([18]). So the solution of such problem is restricted to the competent authorities of the Contracting States that will do their best to solve the question by mutual agreement and determine the mode of application of the Convention in respect of that person.

[18] Article 4, paragraph 3 of United State-Italy Income and Capital Tax Convention.

This is another clause in the treaty typical U.S. Model according to which the right to unlimited tax liability rests with the State in which company was incorporated, and that deny the application of the treaty to a company for which the issue of the double tax residence cannot be solved within the framework of a mutual agreement procedure.

Another peculiarity of the Italy-U.S. Treaty, about the relationship between residence State and source State, is the "saving clause".

Normally, when a person is a resident of the State A (the residence State), the other State, the State B (the source State), levies to the said person only income earned in its territory.

In Italy-U.S. treaty exists, however, the saving clause that is found in all the treaties made by the United States because contained in U.S. Model of the Conventions.

With this clause the U.S. reserve the right to tax their residents and their citizens in accordance with the U.S. internal law as if the Convention did not exist. This clause is for both states, and then even Italy may adopt it.

2.4.3. Objective scope of application

Under the objective aspect, the Convention shall apply to taxes on income imposed on behalf of a Contracting State. This formulation differs from the OECD model that also considers the taxes withheld on behalf of not only the State but also on behalf of its political subdivisions or local authorities because, according to the United States, the treaties may only cover the federal taxes, therefore taxes imposed by individual States or municipalities remain excluded. It depends on the constitutional principles of the United States that ascribe to the individual States a strong fiscal autonomy that cannot be limited by a federal law as a party of a treaty against double taxation. Excluding local tax by a treaty may produce consequences both in the source State and in the Residence State. If in the source State income is subject both to national tax and local tax and the Convention provides for a limitation to taxation, the source State will apply this restriction only for the purposes of national taxes and local taxes will apply as provided for by internal law. Regarding the residence State, the exclusion from the scope of the local tax does not necessarily mean that there is a double taxation on income subject to tax in the source State, if the residence State credits such tax under the national legislation on credit for foreign taxes (otherwise it may simply involve a higher overall tax burden).

Under the Convention Italy- U.S., taxes imposed by individual States in the U.S. should not be creditable, even according to the Italian national legislation, to IRPEF or IRES because these are two national taxes.

If the residence State has a local tax, this should not affect the foreign income and, for this reason, there is not a possibility of double taxation under this tax. Paragraph 2 indicates for Italy, over IRPEF and IRES also IRAP for the part that is considered as an income tax and also states "although they are collected by withholding taxes".

Paragraph 3 contains the "clause of survival" of the Convention to any identical or substantially similar taxes that will be institute by a Contracting State after the date of signature of the Convention, in addition to or in place of the existing taxes.

2.4.4. Mutual agreement procedure and arbitration

The mutual agreement procedure provided for in the Convention is identical to that contained in article 25 of the OECD Model. The real new aspect, compared to the OECD Model and to other treaties concluded by Italy, is contained in paragraph 5 of article 25 of the Convention Italy-U.S.: this paragraph provides for the arbitration, if the competent authorities are unable to reach an agreement. If the taxpayer and the competent authorities agree, the case can be referred to an arbitration Committee whose decision is binding on the taxpayer and for both States. Under article 25, paragraph 5, the arbitration may be invoked for all cases that may be the subject of a mutual agreement procedure and also of a procedure of consultation between the competent authorities.

2.4.5. Elimination of double taxation

Article 23 deals with the discipline of income, derived from the source State, in the residence State of the recipient, also providing the mechanism for eliminating double taxation.

While in other conventions concluded by Italy, the two States, as residence States, often apply different mechanisms to avoid double taxation for their residents, in this Convention both States avoid the same with the credit method. This means that, with some exceptions, each State reserves the right to tax their residents on income from the other State, according to its own domestic law that provides, in both cases, for the unlimited taxation that is the worldwide taxation.

Paragraph 2 of article 23 provides for the discipline of the tax credit that U.S. apply to their residents for income deriving from Italian sources; instead, paragraph 3 of the same article contains the discipline of the tax credit provided for an Italian resident with U.S. source income.

2.4.6. Branch Profit Tax

About the special section of the Treaty, the most important innovation to underline is the introduction of the "branch profit tax".

The Convention provides for the possibility of the Contracting States to apply an additional tax on the profits of the permanent establishment of a legal person resident in the other State, under the conditions and within the limits provided by Article 10, paragraph 6, of the Convention ([19]).

As evidenced in the U.S.A. Explanation Notes: "a Contracting State may impose a branch profits tax on a company if the company has income attributable to a permanent establishment in that Contracting State, derives income from real property in that Contracting State that is taxed on a net basis under Article 6 (Income from Real Property), or realizes gains taxable in that State under paragraph 1 of Article 13 (Gains). In the case of the United States, the imposition of such tax is limited, however, to the portion of the aforementioned items of income that represents the amount of such income that is the dividend equivalent amount".

However, this provision stands in potential conflict with the provisions of article 24, paragraph 2, of the Convention concerning non-discrimination, according to which "the imposition of a permanent establishment which an enterprise of a

[19] P. Valente, *La tassazione dei dividendi nella nuova Convenzione Italia-Usa*, in Il Fisco, 2010, I, p.6012 e ss..

Contracting State has in the other Contracting State may not be less favorable, in this other State, of the taxation levied on enterprises of that other State in carrying on the same activities". Paragraph 18 of article 1 of the Protocol poses an express derogation from this principle, providing that the provisions of the article 24 cannot be interpreted in order to prevent to any Contracting State to levy a tax which is required by paragraph 6, article 10 (Branch profit tax).

2.5. Exemption or credit method?

With the exemption method, the residence State does not consider taxable income produced abroad by its residents and it attributes unilaterally to the source State the exclusive exercise of taxing rights ([20]).

With the credit method, the residence State computes the amount of tax payable on the foreign income and then reduces this amount by the amount of tax paid in the source State ([21]).

The method preferred by Italy to guarantee fairness in the allocation of income is the credit method.

The assignment of the tax credit for taxes paid abroad to taxpayers resident in Italy, that produce income in other States, aims to achieve the internal fiscal neutrality from the point of view of the capital exporter State: that aims to make sure that the taxation of foreign income is equal to the taxation of income produced within the investor's residence State ([22]).

The foreign tax credit is disciplined by article 165 ITA ([23]). The main characteristics of these method are:

- the foreign tax credit is offset from the tax that individual resident must pay; essentially, it is a deduction due up to the amount of the Italian tax corresponding to the report between foreign income and total income;
- the deduction is given for the tax paid abroad, but not in excess of the amount of the Italian tax proportionally attributable to the foreign income;

[20] C. Garbarino, *Manuale di tassazione internazionale*, cit., p.59.

[21] W.F.G. Wijnen, *Introduction to International Tax Law*, in educational material distributed during class, p.35.

[22] F. Tesauro, *Istituzioni di diritto tributario. Parte speciale.*, Milano, 2012, p.169 e ss..

[23] ITA stands for Income Tax Act.

- if income produced in most foreign States contributes to the formation of the tax base, the deduction is applied separately for each State (per country limitation);
- when foreign income is partly levied, also the foreign deductible tax is reduced correspondingly; tax credit, in fact, is reduced proportionally to the amount of the foreign income that does not concur to the formation of the total income;
- the deduction can be claimed only if the income can be considered produced abroad according to the criteria established for the localization of the income realized by non-residents in Italy, and if foreign income contribute to the formation of the total taxable income (the tax credit is not attributed to the foreign income subject in Italy to withholding or substitute taxes);
- it is necessary that payment of the tax to the foreign State have been made definitively.

About taxation of dividends, Italy adopts the exemption method. This was introduced by Legislative Decree no. 344/2007 and it had a deep impact on the taxation of dividends because it eliminated economic double taxation and replaced the imputation method and the related tax credit.

The participation exemption (*pex*) models the taxation on the objective situation of the company, rather than on the subjective situation of the shareholder. The profit is taxed on the company that produces it and dividends distributed to the shareholders are partially excluded from taxation of income. The exemption of dividends is implemented in an almost total way only towards the subjects taxable of IRES. Indeed, dividends, if distributed to shareholders having the form of a corporation are taxed only to the extent of the 5% of their total. Only dividends that come out from the intercompany circuit and that are distributed to individual shareholders, undergo an additional taxation (but to a lesser extent, to limit the effects of double taxation).

Participation exemption concerns not only dividends but also capital gains (deriving from the sale of immobilized shareholdings).

The application of this regime to the capital gains depends on four conditions: the first two relate to the participating company; the other two relate to the subsidiary ([24]).

The first condition concerns the holding period that must be of a year when the sale happens (it is required the possession from the first day of the twelfth month preceding the month of the sale). The exemption is therefore provided only for the long-term investments.

If the shareholdings were acquired in several tranche, and not all of them are held for a year, the first sold are those purchased in the most recent date: it is applied the LIFO.

The second condition is that shareholdings must be recorded as financial assets in the first financial statements closed during the period of ownership; in this way instrumental reclassifications, made in view of the sale, are prevented.

The initial registration in the financial statements is conclusive; if after the first registration as financial asset, the shareholding was recorded as current asset, the exemption would be maintained. The initial registration, instead, as current asset prevents definitively the application of the exemption method.

The third and the fourth condition concern the subsidiary.

The third concerns the registered address of the subsidiary: the exemption is not granted to the shareholdings in companies having the registered address in a State or territory with a privileged tax regime. If the subsidiary is not taxed or is taxed little, the exemption is not provided neither for capital gains nor for dividends.

This obstacle to the application of the participation exemption can be removed through a ruling, proving that the effect of the localization of income in States or territories with a privileged tax regime is not achieved.

The presumption can be won proving, through ruling, that at least the 75% of the subsidiary's income is not produced in a tax haven but it comes from investments in companies or from permanent establishments having the registered address in States with an ordinary taxation.

The fourth condition concerns the subsidiary's activity that must be a commercial enterprise, as defined by article 55 ITA ([25]).

[24] F. Tesauro, *Istituzioni di diritto tributario*, *Parte speciale.*, cit., p.114 e ss..

The exemption is prevented, therefore, for the shareholdings in "companies without enterprise". Particularly, the exemption is prevented for investments in real estate companies of mere enjoyment, that are companies not carrying out an actual commercial enterprise.

At the time of realization of the capital gain, the last two conditions must be integrated continuously since the third tax period prior to the realization.

In order to apply this regime to dividends, instead, it is required only a condition: dividends must not come from a tax haven.

About losses, subjects whose profits are exempt may report the loss only for the amount that exceeds profit not taxed in previous financial years ([26]). The reportable tax loss is, therefore, only that exceeding the exempt profits, net of expense items that are not deductible because they relate to exempt profits. Tax losses are significant in amount corresponding to the taxable income and the reportable tax loss should be reduced to the same extent of the exemption ([27]).

Indeed, coherently with the participation exemption provided for dividends and capital gains with the Tremonti's reform, the legislator established the total non-deductibility of the losses deriving from the realization of exempt investments and of the devaluations resulting from the evaluation of investments ([28]).

However, also after the current changes (the total exemption has become a partial exemption), legislator maintained the rule of the total non-deductibility of losses and devaluations. So there is an asymmetry in the treatment of losses and profits because in front of a partial exemption (95%), it is provided the total non-deductibility of the losses connected to exempt investments, related to corporations and similar entities.

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[25] Article 55 ITA states:
"Exercise of business activity means the exercise for usual occupation, although not exclusive, of the activities mentioned in article 2195 c.c. and activities specified in subparagraphs b) and c) of paragraph 2 of article 32 which exceed the limits laid down therein, although not organized in the form of enterprise".

[26] Article 84, paragraph 1 ITA.

[27] F. Tesauro, *Istituzioni di diritto tributario, Parte speciale.*, cit., p. 89.

[28] A. Dragonetti, V. Piacentini, A. Sfondrini, *Manuale di fiscalità internazionale*, cit., p.537 e ss..

2.6. OECD-MTC vs. UN-MTC

The UN and Organization for Economic Development and Co-operation Model Tax conventions present some differences that affect allocation of income between residence State and source State. Analyze them below.

About business profits, clauses b) and c) of paragraph 1 of article 7 strengthen the position of the source State by extending its right to tax to profits from business activities that are not carried out by an enterprise through its permanent establishment ([29]). The source State may attribute such non-permanent establishment profits to a permanent establishment of the enterprise if they are derived from the sale of goods or merchandise or any other business activity in the source State, provided that these transactions are similar to those concluded through the permanent establishment ([30]).

In paragraph 3 of the same article of the UN Model Convention also there is some extra clarification of the treatment of deductions in determining PE profits, as compared to the OECD Model Convention ([31]).

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[29] Article 7, paragraph 1 of the UN Model Tax Convention states that:

"the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment".

[30] Willem F.G. Wijnen and Marco Magenta, *The UN Model in practice*, in *Rass. fisc. int*., 1997, II, p.10.

[31] Article 7, paragraph 3 of the UN Model states:

"in the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or

About shipping, inland waterways transport and air transport, article 8B of the UN Model Tax Convention attributes to the source State a limited right to tax shipping profits, if the shipping activities in the source State are more than casual ([32]).

About associated enterprises, it is established that the provision of paragraph 2 (providing for a "correlative adjustment" to be made by one country following adjustments by the treaty partner country, to avoid double taxation) "shall not apply where judicial, administrative or other legal proceeding have resulted in a final ruling that by actions giving rise to an adjustments or profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or willful default" ([33]). In other words there may be in effect an additional penalty for such transactions, that a double taxation ([34]).

About dividends, the maximum dividend withholding tax rate allowed to the source country is not specified, but it is left subject to negotiation as between

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for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise by way of interest on moneys lent to the head office of the enterprise or any of its other offices".

[32] Article 8B of the UN Model reads as follows:

"profits from the operation of ships in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated unless the shipping activities arising from such operation in the other Contracting Stat are more than casual. If such activities are more than casual, such profits may be taxed in that other State. The profits to be taxed in that other State shall be determined on the basis of an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations. The tax computed in accordance with such allocation shall then be reduced by ¼ per cent. (The percentage is to be established through bilateral negotiations.) (...)".

[33] Article 9 of the UN Model Tax Convention.

[34] Michael Lennard, *The UN Model Tax Convention as compared with the OECD Model Tax Convention-Current Points of Difference and Recent Developments*, in *Asia-Pacific Tax Bulletin*, 2009, p.8 e ss..

prospective treaty partners ([35]). Countries following the UN Model Convention generally have higher maximum rates than under the OECD Model Convention. Perhaps somewhat contrary to expectations, the threshold to qualify for foreign direct investment, as opposed to portfolio investment is lower under the UN Model Taxation than under the OECD Model Convention (10% as compared with 25%). This is explained in the Commentary on the basis that in some developing countries non-residents are limited to a 50% share ownership, and 10% is seen as a significant enough portion of such permitted ownership to qualify for the foreign direct investment categorization.

About royalties, it is provided for a source country taxation of royalties ([36]). This is an approach not provided for in Art.12 of the OECD Model Convention itself, but which is followed by about half of the OECD Member countries and is therefore addressed in the Commentary to the OECD Model Convention on this article. Such an approach is premised upon the idea that the country of use of intellectual (including industrial) property has a right to tax profits from such use accruing to the intellectual property owner.

About independent personal services, article 14 has been deleted from the OECD Model Convention, and cases it dealt are now covered by a combination of articles 5 and 7. Instead, the UN Tax Committee recently decided to retain this article.

Italy follows almost completely the OECD approach in the allocation of income; the only rule more similar to the UN Model is that concerning the duration test for building sites that is of only 3 months (in UN Model the duration test is of six months) instead of the 12 months provided in the OECD Model.

In the early past, in Italy there have not been any cancellations or adjustments of tax treaties.

Moreover, there have not been cases of violation of the principle of equal treatment due to a different allocation of income generated through similar activities; in other words, the aim of a fair inter-state allocation never conflicted with a fair intra-state taxation of taxpayers.

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[35] Article 10 of the UN Model Tax Convention.
[36] Article 12 of the UN Model Convention.

2.7. The tax sparing credit

In order to help developing countries, Italy, as residence State, recognizes a credit for income taxes or for withholding taxes applied in the source State which in fact have never been withheld. This case is known as tax sparing credit or matching credit.

The article 23B of the OECD-MTC ([37]) allows the introduction in a conventional way of the tax sparing credit whose function is to maintain, for the subject resident in Italy, the exemptions enjoyed in the source State ([38]).

The clause is formulated in the following way: *"If, under the legislation of one of the Contracting State, taxes to which is applied the Convention are not levied, in whole or in part, for a limited time period, these taxes will be deemed fully paid to the effects of the application of the methods to avoid double taxations"*.

Normally, the tax sparing credit is granted for all income and without limitations, but often the clause is limited to some income categories and within certain maximum tax rates; the restrictive clause usually is formulated in the following way: "*When the tax on dividends, interest or royalties deriving from a Contracting State is not levied, in whole or in part, for a limited time period under the legislation of that Contracting State, this tax not levied in whole or in part is deemed paid for an amount not exceeding…per cent of the gross amount of dividends, interest and royalties"*.

[37] Article 23B of OECD Model, paragraph 2 states:

"*Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital"*.

[38] A. Dragonetti, V. Piacentini, A. Sfondrini, *Manuale di fiscalità internazionale*, cit., p.65.

3. *Business profits and other independent activities*

3.1. Permanent Establishment

The original notion of permanent establishment appeared as a series of examples of cases; the current notion of the Article 5 of the OECD-MTC represents, instead, an explicit definition with a particular articulation.

Doctrine and jurisprudence state that this disposition is composed by two parts, as two *species* of a only *genus*:

- the *material permanent establishment* (article 5, paragraphs 1 to 4);
- the *personal permanent establishment* (article 5, paragraphs 5 and 6).

The last paragraph (paragraph 7) rules a peculiar situation of exclusion ([39]).

The permanent establishment is characterized by three elements:

(a) objective elements, dealing the location of the installation business which is situated within the foreign State as a circumscribed place where all or part of business activity is carried on and whose essential character is the fixity;

(b) subjective elements, as the availability of the permanent establishment for the foreign enterprise or the temporal permanence;

(c) functional elements, as the functional relationship between the parent and the permanent establishment, which means that the installation is essential for the foreign enterprise as a way to carry on its business and it must be actually linked to the exercise of the foreign entity.

Article 5, paragraph 1 of OECD-MTC defines a permanent establishment as a fixed place of business through which the business of an enterprise is wholly or partly carried on. So, it is necessary to satisfy some conditions in order to suppose the existence of a permanent establishment:

(1) It is essential a place of business;
(2) the place of business must be fixed;
(3) the taxpayer must have the right to use this place of business;
(4) the use of the place of business must respect a minimum time period;
(5) the business activity must be carried on through that place of business.

[39] C. Garbarino, *Manuale di tassazione internazionale*, cit., p.301 e ss..

In this definition are included locals, tools, machinery used in the economical activity.

The paragraph 2 procures a list of examples, called “positive list”. Inside this list there are: a place of management; a branch; an office; a factory; a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources ([40]).

Under the article 5, paragraph 3 a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. Therefore, this paragraph extends, through a presumption, the scope of the general rule of the paragraph 1, as these construction or installation projects unlikely fulfill the general condition of the temporal and physical permanence. According to the Commentary of the OECD-MTC are included in the scope of this paragraph the following activities: construction of immovable property; construction and installation of roads, bridges, canals, oil pipelines; excavation and drilling activities; the final assembly of parts of movable property; all activities that are necessary to the completion of a construction; all demolition and disinvestment activities.

The article 5, paragraph 4 excludes from the definition of permanent establishment all preparatory and auxiliary activities that are identified with a “negative list”. The decisive parameter to recognize one of these activities is to value if the activity is or not an essential and significant part of the enterprise as an unique set.

Under the article 5, paragraph 5, an agent can constitute a permanent establishment, also denominated “personal permanent establishment”. There are some conditions:

(a) the agent must act on behalf of an enterprise;

(b) the agent has the power to conclude contracts and he habitually exercises this power.

The term “dependent agent” includes employees, other individuals and legal persons.

[40] A. Dragonetti, V. Piacentini, A. Sfondrini, *Manuale di fiscalità internazionale*, cit., p.75 e ss..

Under the article 5, paragraph 6 a broker, general commission agent or any other agent of an independent status is not included in the scope of paragraph 5. People with similar functions are considered dependents if they are not subject to the entrepreneurial risk.

The article 5, paragraph 7 specifies that if a parent owns the capital of a subsidiary, the latter cannot be considered *a priori* dependent by the first because substantial indices other than mere stock control are necessary to configure a controlled company as a permanent establishment.

The paragraph 7 presents the "anti-single entity clause", according to which it is recognized for tax purposes the legal autonomy of the subsidiary ([41]).

Conclusively, it is possible to underline that article 5 of OECD-MTC is internally coherent because it poses a positive rule and some exemplifications and then it identifies a negative definition that circumscribes the scope of the first one. It also includes a presumption in the paragraph 3 in order to extend the scope of the positive definition and, in the last paragraph, an exclusion that works also as a closing formula.

3.1.1. The permanent establishment in Italy

The necessity to adapt the fiscal rules to the fundamental principles of the EU law and to the obligations deriving from international treaties was at the basis of the fiscal reform approved in the 2003 with the Law 7 April 2003, no.80 and realized with the Legislative Decree 12 December 2003, no. 344. This reform introduced, for the first time in the domestic law, the definition of permanent establishment for the purposes of income taxes, borrowing it from the structure of the article 5 of the OECD-MTC, and it reformulated the discipline of the credit for taxes paid abroad in order to make this coherent with the tax consolidation and with the tax transparency.

The notion of material permanent establishment described by the paragraph 1 of the article 162 ITA is congruent with that of the article 5, paragraph 1 of OECD-MTC.

[41] C. Garbarino, *Manuale di tassazione internazionale*, cit., p. 339.

According to Italian legislature, a place of business can consist in every kind of building, facility or installation, also if it is situated in subsoil, used for carrying on business and also in a area, as a market or a customs area of deposit.

For the identification of a place of business it is not necessary the presence of the staff permanent assigned to it; a fixed place can be represented also by automatic machinery, as the vending machines and the gaming machines. Intangible assets and credit rights do not represent a place of business, as the availability of securities or bank accounts.

The article 162, paragraph 2 presents a non-exhaustive list of practical examples of permanent establishment. Every example can be seen isolated but always in function of the existence of the constitutive elements of the permanent establishment of paragraphs 1 and 3.

Italy, however, does not support the thesis under which the positive list must be read in conjunction with the paragraph 1 of article 5 of OECD-MTC, clarifying that these exemplifications can be always as hypothesis that, *a priori*, configure permanent establishments.

The article 162, paragraph 2 follows the paragraph 2 of article 5 of OECD-MTC with the exception of the letter f) that in the OECD version includes only "a mine, an oil or gas well, a quarry or any other place of extraction of natural resources", whereas in the formulation of the ITA it extends the territorial scope also to the areas outside the territorial waters in which the State may exercise rights with respect to the seabed, the subsoil and natural reserves.

The expression "place of management" covers all locals, infrastructures or installations used for carrying on industrial or commercial activities of the enterprise.

With the term "branch", non defined in the OECD Commentary, it is designated a segment of the enterprise, a part physically and territorially detached by the seat, with a certain economical and commercial independence.

The article 162, paragraph 3 saves to buildings a disposition ad hoc conforming to OECD-MTC and not to the Italian conventional praxis where buildings are mentioned in the positive list of the article 5, paragraph 2.

The article 162, paragraph 3 is more restrictive than the OECD-MTC, not only for the presence of a deadline (3 months) significantly lower to that of the OECD-MTC, but also for the circumstance that the Italian rule considers permanent establishment also the exercise of monitoring activities linked to the building.
The expression “building of construction or assembly or installation” includes not only the construction of real estate but also the construction of roads, bridges or canals, the renovation of real estate, roads, bridges or canals, the construction of pipeline or excavations and well drilling.
The setting of a deadline particularly reduced in order to identify a permanent establishment in Italy can be interpreted as a disposition to contrast abusive behaviors direct to use companies resident in tax havens with which Italy does not stipulate any treaty to exercise the activities of the article 162, paragraph 3.
The negative list of the article 162 is congruent with that of the article 5 of OECD-MTC. The activities contained in the negative list have the common characteristic of being preparatory and auxiliary activities. This character must be valued case by case both in qualitative and in quantitative terms.
About the use of the installation for the purpose of delivery of goods or merchandise of the enterprise referred to in subparagraph a), it is possible to mention the installations used exclusively for advertisement, for giving information, for scientific researches or for supervising to the execution of a contract related to a patent and know-how if these activities have preparatory and auxiliary character. A permanent establishment can be constituted where an enterprise owns a fixed place of business for the delivery of spare parts for the repair or the maintenance of machinery provided to the customers, because these activities go beyond the mere delivery.
The domestic notion of permanent establishment is different from the corresponding notion contained in the treaties because it provides for the non configurability of the material permanent establishment also in the case in which through it more activities with preparatory or auxiliary character are carried out. Unlikely from the OECD-MTC, the negative list does not seem to apply to the dependent agent of the article 162, paragraph 6 because this paragraph makes no express reference to the paragraph 4 and it excludes the existence of a personal

permanent establishment in the only case in which the dependent agent negotiates contracts other than those of purchase of goods.

The article 162, paragraph 5 relates a further hypothesis of exclusion in addition to those mentioned in the paragraph 4; indeed, the availability of computers and related auxiliary facilities that allow the collection and the communication of data and information oriented to the trade of goods and services.

The article 162, paragraph 6 adopts in a shorter form the paragraph 5 of the OECD-MTC except for the last part; while the OECD-MTC denies the qualification of permanent establishment when its activities are limited to those with preparatory and auxiliary character, the last part of the article 162, paragraph 6 is referred only to the contracts relating to the purchase of goods and not to contracts relating to all the other preparatory and auxiliary activities.

The article 162, paragraph 6 and 7, draws the notion of personal permanent establishment that is different from the material permanent establishment because this latter is characterized by a fixed place of business, whereas in the first this requisite is missing. The two types of permanent establishment are in an alternative relationship, since the existence of the prerequisites for the first makes not necessary to verify the existence of the second.

The personal permanent establishment makes a distinction between the dependent agent and the independent agent. The dependence of the agent from his assignor must be valued both from the legal and economical point of view. The independence of a person toward the enterprise that he represents is verified depending on the extent of the obligations that he takes on toward the enterprise. If the industrial and the economical activities that he exercises on behalf of the enterprise are subject to detailed instructions and to a general control, this person cannot be considered independent from the enterprise.

Another important parameter is to determine if the risk of the entrepreneur must be borne by the person or by the enterprise that this represents.

There is a personal permanent establishment if a subject, resident or not, habitually concludes in Italy on behalf of the foreign enterprise contracts other than those for the purchase of goods.

About the authority to conclude contracts, the Court of Cassation, in the judgment no.3368/02, established that "this authority, according to the Commentary OECD, should not be understood in the meaning of a direct representation, but it includes also all these activities that have contributed to the conclusion of contracts, even if they have been concluded in the name of the company" ([42]). In the same judgment, the Court underlines that the split-up of business responsibilities on the hand and legal authority on the other can be considered as tax circumvention.

So, for the application of the paragraph 5, the substance should be considered prevailing over the form.

In other words, the assessment of the authority to conclude contracts must be reported to the economic reality and not to the civil law, and the same may relate to the individual phases, as the negotiations, and it does not necessarily include the authority to negotiate the contract.

When the business of a non resident enterprise is carried on in Italy by a broker, general commission agent or any other agent of an independent status, there is not a permanent establishment if the agent acts in his ordinary activity. In establishing if certain activities are included or not in the ordinary activity of an agent, it is necessary to put himself in the perspective of the same agent and not in that of the economical sector to which he belongs; whereas in the OECD Commentary, it is established that for the assessment of the ordinary nature of an agent it is required to consider the activities usually carried on in the industrial and economical of the agent as broker, general commission agent or any other agent of an independent status rather than the other activities carried on by the same.

The article 162 provides for a definition of personal permanent establishment according to which the negotiation activity carried on by the dependent agent on behalf of the foreign enterprise seems to represent a personal permanent establishment also when it is related to activity with preparatory and auxiliary activities; this because the only excluded activity is that concerning the purchase of goods.

The article 162, paragraph 8 has the purpose to exclude the qualification of personal permanent establishment also when the broker or the ship's agent act

[42] M. Piazza, *Guida alla fiscalità internazionale*, ed. *Il Sole-24Ore* , 2004, p.237.

outside their ordinary activity taking care of the commercial and operational management of the ships of the foreign shipping enterprise.

The final result is identical to that reached by the conventional rule; the article 8 of the OECD-MTC, indeed, limits the fiscal power of the Source State, when the permanent establishment exists, allocating the exclusive taxation to the State where the place of effective management of the enterprise is situated.

About owner relationships referred to in article 162, paragraph 9, it is generally recognized that the existence of a subsidiary does not implies that the same constitutes of itself a permanent establishment of the parent. This conclusion derives from the principle according to which, on the fiscal point of view, this subsidiary constitutes an independent legal entity. Also the fact that the subsidiary's activity is managed by the parent does not involve that the subsidiary is a parent's permanent establishment.

Moreover, in the Philip Morris case, the Court of Cassation stated that "a corporation resident in Italy can assume the role of a multiple permanent establishment of companies of foreign companies belonging to the same group and following an united strategy" ([43]). In this case, the reconstruction of the activity of the domestic company, in order to value if it is or not a preparatory or auxiliary activity, must be unitary and related to the plan of the group considered in an unitary way.

Particularly, in the grounds of the judgments ([44]) relating to this case, the Court established that, "although the group is not, in the current moment of the Italian law, global reference center of legal relationships, also in terms of tax law, it is necessary, however, to consider that one or more group's companies can exercise a management activity through a structure operating in the source State, as an integral part of a broader program referred to the same group".

The Court of Cassation further explains that, even if the judgment is carried out in respect of only two companies in the group, "the synergies of the various companies, to which the national structure refers, cannot to not be considered

[43] S. Guglielmi, *Il caso "Philip Morris"nelle recenti modifiche al Commentario OCSE,* in *Fiscalità internazionale*, 2006, p.150.

[44] Sent. Cass. Civile, sez. Tributaria, 07-03-2002, n.3367 e 3368; Sent. Cass. Civile, sez. Tributaria, 25-07-2002, n.10925; Sent. Cass. Civile, sez. Tributaria 25-05-2002, n.7682.

unitarily, and, therefore, it is an undue division of the phenomenon the non-use of all the evidence which, while not concerning the individual relationship between each company and the national serving structure, helps to verify the existence of a functional relationship of dependence in relation to a program to which the various group's companies contribute".

According to the Court, it is configurable not only the notion of subsidiary reclassified as permanent establishment of a single parent company, but also the notion of subsidiary reclassified as multiple permanent establishment with reference to more than one group's companies globally understood, each of which would dispose *pro parte* of a permanent establishment within the indirectly or effectively controlled Italian company ([45]).

Recently, the jurisprudence of the Court of Cassation on the permanent establishment has stated that the scrutiny of the requisites of the stable centre of activity or of the permanent establishment must be made not only on the formal plan but also on the substantial one.

A permanent establishment may be constituted also by an entity with a legal personality to which is committed the care of business by a foreign company; in this case the purpose of the group policy understood as unitary or the participation to negotiation or stipulation of contracts can be relevant.

In order to value the presence of a permanent establishment in Italy, the consideration of the activities carried on concretely by the Italian company assumes relevant preeminence, beyond those activities constituting the formal social object.

In the Circular 04/6799, the Italian Court of Cassation has clarified that a permanent establishment can be constituted also by an organized structure of means and people depending by the non-resident.

3.2. Methods of apportioning income to a permanent establishment

With the fiscal reform approved in the 2003 with the Law 7 April 2003, no.80 and realized with the Legislative Decree 12 December 2003, no. 344, the

[45] C. Garbarino, *Manuale di tassazione internazionale*, cit., p. 343.

legislator has lost the occasion to introduce specific rules about the determination of the permanent establishment's income.

The ITA, in the article 151, has only reaffirmed the principle of territoriality, under which for the non-resident companies and commercial entities the total income to subject to taxation is composed exclusively by income considered as produced within the State, with the only exception of the exempt income and of those subject to a withholding tax or to substitute tax.

The following article 152 ITA states that, in the presence of an Italian permanent establishment, the total income of a non resident is determined under the rules related to the determination of the corporate income tax (IRES) ([46]).

3.2.1. The tax base of an Italian permanent establishment of a non-resident

The article 14, paragraph 5, of the D.P.R. no. 600/1973, establishes that the resident companies that exercise commercial activities abroad through a permanent establishment and the non-resident companies that exercise commercial activities in Italy through a permanent establishment must notice in the bookkeeping, separately, the management events that concern the permanent establishment determining separately the profit for the year related to each of them. Function of this disposition is to allow the determination of the profits related to the single permanent establishment.

According to the Court of Cassation ([47]), the article 14 of D.P.R. no.600/1973 affirms that the permanent establishment's income must be calculated, although some exceptions, applying the "direct method". Under this method, it is opportune to consider the permanent establishment as a separated economic entity and to apply to the internal transfers between the different unities of the same enterprise the same treatment provided for transfers with third parties.

This principle is coherent, in the international area, with the approval by the Committee on Fiscal Affairs of the OCSE of the "Report on the Attribution of Profits to Permanent Establishments". The Report, after identifying the main methods to determine income of a permanent establishment, concludes that the

[46] E. Cacciapuoti, *I rapporti tra casa madre e stabile organizzazione: tra valore di mercato e costo storico*, in *Rass.Trib.*, 2010, I, p.173 e ss..

[47] Court of Cassation, judgment 23 maggio 2002 no.7554.

"functionally separate entity approach" is the most suitable method for reaching the purposes of the OECD-MTC. Under this perspective, the permanent establishment should achieve an income at market value to exercise its functions, taking in account the used goods and the undertaken risks, as an independent enterprise comparable to it.

3.2.2. Transfers of goods and services with the permanent establishment

It is necessary to value also if the rules disciplining the determination of the transfer prices within the same group are applicable to the transactions dealing the permanent establishment.

Article 110, paragraph 7 ITA establishes that "income elements deriving from operations with companies resident within the State, that directly or indirectly control the enterprise, are controlled by it or by the same company controlling the enterprise, are valued on the basis of the normal value of the given goods and the services provided and the received goods and services, determined in accordance with paragraph 2, if derives an increase in income".

There are no doubts about the application of this rule to the transactions existing between the Italian permanent establishment and the other unities of the same company abroad. In effect, the concept of enterprise extends the scope of the rule to partnerships, individual companies and permanent establishments.

Also the Italian financial Administration has clarified ([48]) that the concept of "Italian enterprise" must be interpreted in an extensive way, including therefore also the permanent establishments of foreign companies. In accordance with the legislation about transfer prices, the transactions between an Italian permanent establishment and the other unities of the same foreign enterprise should be value on the basis of the "normal value" of the given good or of the provided services. This principle should be adopted both with the goods transferred and services provided by a permanent establishment in Italy to other unities of the same enterprise situated abroad and with goods transferred or services provided to an Italian permanent establishment by another unity of the non-resident enterprise to

[48] Circular 22 September 1980 no. 32/9/2267.

which belongs. In other words, when a good is transferred to an Italian permanent establishment, the fiscal value of the same good should be determined on the basis of the "market value".

This conclusion is coherent with the rules included in the article 110, paragraph 7, ITA, about intercompany transfer prices. It is a principle of general character, under which only income concretely produced by the permanent establishment should be ascribed to this latter, excluding the hidden surplus values or revenues not yet realized, generated before that the good can be considered concretely lined to the same permanent establishment.

3.2.3. The allocation of overheads through "indirect methods"

The Italian law considers the permanent establishment as a separate and distinct economic entity. As a consequence it comes that the determination of the permanent establishment's income must be made following an analytical criterion that consider all elements of income specifically attributed to the same entity.

In some cases it is not possible to make this analytical allocation because the elements of income are not susceptible of direct imputation. It is the situation of the management expenses. These expenses are generally represented by general costs of administration and of direction that relate the activity of the whole enterprise and, consequently, the activity of its permanent establishment ([49]). For their nature, it is difficult to attribute these expenses in an analytical way to the single enterprise's unities.

Law and administrative practice overcome this problem through the application of standard methodologies for the attribution of costs.

The Court of Cassation ([50]) recognized as adequate the method used by an Italian branch, based on a proportional distribution of expenses through which was attributed to every branch the share of overhead costs according to the ratio between the sales commissioned to every of them and the total sales of the company.

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[49] E. Cacciapuoti, *I rapporti tra casa madre e stabile organizzazione: tra valore di mercato e costo storico*, cit., p.178 e ss..

[50] Court of Cassation, judgment 1 August 2000, no. 10062.

The Italian tax authority ([51]) clarified that the impossibility of attributing management costs specifically to the single enterprise's unities makes necessary to resort to allocation methods based on parameters considering the peculiarities of the activity carried on or of significant accounting elements in accordance to the typology of the controlled company.

3.2.4. The Authorized OECD Approach

The AOA approach is introduced by the OECD to align the rules for business profits under tax treaties with those of the arms length principle of Art. 9 of the OECD and the OECD Transfer Pricing Guidelines.

Under the AOA the profit allocation to a PE is based on the following principles:

1) the PE is a separate enterprise engaged in the same or similar activities;

2) the PE is independent from the rest of the enterprise of which it is a part and any other legal person, which means that its profits must be determined by means of the arm's length principle.

Under the AOA approach, the profit allocation between the PE and the head office will be calculated in two steps.

Under the first step a functional and factual analysis must be executed in which the significant people functions of the PE must be determined, i.e. the functions which the employees of the PE actually carry out compared to the rest of the enterprise and the related responsibilities. Based on this analysis, the assets needed to perform those activities and the related risks must be attributed to the PE.

Under the second step, the dealings between the PE and its head office must be determined with the arm's length transfer prices.

This calculation will be carried on by reference to the functions performed, assets used and risks assumed by the hypothesized head office and PE enterprises.

Under the first step of the AOA, the Significant People Functions ("SPF") must be determined**.**

[51] Circular 21 October 1997, no.271/E.

The AOA attributes to the PE those risks for which the significant functions relevant to the assumption and/or management of risks are performed by people in the PE and also attributes to the PE the economic ownership of assets for which the significant functions are performed by people of the PE.

Depending on the functions performed by the PE the risk could, inter alia, be of a financial and/or operational character. Examples could be direct business risk, inventory risk, credit risk, currency risk, interest rate risk, market risk, product liability, warranty risks, regulatory risk etc.

In line with paragraph 1.52 of the OECD Transfer Pricing Guidelines the division of risks and responsibilities within the enterprise must be deduced from the conduct between the head office and the PE and the economic principles that generally govern relationships between independent enterprises. Relevant factors are the internal practices of the enterprise, such as compensation arrangements and documentation on the allocation of risks between the head office and the PE.

Under the first step of the AOA and the functional and factual analysis, a contribution of “free capital”, i.e. funding of the PE that does not give rise to a tax deductible item in the nature of interest, must be determined. Several methods have been outlined in the Report regarding the proper allocation of free capital to the PE. In the same perspective different methods are available to allocate arm’s length interest and other funding expenses to the PE. The OECD report first mentions the “capital allocation method” under which capital is allocated on the basis of the proportion of assets and risks attributed to the PE by the functional analysis. The application of this method may be problematic if the activities of the PE differ substantially from those of the head office, when the market conditions in the PE country are very different or when the enterprise is thinly capitalized. For that reason a second method, called the “thin capitalization method” is mentioned, under which a PE should have the same amount of free capital as an independent enterprise carrying on similar activities under similar conditions.

With respect to funding expenses a distinction is made between a tracing method and the fungibility method. Under a pure tracing method all internal movements of funds provided to a PE are traced back to the original provision of funds by third parties. Under a pure fungibility approach, money borrowed by a PE of an enterprise is presumed to contribute to the whole enterprise‘s funding needs. A portion of the whole enterprise's actual interest expense paid to third parties on some pre-determined basis is allocated to each PE.

As second step, the profits of the PE must be determined by means of accepted transfer pricing methods mentioned in the OECD Transfer pricing Guidelines, such as the Comparable Uncontrolled Price Method and the Resale Minus method. In line with the OECD Guidelines a comparable price or profit must be determined by means of the following factors: characteristics of property or services, functional analysis, contractual terms, economic circumstances, and business strategies.

The AOA is not implemented yet in the double tax treaties stipulated by Italy. It may be that in the next future this new approach will be possible read in the Italian treaty policy.

3.2.5. Method of formulary apportionment

The global formulary apportionment is defines as "An approach to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined formula". This method is though considered in contrast with the principle of free competition. It, moreover, may cause events of double taxation that probably are not solvable. For this reason it has never been used in international transaction.

3.3. Income from employment

The OECD-MTC presents different rules disciplining the different types of income from employment. The Convention dedicates to directors' fees an appropriate rule, the article 16 that establishes that "directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State". Therefore from this rule arises the recognition of the primary right to the taxation to the source State also if in this last State there was not materially the payment of the fee, resulting relevant only that the supplying company results beneficiary of the directors' activities and excluding the necessity that activity is carried on within the residence State's company. The derogatory nature of this discipline arises *per tabulas* reading the paragraph 2 of the Commentary to the article 16, under which "it is clear that the article is not applicable to the remuneration paid to these subjects related to other functions" that the same people can carry on in favor of the same subject, such as those of ordinary employee or of the consultant or adviser. The justifying reason of the specific treatment of the fees received by the members of the Board of directors or of the Board of Auditors or by the accounting auditor is represented by the necessity that the residence State of the company paying fees and receiving the relative performance, can tax them as percipient's income ([52]). In this way the residence State of the beneficiary company sees as equilibrate the tax reduction of the company supplying the fee to the director (reduction due to the deduction of this from the taxable income's company) with the subjection to taxation of the fee in determining of business income. The taxation principle in the source State is based on the presumption that the management performance of a company by a subject resident in a State other than where the company is registered, is deemed to carry out in this latter State.

Instead, artistes and sportsmen income is usually income having the source in a certain State but perceived and economically attributed to an individual resident in a State other than the source State, that is the residence State's recipient. The localization criterion of artistes and sportsmen cross-border income is generally univocal and it is the place where the artistic or athletic activity generating this income is carried on. The positive law adopts the criterion of the place of the artistic and athletic performance. On the basis of these considerations article 17 of OECD-MTC adopts, about income that a resident in a Contracting State, as an artist or a sportsman, gains from his personal activities carried on in the other Contracting State, the criterion of the personal activities as criterion for the attribution of the concurrent tax power of the source State and the residence State of the earner. This criterion is also adopted for the income related to personal

[52] C. Sacchetto, L. Perrone, E. Della Valle, V. Uckmar, *La mobilità transnazionale del lavoratore dipendente. Profili tributari.*, Padova, 2006, p.119 e ss..

performance of artistes and sportsmen paid not directly to them but to another person.

The most important economical aspect of these income is that they, for their same nature, are subject to the source State's fiscal policy, therefore usually artistes and sportsmen's assets are held through companies or trusts in order to reduce the impact of the taxation toward the subject carrying out the artistic or athletic activity ([53]).

About pensions, the OECD-MTC provides for two dispositions depending on the subject toward the work that originated pension is carried on. If this work performance was rendered to the State or subdivision or authority, the article 19, paragraph 2 will be applied (public pension); in all other cases the general rule of article 18 will be applicable (private pension). Under this latter rule, "subject to the provisions of paragraph 2 of Article 19, 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 the conventional field, the conflict between concurrent tax power of the two Contracting States about foreign private pension is solved in favor of the residence State of the beneficiary.

The private pension perceived by the individual resident in Italy will be taxable only in our State if they come from States with which was signed a double tax convention ([54]). In some bilateral agreements, the exclusive taxation in the residence State of the beneficiary is however subject to the failure to pass certain thresholds, over which the foreign private pension becomes taxable in both Contracting States. In other specific agreements, such as the double tax Convention signed with Denmark, the concurrent tax power of the foreign source State is instead subject to the circumstance that the beneficiary resident in Italy beforehand lived for a minimum time period in the foreign source State and that the same has the nationality of this foreign State and not also the Italian. Other times, it is established that pension is taxed in the source State if the same is excluded from taxation in the residence State of the beneficiary.

[53] Garbarino, *Manuale di tassazione internazionale*, cit., p. 593.

[54] C. Sacchetto, L. Perrone, E. Della Valle, V. Uckmar, *La mobilità transnazionale del lavoratore dipendente. Profili tributari.*, cit., p.193 e ss..

Some conventions provide for peculiar sourcing rules. It is the same Commentary on the OECD-MTC to suggest similar opportunities, giving to the free initiative of the Contracting States the possibility to agree about the insertion of an additional paragraph in the article 18 in order to recognize to the source State (the State delivering payments) the chance to exercise its tax power on the treatments of social security.

About public pension (government service) ([55]), their distinctive characteristic compared to private ones is in their origin. It is possible to define, indeed, public pension only that paid for services rendered to the State or subdivision or authority. The conventional tax system chosen for this pension is opposed to that provided for the private one, being established its exclusive taxation in the State supplying payments. This criterion is applicable as long as the residence State and the nationality of the beneficiary do not correspond, having on the contrary attributing the right of exclusive taxation to the residence State.

So it is possible to say that foreign public pension perceived by individuals resident in Italy may be taxable exclusively in our State only when the beneficiary has also the Italian nationality. If there is not this latter condition, the pension will remain excluded from taxation in Italy and may be taxed only in the foreign source State. There are also bilateral agreements in which the condition of nationality is more strict, asking in order to tax pension exclusively in Italy, that the Italian beneficiary has contextually the Italian nationality and not that of the foreign source State. In sporadic episodes, this condition acts in a less severe way, being sufficient in order to tax the pension exclusively in Italy that the Italian beneficiary has not the nationality of the foreign source State. Italy treaty policy follows these concepts and until now there were never problems with respect domestic tax law or constitutional tax law.

An example of double tax convention including special rules dealing with income from private pension schemes is that concluded by Italy with U.S.. This

[55] Article 19, paragraph 2 of OECD-MTC states:

"a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State". " b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State".

Convention seems very significant because under the paragraph 6 of article 18 ([56]), it is recognized by a resident of a Contracting State who works in the other Contracting State the deductibility of the contributions paid by the employee to pension plans existing in the Contracting State of origin of the same employee. Contributions paid by the employer are deductible from the taxable income of the residence State. It is also clear that the share of deductible contributions is fixed at a non-discriminatory measure, so that the non-resident may deduct contributions to the same extent provided for a resident. It also provided that the amount charged to the employer is deductible from employer's income in the State where employee carries out his activity. It is the case of an individual resident in Italy who works in the U.S.; he, if enrolled in an Italian pension plan may deduct from his income taxable in the U.S. contributions paid to this pension plan to the same extent provided for American workers and the employer may deduct from American income the contributions to its load ([57]). The recognition of the deductibility of contributions is subject to two conditions. First, contributions have to be paid "before the arrival of that person in the other State": this provision means that it is necessary that worker is already a member of supplementary pension scheme of the State of which he is resident before starting work in the other State. Continuing the example it is necessary that Italian worker belongs to an Italian pension scheme. Secondly, this scheme is allowed provided that the

[56] Article 18, paragraph 6 states:

"For the purposes of this Convention, when an individual, who participates in a pension plan established and approved in accordance with the legislation of one of the Contracting States, carries on a business in the other Contracting State:

(a) contributions paid to the pension plan by or on behalf of the individual during the period in which the person carries on this activity in the other State are deductible (or vulnerable to exclusion) from the calculation of its taxable income in that State. The amounts accrued in accordance with the pension plan or payments made to the pension plan by or on behalf of his employer during that period are not considered as part of the employee's taxable income and shall be allowed as deduction in computing of the employer's profits in that other State;

(b) The provisions of this paragraph are applied only if:

(i) contributions paid by or on behalf of the individual for the pension plan (or other similar plan that has replaced the first) have been paid before the arrival of that person in the other State;

(ii) the competent authority of the other State has approved that the pension plan corresponds in general to a pension plan recognized for tax purposes by that State.

The amounts paid pursuant to this paragraph may not exceed the amounts which would have been recognized by the other State to its residents in relation to contributions paid, or amounts otherwise accrued under a pension plan recognized for tax purposes by that State."

[57] F. Rasi, *I profili internazionali della previdenza complementare*, in archivioceradi.luiss.it, 2012, p.23.

payment is made to pension plans recognized by the other State. In other words, it is indispensable that the pension plan of the worker's residence State has been recognized by the competent authorities of the State where worker performances his activity. In the case above mentioned, the Italian pension plan should get a recognition from the American authorities.

3.3.1. Differences between the OECD-MTC and the UN-MTC

About differences between the two MTC, the UN Model Convention, as compared to the OECD Model Convention, extends the scope of the article 16 by including both directors and "high level managers". This is based on the principle that where a top level managerial position of a company resident in a Contracting State is occupied by a resident of the other Contracting State, the remuneration paid to that official should be subject to the same principle as director's fees. The term "top-level managerial position" in this respect refers to a limited group of positions that involve primary responsibility for the general direction of the affairs of the company, apart from the activities of the directors. Article 18 of the UN Model Convention provides for two alternatives. Article 18A, like article 18 of the OECD Model Convention, assigns to the residence State the exclusive right to tax pensions and other similar remuneration, but it departs from the OECD article by granting to the source State of the pension the exclusive right to tax when the payments involved are made within the framework of a public scheme which is a part of the social security system of that State or political subdivision or a local authority thereof. The alternative provision in the UN Model Convention, article 18B, provides for a sharing between the residence State and the source State of the right to tax pensions and other similar remuneration when the payments involved are not made within the framework of a public scheme which is part of the social security system of a State or a political subdivision or a local authority thereof. In the case where payments are made within the framework of a such public scheme, the right to tax belongs only to the source State ([58]).

[58] Michael Lennard, *The UN Model Tax Convention as compared with the OECD Model Tax Convention-Current Points of Difference and Recent Developments*, cit., p.9.

Article 17 of the UN-MTC reproduces article 17 of the OECD-MTC with one modification. Instead of the word "sportsman" used in the OECD-MTC (in place of "athlete" earlier used in both the UN and the OECD Model Conventions), it has been decided to use the gender neutral word "sportsperson", which unlike the term "entertainer" was not followed in paragraph 1 by illustrative examples but is nevertheless likewise to be construed in a broad manner consistent with the spirit and the purpose of the article.

About article 19, in 2011 the Committee of experts made some changes in the same. Firstly the words "other than a pension" were deleted in paragraph 1. Secondly, the words "Notwithstanding the provisions of paragraph 1" were added in paragraph 2. Thirdly, in paragraphs 2 and 3, the word "pension" was replaced by the words "pensions and other similar remuneration". As a result, article 19 of the UN Model Convention reproduces article 19 of the OECD Model Convention.

3.3.2. Frontier Commuter

It is not possible to find a univocal definition of frontier commuter both in the international law and in the EU law. The term "frontier commuter" identifies different cases having different purposes. A first definition originating by EU law is in the article 1, letter b), of the regulation CEE no.1408/71 of the 14 June of 1971, concerning social security. Under this rule the term "frontier commuter" indicates any worker occupied within a member State and resident in another member State where he returns every day or at least once a week. However, frontier commuter, who is detached from the enterprise by which he depends, maintains this qualification for a period not exceeding four months also if, during this detachment, cannot return every day or once a week to the place where he lives. This definition is applicable, however, only for the social security purposes within UE. When a worker lives or carries on his own work in a non-UE member State it is necessary to refer to any international agreements. It is the case of Swiss Confederation that concluded, in 2002, an Agreement on the free movement of people with the EU and its member States. Under article 28 of the attachment I of the Agreement, the frontier commuter is a citizen of a Contracting Party having his regular main domicile in border areas of Switzerland or of neighboring countries, exercising a paid employment in border areas of the other Contracting Party and returning to his main own residence every day or at least once a week ([59]). This definition, giving relevance to the time criterion of the daily or weekly return to home, is substantially similar to that contained in EU regulation, with the only difference that this Agreement specifies that border areas are those defined as such by the agreements concluded between Switzerland and neighboring countries.

About tax law, the notion of frontier commuter is deduced from the provisions contained in the bilateral double tax conventions stipulated between adjacent or neighboring States. Generally these conventions establish more restrictive conditions for the qualification of the work as border. It is often required another condition having territorial character, under which the residence or the workplace must be located in a border area in strict sense.

About domestic law, the definition is contained in article 38, paragraph 1 of the Law no. 146/1998, in the article 3, paragraph 2 of the Law no. 388/2000 and in the article 2, paragraph 11 of the Law no. 289/2002. The first provision refers to "income from work performed in border areas and in other neighboring States by residents within the State"; the second and the third provisions deal with "employee performed, on an ongoing basis and as the exclusive purpose of the employment, abroad in border areas or in other neighboring countries, by residents within the State". The Italian tax authority ([60]), interpreting these rules, affirmed that the same are applied exclusively to employees resident in Italy who daily go abroad to carry on their work. This interpretation is very strict because limits considerably the scope of the definition, excluding all workers who do not cross daily the border. This restriction, therefore, does not appear either in EU legislation or in international conventions concluded by Italy.

Currently, in Italy, for income from work performed abroad and for cross-border income the relevant rule is the article 51, paragraph 8-bis ITA. Under this provision, notwithstanding the ordinary rules about determination of the income

[59] C. Sacchetto, L. Perrone, E. Della Valle, V. Uckmar, *La mobilità transnazionale del lavoratore dipendente. Profili tributari.*, cit., p.73 e ss..

[60] Circular 3 January 2001, no.1/E, in *Boll. Trib.*, 2001, 107, confirmed by the Circulars of 1 February 2002, no.15/E, *Boll. Trib.*, 2002, 277 and of 15 January 2003, no.2/E, in *Il fisco*, 2003, 2, 453.

employment, when this is performed abroad on an ongoing basis and as an exclusive object of the employment by employees staying, in a period of twelve months, in the foreign State for a period exceeding 183 days, the same is determined on the basis of conventional retribution defined annually with decree of the Minister of Labor, in concert with that of Economics (cross-border workers).

The paragraph 10 of the article 165 ITA establishes that, when the foreign income contributes partially to form the total income, the foreign deductible tax must be reduced by a corresponding amount.

According to the resolution no. 48/E/2013, this provision is applied also when income derived by employment performed abroad on an ongoing basis and as an exclusive object of the same employment referred to in article 51, paragraph 8-bis ITA.

Indeed, article 36, paragraph 30, of the Law Decree 4 July 2006, no. 223, converted by Law 4 August 2006, no.248, introduced an authentic interpretation rule under which in the case of income calculated conventionally in a limited extent, according to the provisions of article 51 paragraph 8-bis ITA, the resident employee benefits, for taxes paid abroad, from a tax credit not full but proportional to foreign income contributing to form its total income.

So, for the determination of the tax credit referred to in article 165 ITA, the taxes paid abroad outright should be reduced proportionally to the ratio between the conventional salary determined in accordance with article 51 paragraph 8-bis ITA and the employment income that would be taxable in the ordinary way, and not in the conventional measure, in Italy.

If, instead, the employee performs his work abroad for a period of less than 183 days the taxable income is that actually perceived (frontier commuters).

In this case, article 1, paragraph 175 of Law no.147/2013 proposes the income tax exemption for frontier commuters; indeed, with effect from 1 January 2014, the employment income performed abroad, in the border area or in other neighboring countries to the national territory, on an ongoing basis and as an exclusive object of the employment, by individuals resident within the Italian State, contribute to form the total income for the amount exceeding 6.700 euro.

Unlike previous provisions on the subject, the new rule extends *a regime* the exemption for such individuals.
Most of the Conventions concluded by Italy accepts the OECD-MTC, whose article 15, paragraph 1, while establishing the principle of taxation in the residence State, however it provides for the possibility of taxation also in the State where the employee is performed, if different from the first. In this latter case, the double taxation will be contrasted with the recourse by the residence State to the exemption method or to credit method.
In Italy the usual method is to grant a credit for taxes paid abroad, corresponding to that of article 165 ITA. However, in order to not penalize excessively situations characterized by short stays abroad, the article 15, paragraph 2 of the OECD-MTC provides for exceptions to the general rule, attributing in some cases the tax power exclusively to the residence State.
Some conventions stipulated by Italy, specifically those with Austria, France and Switzerland have a peculiar discipline for income perceived by frontier commuter. Moreover, therefore there are not conventions concluded with Principality of Monaco and San Marino, the frontier commuter's income will be taxed in accordance the domestic law, with the possibility to avail of the credit for taxes paid abroad.
About conventions with Austria and France, these attribute an exclusive tax power in favor of the residence State of the frontier commuter.
About Switzerland, article 15 of the related Convention refers to the Agreement related to the taxation of frontier commuters of the 1974, that at article 1 provides for the taxation of the frontier commuter exclusively in the State where the activity is carried on. Moreover, each of the Swiss Cantons of Grisons, of Ticino and of Valais, under article 2 of the Agreement, has to pay annually a part of the tax revenue deriving from the taxation of remunerations of Italian frontier commuters for the benefit of Italian border municipalities.
About the fiscal treatment of employment income produced by Italian frontier commuters State of Vatican City, the rule applicable is article 3 of the D.P.R. no.601/1973. This rule exempts from IRPEF the remunerations paid by the Holy See, by other central agencies of the catholic Church and by entities managed

directly by the Holy See. If, instead, the remuneration is paid by other employers different from those identified by the rule the related income is subject to the fiscal treatment provided for by the domestic law for the others frontier commuters.

3.4. Dividends, interest, royalties in the OECD-MTC

Distribution rules about dividends, interest and royalties pursuing the elimination of double taxation, arising when the taxpayer has an economic attachment to one State and a personal attachment to another. In other words, the person derives income from one State but he is resident in another State. The structure of the provisions of OECD-MTC related to the taxation of dividends, interest and royalties is very similar. These rules, together with those concerning the permanent establishment and the taxation of business profits, represent the most relevant part of the treaty. All the three rules attribute, in order to reach the purpose aforesaid, the tax power to the residence State of the perceiver or of the beneficial owner, providing for a limited tax right of the source State. The three categories should be treated equally because they represent capital income, deriving from the participation in companies or entities or from loans and in general from every report having as object the use of the capital; they present the same dynamics and the same problems, so it is opportune to establish the same or at least a similar treatment of these income categories.

3.4.1. Peculiarities of the Conventions signed by Italy

Usually, the criteria for allocating income provided in double tax conventions concluded by Italy are identical to the criteria used in the OECD-MTC. However, in some cases, there are some deviations or peculiarities from the model.

About dividends, conventions concluded by Italy show some differences referred to maximum percentage of the gross amount of the taxable dividends in the source State. Conventions signed with Germany, Luxembourg, Belgium, Ireland, Switzerland, Austria, Spain, Portugal do not include any distinction about existence of a qualified or less participation in the company paying dividends.

These Conventions contain only the clause under which the withholding tax, according to the relative internal discipline, shall be granted up to a maximum of 15% of the gross amount of dividends ([61]). This limitation falls when there is the mere presence of the permanent establishment of the recipient in the State of origin of the dividend.

The bilateral Convention against double taxation between Italy and Switzerland contains the so-called "absolute reserve" on the power of taxation of the source State in an amount not exceeding the 15% of the gross one. In the case of the mere presence of permanent establishment in Italy of the Swiss company percipient the dividend, this one becomes taxable by Italy according to Italian law.

"Mere presence" means the simultaneous possession of a fixed place in Italy and of a holding in an Italian corporation by the Swiss company. In this case, dividend is not considered attracted to the permanent establishment and it is levied with a withholding tax in Italy according to Italian legislation.

Most of the other conventions, instead, present a "relative clause" under which the holding must be linked actually to the permanent establishment, so that the source State is not limited in its power to tax.

About interest, the percentage subject to the source State's taxation varies in the single Conventions concluded by Italy, representing an element of distinction among the same ones. The main Conventions add a third paragraph, not included in the OECD-MTC, which admits taxation exclusively in the residence State of the percipient of two categories of interest:

(a) interest deriving from credit sales;
(b) interest paid by the State or by its subdivisions.

Treaties concluded with Germany, Denmark, France and the United Kingdom provide for the exemption in the source State for both categories.

Another peculiarity concerns treaty stipulated between Italy and United Kingdom, because it adds two paragraphs to article 11, limiting the use of the Convention for abusive purposes. The paragraph 9 of article 11 does not admit the application of this article when the debt-claim has not been formed or otherwise assigned, in

[61] A. Dragonetti, V. Piacentini, A. Sfondrini, *Manuale di fiscalità internazionale*, cit., p.430 e ss..

bona fide, for commercial reasons, but essentially to benefit of the Convention. Paragraph 10 of article 11 provides that tax reductions of the paragraphs 2,3 and 4 of the same article are not admitted when the beneficial owner has an exemption on such income in his residence State and he sells the participation producing interest within three months from the date of purchase of the same.

About royalties, only the provisions of the Convention between Italy and Austria are identical to that of the OECD-MTC, because the percipient must be the beneficial owner, so that royalties are exclusively taxable in the residence State. Other Conventions merely provide that royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable in that other State. About withholding tax rates provided by the double tax convention concluded by Italy, the amount of the tax rate does not depend on the classification of the other Contracting State but on the discretionary agreements among States, without considering any distinction between developed and developing countries.

3.5. Immovable property

Distribution rules about income from immovable property are two, article 6 and article 13.

About article 6, paragraph 1, it gives the right to tax income from immobile property to the source State, that is, the State in which the property producing such income is situated. This is due to the fact that there is always a very close economic connection between the source of this income and the source State. Although income from agriculture or forestry is included in article 6, Contracting States are free to agree in their bilateral conventions to treat such income under article 7. Article 6 deals only with income which resident of a Contracting State derives from immovable property situated in the other Contracting State.

Defining the concept of immovable property by reference to the law of the State in which property is situated, as is provided in paragraph 2, will help to avoid difficulties of interpretation over the question whether an asset or a right is to be regarded as immovable property or not. The paragraph, however, specifically mention the assets and rights which must always be regarded as immovable property. In fact, such assets and rights are already treated as immovable property according to the laws or the taxation rules of most OECD member countries.

Conversely, the paragraph stipulates that ships, boats and aircraft shall never be considered as immovable property.

Paragraph 3 indicates that the general rule applies irrespective of the form of exploitation of the immovable property.

Paragraph 4 makes it clear that the provisions of paragraph 1 and 3 apply also to income from immovable property of industrial, commercial and other enterprises. It should be noted in this connection that the right to tax of the source State has priority over the right to tax of the other State and applies also where, in the case of an enterprise, income is only indirectly derived from the immovable property.

This does not prevent income from immovable property, when derived from a permanent establishment, from being treated as income of an enterprise, but secures that income from immovable property will be taxed in the State in which the property is situated also in the case where such property is not part of a permanent establishment situated in that State.

It should be noted that the provisions of the article do not prejudge the application of domestic law as regards the manner in which income from immovable property is to be taxed.

The same considerations value for article 6 of the UN-MTC.

About article 13, paragraph 1 states that gains from the alienation of immovable property may be taxed in the State in which it is situated. This rule corresponds to the provisions of article 6 and of paragraph 1 of article 22. It applies also to immovable property forming part of the assets of an enterprise. For the definition of immovable property, paragraph 1 refers to article 6.

Paragraph 1 of article 13 deals only with the gains which a resident of a Contracting State derives from the alienation of immovable property situated in the other Contracting State. It does not, therefore, apply to gains derived from the alienation of immovable property situated in the Contracting State of which the alienator is resident in the meaning of article 4 or situated in a third State; the provisions of paragraph 5 shall apply to such gains. The rules of paragraph 1 are supplemented by those of paragraph 4, which applies to gains from the alienation of all or part of the shares in a company holding immovable property.

Paragraph 2 deals with movable property forming part of a permanent establishment of an enterprise.

The term “movable property” means all property other than immovable property which is dealt with in paragraph 1. It includes also incorporeal property, such as goodwill, licenses, etc. Gains from the alienation of such assets may be taxed in the State in which the permanent establishment is situated. The paragraph makes clear that its rule apply when movable property of a permanent establishment is alienated as well as when the permanent establishment as such is alienated.

On the other hand paragraph 2 may not always be applicable to capital gains from the alienation of a participation in an enterprise. The provision applies only to property which was owned by the alienator, either wholly or jointly with another person. Capital gains from the alienation of such participations, like capital gains from the alienation of shares, are therefore taxable only in the State of residence of alienator. Contracting States may agree bilaterally on special rules governing the taxation of capital gains from the alienation of a participation in a partnership.

For the purposes of the paragraph, property will form part of the business property of a permanent establishment if the “economic” ownership of the property is allocated to that permanent establishment. The economic ownership of the property means the equivalent of ownership for income tax purposes by a separate enterprise, with the attendant benefits and burdens.

An exception from the rule of paragraph 2 is provided for ships and aircraft operated in international traffic and for boats engaged in inland waterways transport and movable property pertaining to the operation of such ships, aircrafts and boats. Normally, gains from the alienation of such assets are taxable only in the State in which the place of effective management of the enterprise operating such ships, aircraft and boats is situated. This rule corresponds to the provision of article 8 and of paragraph 3 of the article 22. By providing that gains from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in a Contracting State may be taxed in that State, paragraph 4 provides that gains from the alienation of such shares and gains from the alienation of the underlying immovable property, which are covered by paragraph 1, are equally taxable in that State.

Paragraph 4 allows the taxation of the entire gain attributable to the shares to which it applies even where part of the value of the shares is derived from property other than immovable property located in the source State.

As regards gains from the alienation of any property other than referred to in paragraphs 1,2,3 and 4, paragraph 5 provides that they are taxable only in the State of which the alienator is resident. This corresponds to the rules laid down in article 22. This residual clause of exclusive taxation in the residence State of the alienator is concretely adopted by all Conventions UE concluded by Italy, excluding of that with Ireland that limits this exclusivity to the sale of movable property.

Conventions concluded by Italy with Netherlands, Sweden, Finland and United Kingdom provide for, at article 13, par.5, rules to prevent abuse having a structure similar, with some substantial differences.

Convention with Netherlands establishes that provisions of paragraph 4 do not compromise the right of each State to collect, in accordance with their laws, a tax on gains from the alienation of shares or other rights of a company resident of that State whose capital is, in whole or in part, divided into shares, when these gains are made by an individual resident of the other State, having the nationality of the first State without having that of the other State and who has been resident of the first State during the last 5 years before the alienation.

Similarly, Convention with Sweden establishes that provisions of paragraph 4 do not compromise the right of a Contracting State to subject to taxation in accordance with its own legislation gains deriving from the alienation of shares of a company, whose goods are constituted mainly by immovable property situated in that Contracting State, if the alienator is an individual resident in the other Contracting State that: a) has the nationality of the first Contracting State; b) has been resident for some time of that Contracting State during a period of 5 years immediately before the alienation; c) in the moment of the alienation he exercised alone or with a family person a dominant influence on society.

Article 13, paragraph 2 of the Convention with Finland states that gains that a resident of a Contracting State obtains from the alienation of shares or other rights referred to in paragraph 4 of article 6 are taxable in the Contracting State in which the immovable property owned by the company is situated ([62]).

Finally, in the Convention with United Kingdom the provisions of paragraph 4 of article 13 do not compromise the right of a Contracting State to collect, accordingly to its own legislation, a tax on gains, deriving from the alienation of any property, realized by an individual who: a) is a resident of the other Contracting State; b) has been resident of the first Contracting State in any moment during the five years immediately before the alienation of the property; c) is not taxable for these gains in the other Contracting State. These clauses to prevent abuse do not contradict the mechanism of the exclusive taxation. It is possible to conclude that provision referred to in article 13, paragraph 4 represents a standard of the treaty network of Italy.

[62] Garbarino, *Manuale di tassazione internazionale*, cit., p. 543 e ss..

4. Domestic law about allocation of income between States

The main Italian provisions affecting the allocation of income between States are articles 23 and 165 ITA.

The article 23 ([63]) indicates the conditions to consider income, attributable to a non-resident, produced in Italy for the purposes of IRPEF and also of IRES. The rule is expression of the principle of territoriality which establishes the relevance of the localization of the source for the purposes of the taxation of income deriving from that.

In order to apply this rule it is necessary the qualification of the subject as a "non-resident", that is who cannot be qualified as a tax resident.

As regards individuals, residents are the people who for the most part of the tax period are entered in the register of the resident population or who have in the State the domicile or the residence within the meaning of the civil code ([64]).

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[63] Article 23 ITA says:

"*For the application of tax in respect of non-residents are considered produced within the State: a) income from land; b) capital income paid by the State, by subjects resident within the State or by permanent establishments within the State of the non-residents, with the exclusion of interest and other income deriving from deposits and bank and post office accounts; c) employment income performed within the State, including income similar to those of employees referred to in subparagraphs a) and b) of paragraph 1 of article 50; d) self-employment income deriving from activities exercised within the State; e) business income deriving from activities carries on within the State through permanent establishments; f) different income deriving from activities carried on within the State and by property that is within the same territory, as well as capital gains deriving from the transfer for consideration of participations in resident companies, with the exclusion of: 1) capital gains referred to in subparagraph c bis) of paragraph 1 of article 67, deriving from the transfer for consideration of participations in resident companies negotiated in regulated markets, everywhere held; 2) capital gains referred to in subparagraph c ter) of the same article deriving from the transfer for consideration or from refund of securities not representative of goods and of certificates of mass negotiated in regulated markets, as well as from transfer or withdrawal of foreign currencies arising from the deposits and current accounts; 3) income referred to in subparagraphs c quarter and c quinquies) of the same article arising from contracts concluded, also through the intervention of intermediaries, in regulated markets; g) income referred to into articles 5, 115 and 116 attributable to members, associates or non-resident participants. 2. Regardless of the conditions referred to in subparagraphs c), d), e) and f) of the paragraph 1 are considered produced within the State, if paid by the State, by subjects resident within the State or by permanent establishments within the same territory of non-residents: a) pensions, allowances similar to them and severance benefits referred to in subparagraphs a), c), d) e) and f) of the paragraph 1 of article 17; b) income similar to those of employees referred to in subparagraphs c) and c bis), f), h) h bis), i) and l) of the paragraph 1 of the article 50; c) fees for the use of intellectual property, industrial patents and trademarks and of processes, formulas and information relating to the experience gained in the industrial, commercial or scientific field; d) fees earned by companies, corporations or non-resident entities for professional or artistic services performed on their behalf within the State*".

[64] Article 2 ITA.

As regards companies or entities, they are considered as resident if, for the most part of the tax period, they have the registered office or the place of management or the main object in the State ([65]).

So the qualification of the subject as a non-resident is obtainable from a negative reading of articles 2 and 73 ITA.

For every category of income, the article 23 selects a peculiar connecting factor, whose spatial location, within the State, becomes condition of relevance for income taxes. These are connecting factors different for every category of income on the basis of the peculiarities of the related source. This means that, in order to identify the applicable criterion, it is necessary a preliminary operation of qualification of income. About the nature of these connecting factors there are different points of view among scholars, indeed, according to Fantozzi and Falsitta, they are absolute legal presumptions of the production of income within the State; according to Garbarino, instead, they may be the direct expression of the legislation will to identify a reasonable link between the taxable event and the territory of the State.

At any rate, this rule identifies only the conditions to consider income located within the State and not also the specific fiscal treatment, which must be object of a distinct analysis.

For the application of the rule, the expression "territory of the State" must be understood as the one on which the State exercises its sovereignty, that is the political territory which is distinct from the customs territory, relevant only for the application of taxes taken at customs.

Now we analyze the single categories.

About income from land, the criterion of territoriality is that of easier application, because the related case contains in itself a territorial element; indeed, under article 25 "they are income relating to land and buildings situated in the territory of the State that are or should be entered, with the allocation of income, in the land cadastre or in the land registry". The possession of a property referred to in article 25 by way of ownership, lease, usufruct or other real right, necessarily implies the territoriality of income deriving from that possession, not being

[65] Article 73 ITA.

conceivable, according to Italian law, income from land produced abroad. The failure prediction of a withholding tax on this kind of income makes always necessary the presentation, by the non-resident, of the related tax return.

About capital income, the subsistence of the territorial requisite, represented by the lender's residence within the State, is subordinated to the verification that the actual payment of income derives from the State, from a resident or from a permanent establishment within the State of non-residents. A derogation to this rule was introduced with the Legislative Decree no. 259/1999, relating to the interest and to the other income deriving from bank or postal current accounts or deposits, which, if perceived by non-residents, must be considered in each case without the territorial requirement.

The substantial tax discipline of the capital income establishes that some income, though produced in Italy, are not taxable if perceived by non-residents, when there are some conditions. Other income, while taxable, are subject to a diversified scheme, depending on the residence, in Italy or abroad, of the perceiver.

A first exemption concerns bond interest paid by bank and listed companies.

This income is not subject to taxation if perceived by non-residents, providing that they have the residence within one of the States included in the *white list*. On the application level, the exemption is subordinated to the deposit, direct or indirect, of securities in a bank or a resident brokerage company or a permanent establishment in Italy of bank or non-resident brokerages companies.

Another exemption concerns, for non-residents, interest and other remunerations deriving from the mortgages of things different by money, deposits and current accounts; the perpetual annuities and perpetual annual performance; fees for the provision of surety and other security; income from carry-overs and repurchase agreements on securities and currencies and income from securities lending. For this exemption it is necessary that the perceiver has the residence in one of the States included in the white list.

Other exemptions concern income deriving to non-residents by the participation to real estate investment trusts and payments of interest and royalties between associated companies of different member States. These exemptions are characterized by an obligation for paying agents to report to the Inland Revenue the information relating paid interest or whose payment is attributed directly to individuals resident in another member State who are the beneficial owners.

Apart from the aforementioned exemption schemes, capital income produced in Italy by non-residents, where taxable is, in the generality of cases, subject to alternative systems, whose typology and amount is different depending on the specific nature of income.

About dividends paid to non-residents, the current article 27 of the D.P.R. no.600/1973 establishes that profits distributed to non-residents from investments, securities treated as shares or contracts to joint ventures non related to permanent establishments in the territory of the State, are generally subject to a withholding tax, to the extent of 20%. The same treatment is established for saving shareholders. This discipline is only applicable to the individuals non-residents in Italy and to companies and entities resident in a non-EU country.

Profits paid to companies and entities subject to a tax on corporate income in one of the member States of the European Union and in the States parties to the Agreement on the European Economic Area included in the white list are subject to a treatment similar to that of profits distributed to residents that, for the participation exemption, contribute to the formation of the total taxable income only to the extent of 5%. Toward these subjects and provided that it does not concern participations related to their permanent establishments within the State, the withholding tax is applied to the extent of 1,375 %.

Under article 27-bis of the D.P.R. no.600/1973, when a company subject to the withholding tax of the 1,375 %, as well as being resident in a member State, has held continuously, for at least a year, a direct participation of at least 10% of the company’s capital distributing profits, it will be entitled to a refund of the withholding tax thus made, presenting a certificate issued by the competent tax authorities of the foreign State, by which the possession of such requirements is attested. Moreover, the application of the withholding tax can be avoided upon written request to the paying company, under the paragraph 3 of the article 27-bis of the D.P.R. no.600/1973, provided that it is expired the minimum holding period of a year.

Differently from the corresponding provision of the OECD-MTC, the article 23, subparagraph c) gives to the interpreter the not easy task to determine when the work is performed in the territory of the State. The provision does not require expressly that the job performance has to be exercised in Italy with stability and it does not care the nationality or the residence of the employer. So it is subject to IRPEF also income linked to services performed in Italy in relation to labor employments whose head office is located in another State.

Crovato has though noticed that it would not be reasonable to consider produced in Italy income deriving from services performed as a result of mere transfers in our State at the hands of a non-resident worker. On the other hand, it is true that a constant presence of the worker on the territory leads to qualify him as resident in Italy, with the consequent practicality of the world wide principle. So it is opportune to distinguish between the two hypothesis of the occasional transfer and of the true transfer in Italy. In this latter area are included the cases of detachment of foreign personnel at businessmen resident in Italy. In these hypothesis, the provision implies the application of IRPEF on employment income, although the work is performed by a non-resident, being this circumstance non influential for the localization in Italy of income.

For some remunerations, even if sortable as employment income, are established criteria of territoriality different from that, general, of the place of performance of the service. A first exception concerns pensions and allowances similar to them, to which it is not applicable the general criterion because of the absence of a job performance to be placed in the space. For this reason, these remunerations are considered produced within the State and subject to IRPEF, provided that they are paid by the State, by residents or by resident's permanent establishments within the State.

The same criterion, represented by the residence of the payer, is applied also to the severance indemnity and to the allowances relating to the termination of the relationship of coordinated and continuous collaboration. The justification, in these cases, must be tracked in the possibility that the subject, resident during the performance of his work, is moving abroad at the end of the employment relationship, assuming the residence in a State different from that in which the entity distributing the pension or the subject supplying the severance indemnity is situated.

About income similar to the employment one, only the fees perceived by workers co-operative members and the allowances and fees perceived by employees for tasks performed in connection with such quality and borne by third-parties are subject to the criterion of the place of performance.

Differently, scholarships, income arising from contracts of continuous and coordinated collaboration, fees paid by the State and by local authorities for the exercise of public functions, annuities and other periodic checks whose production currently neither capital nor work do not contribute, fees received by socially useful workers in accordance with specific statutory provisions, are considered produced in Italy on the basis of the different criterion of the payer's residence.

About self-employment income, it is necessary to verify if in Italy a performance of self-employment is carried out. It is obligatory, although, to underline that in the most of the conventions concluded by Italy another requirement is requested, that is the existence in the territory of a fixed base. Since 2000, however, in the OECD-MTC, the international legitimacy of the taxation in the source State of the self-employment income is no longer subject to the existence of a fixed base, but to the same criterion of the business profits, that is the presence of a permanent establishments.

Law assigns to some remunerations included in the category of the self-employment income criteria of territoriality different from that of the place of performance of work. These are the allowances relating to the termination of agency relationships of individuals, to the termination of notary and those perceived by professional athletes at the end of the sport activity, which are considered produced in Italy provided that they are paid by the State, by residents within the State or by residents' permanent establishments within the State. The criterion of the payer's residence is provided also for royalties, that are fees for the use of the intellectual property, industrial patents and trademarks and of processes, formulas and information relating to the experience gained in the industrial, commercial or scientific field. In the system of income taxes, these remunerations have to be included into the self-employment income or into different income, depending on they are perceived by the author or inventor or by other subjects. If they are perceived, instead, in the exercise of a business activity, they must be attracted in the category of business profits because of the operating of the principle of attraction of territoriality. So the territorial element contribute to create the structure of the case regardless of the income category attracting these remunerations; indeed, even if they are perceived in the exercise of a business activity, they will be considered produced in Italy by the non-resident entrepreneur regardless of the subsistence of a permanent establishment within the State. If they are achieved through a permanent establishment, a withholding tax at the rate of 30% is applied on the taxable part of these remunerations. This mechanism is not applicable when fees are paid to a non-resident's permanent establishment within the State. In this casa the taxpayer has to include the remuneration among the business profits and to indicate it in the tax return.

About fees earned by companies, corporations or non-resident entities for professional or artistic services performed on their behalf within the State, they must be considered produced in Italy to the dual condition that performance is carried on in the Italian territory and they are paid by Italian residents.

Also business profits have to be considered produced within the State provided that they derive from a business activity carried out there and the performance is operated through a permanent establishment. For the application of this territorial condition is necessary the prior placement of the patrimonial variation in the category of the business profits.

About other income, there is a double criterion of identification. It must be consider as produced in Italy the other income deriving:

(a) from activities carried on in the territory of the State;
(b) from property situated in the same territory.

With the entry into force of Legislative Decree no.461/1997, the discipline of the capital income was completely reformulated. It was introduced the general requirement of territoriality of different income and it was extended the territorial scope of this category including also the participations of capital gains deriving from the sales of shares in resident companies.

About article 165 ([66]), Italian law adopts as unilateral system against international juridical double taxation the "credit for taxes paid abroad". The current formulation of legislation dates back to the Legislative Decree no.344/2003 which modified the previous article 15 ITA.

Currently neither article 165 nor article 15 ITA are based on the condition of reciprocity as previous version of such law. This condition that subordinated the granting of the same to the existence of an identical rule within the tributary law of the host State, represented the result of a wrong interpretation of the Law no. 825/1971 about necessity to prescribe "criteria and procedures to be determined in

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[66] Article 165 ITA states:

"If to the total income contribute income produced abroad, taxes definitively paid there on such income are deductible from the net tax payable up to the amount of the part of the tax corresponding to the ratio between foreign income and total income, net of losses of previous tax periods admitted in deduction. 2. Income is considered as produced abroad on the basis of criteria reciprocal to those provided for in article 23 to identify those produced in the territory of the State. 3. If income produced in more foreign States concur, deduction applies separately for each State. 4. The deduction referred to in paragraph 1 must be calculated in the tax return relating the tax period to which it belongs foreign income to which it refers the tax referred to in that paragraph 1, provided that the outright payment is made before its submission. If the outright payment is made later, it is applicable the paragraph 7. 5. About business profits produced abroad through a permanent establishment or subsidiaries referred to in the section III of chapter II of title II, deduction can be calculated since the tax for the attributable period also if the outright payment is made within the time limit for filing the tax return relating to the following first tax period. The exercise of the option referred to in the previous period is subject to the indication, in the tax return, of foreign taxes deducted in respect of which the outright payment has not happened yet. 6. In the case of business profit produced, by the resident enterprises, in the same foreign State, the foreign tax definitively paid there on such income exceeding the amount of Italian tax on the same foreign income, represents a tax credit up to the excess of the amount of the Italian tax than the foreign tax paid definitively in relation to the same foreign income, occurred in previous periods until the eighth. If in the previous years this excess did not occur, the excess of the foreign tax may be carried forward until the following eighth year and to be used as a tax credit in the case that the excess of the amount of the Italian tax than to the foreign one relating to the same income referred to in the first period of this paragraph is produced. The provisions of this paragraph relating to the carry-forwards and backwards of the excess are applied also to the business profits produced abroad by the single companies participating to the national and global consolidated, even though resident in the same country, except as provided for in article 136, paragraph 6. 7. If the tax payable in Italy for the tax period in which the foreign income has contributed to form the tax base has already been paid, there shall be a new settlement taking into account also the possible greater foreign income, and deduction is made from tax payable for the tax period covered by the settlement in which it was requested. If the time for the assessment is already expired, deduction is limited to the amount of the foreign tax proportional to the amount of income earned abroad acquired to taxation in Italy. 8. Deduction is not recognized in case of failure to submit the settlement or non-disclosure of income produced abroad in the presented tax return. 9. For taxes paid abroad by companies, associations and enterprises referred to in article 5 and by companies which have exercised the option referred to into articles 115 and 116, deduction is recognized to the individual partners in the proportion established there. 10. If income produced abroad contributes partly to form the total one, also the foreign tax has to be reduced correspondingly".

relation to the reciprocity of treatment”. The Legislative Decree no. 344/2003 acted decisively on the previous article 15, replacing it with the new article 165 ITA containing a lot of new features, including: a) the definition of income produced abroad; b) the reshaping of the period within which the deduction of taxes paid abroad must be requested; c) the carryover of excess foreign tax with respect to Italian tax corresponding to foreign income; d) a discipline ad hoc when foreign income contributes only partially to form the total one of taxpayer; e) the discipline of the carry-back of the excess for holders of business income.

The Italian tax legislator establishes a maximum limit to the deductibility of the foreign tax, determined by the product of two factors: a) the Italian tax corresponding to the sum of domestic and foreign income, net of deductible expenses (it is called as “tax of reference”); b) a quotient whose numerator is income and whose denominator is the total gross income (it is called as “coefficient of deductibility”). This maximum limit can never exceeds however the tax actually paid abroad; the article 165, therefore, limits down the tax paid abroad.

According to the Italian tax authority, the amount not deductible cannot be subject to deduction of income, but only to the carry-over. Moreover, the Italian tax authority, in the resolution no.62/E/1982, underlined that the tax credit, determined under article 165, paragraph 1, as the lesser amount between foreign taxes and parts of the Italian gross tax, may not exceed the absolute limit of the Italian net tax, relating to the same tax period of production of the foreign income.

The credit for taxes paid abroad is applicable also to non-residents carrying out a business within the State through a permanent establishment.

About method of calculating the tax credit, Italian legislator provides for the “per country limitation”, that is the calculation of the tax credit for each country; indeed, the tax credit is calculated separately for each State and not on the global amount of the foreign income.

Conversely, the “overall method” implies a credit loss for taxes paid abroad where one or more foreign operations were closed at a loss. In this case, considering foreign income in its totality means the reduction of the amount of the obtainable tax credit. On the contrary, the application of the “per country limitation” allows to obtain a tax credit relating to operations closed in active.

About conditions to avail of the tax credit, it is necessary that there is income produced abroad. Under article 165 ITA, income is considered as produced abroad on the basis of criteria reciprocal to those provided for in article 23 to determine income produced within the State by non-residents.

When there is a convention against double taxation, there are two relevant elements. On one hand, the levy of a tax in the absence of the conditions required by the convention does not allow the person subject to it to apply article 165 ITA. On the other hand, the presence of a convention against double taxation should determine the insignificance of the place of production as required by article 23 ITA; so the tax credit is recognized also in accordance with foreign taxes paid on elements of income with foreign origin but not classifiable as such under article 165, paragraph 2 ITA and which form object of taxation under the Convention.

About the tax return significant to detract taxes paid abroad, the previous article 15 affirmed that taxpayer had to ask, subject to forfeiture, deduction of the foreign tax in the tax return relating to the tax period in which the payment was definitive. It was a penalizing treatment because taxpayer was constraint to use tax paid abroad at least in the year following that in which income produced abroad has to be declared. The article 165 made an innovation, providing that the credit must be calculated in the tax return relating the tax period to which belongs income produced abroad which tax relates, provided that the outright payment is made before its submission. So, it is possible to apply the accrual basis, suitable to connect income produced abroad with related taxes paid abroad. This deadline is dilated in the case of foreign permanent establishments, being determined in the deadline for submission of the tax return relating to the following first tax period., provided that taxpayer indicates in the tax return the deduced foreign taxes for which the outright payment has not yet been done. The article 165, paragraph 8, as a sanction, establishes finally that deduction is not recognized in case of failure to submit the settlement or non-disclosure of income produced abroad in the presented tax return. In the resolution no.59/E/1999, the Italian tax authority clarified that this provision does not contrast with double tax conventions concluded by Italy.

4.1. Treaty override

As regards the adaptation of the domestic law to the double tax conventions, the International rule may constrain domestic laws in several aspects.

Sometimes, the convention acts on the extension of the criterion of personal attachment ([67]). For example, some double tax conventions limit the application of the worldwide principle to Italian residents, when these establish the taxation of income only in the source State and oblige Italy to refrain from the imposition.

In other cases, the conventional rule modify the relevant real attachment. These are the cases when the domestic connecting factors, referred to in article 23 paragraph 1 subparagraph d) ITA, are different from those provided by conventions.

In other cases, the conventional rule limits the *quantum* of the levy. The typical example is that of income for which the convention, after assigning the right to tax to the percipient's residence State, allows to the payer's State to levy a withholding tax not exceeding a certain percentage.

In all these cases, the convention prevails on the previous domestic rule according to the principle of specialty.

The domestic rule remains in force in order to apply not only to the cases not included in the subjective scope of the double tax convention but also to cases not covered by the objective or territorial scope of the same. Moreover, the international rule integrates the domestic law, not replacing it.

The problem arises in the case of subsequent conventional rules more unfavorable than domestic ones, indeed, it is necessary to determine which of the two rules will prevail.

First, it is required the verification of the existence of a general principle of customary international law, that is the principle of non-aggravation. This proof is very controversial.

About the Italian law, this principle seems to have been received by the bodies

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[67] G. MELIS, *Vincoli internazionali e norma tributaria interna*, in *Riv. dir. trib.*, 2004, X, p.1117 e ss..

responsible for implementing the double tax conventions, but also and above all the Italian legislator believes in the principle of existence in the Italian law.

The primacy of international law over domestic law in tax matters resulting from the principle of specialty was reiterated by the legislator of the tax reform in two separate rules. On one hand, with the article 75 D.P.R. no.600/1973, according to which "in the application of the provisions concerning income taxes, the international agreements ratified in Italy are without prejudice"; on the other hand, with the article 41 D.P.R. no. 601/1973, according to which "the exemptions and the benefits provided by the international agreements ratified in Italy and by laws relating to international bodies and organizations continue to be applied".

These rules have always been considered superfluous because they affirm a generic principle of specialty. The Italian legislator, therefore, with article 128 ITA (now article 169 ITA), established that "provisions of this ITA are applied, if more favorable to the taxpayer, also notwithstanding the international double tax conventions", assigning to this rule the function of making clear the only meaning attributable to article 75 D.P.R. no.600/1973. Indeed, if taken literally, this provision would be entirely superfluous because the obligation to observe international agreements, also in derogation to the domestic legislation, derives from laws that make them enforceable in Italy. It is for this reason that the provision was constantly referring to the double tax agreements, which, for the purposes of taxes due in Italy, do not affect the application of domestic rules most favorable to the taxpayer. So the rule is reformulated in accordance with this interpretation.

Article 169 ITA does not reiterates a general principle of specialty but tempers its effects, allowing the taxpayer to make a choice as to the applicable rule. So if the domestic rule is more favorable to the taxpayer than the conventional rule, he can apply the domestic rule.

It is obvious that only by recognizing the existence of such a customary principle of non-aggravation that article 169 ITA takes on a sense.

It is clear that the existence of such a principle of international law must be reconciled with the existence of a specific obligation contracted by the State at the international level. This obligation must be respected under the penalty of international responsibility. Article 169 ITA allows to comply with this obligation not affecting the taxing power of the other Contracting State as well as conventionally determined. In this respect, article 169 can only lead to a decrease in revenue in the hands of Italy and never for the other Contracting State.

This stated, we have to make some concluding remarks about the relationship between article 75 D.P.R. no.600/1973, ideally repealed by article 169 ITA but still in force. This rule, indeed, actually appeared unnecessary as it underlined a principle of specialty of the international rule that did not need to be reiterated. However, this rule involved all international law while article 169 ITA has limited its operation to the rules of the double tax conventions affecting the rules contained in the Italian Tax Code.

This means, therefore, that a legislative recognition of the principle of the most favorable rule can be found only in connection with such conventional rules and not in relation to other ones, that is nor to the rules contained in international agreements of different types or to those contained in the double tax conventions that do not overlap with those contained in the Italian Tax Code.

Problem different from that ruled by article 169 ITA is that of the treaty override.

Treaty override means the possibility to break treaty with a subsequent change to domestic law. It happens when the subsequent domestic rule is more unfavorable than the international one. This problem is linked to that of the evolutionary interpretation of the treaty. Article 31, paragraph 3, subparagraph c) of the Vienna Convention on the Law of Treaties gives interpretative relevance to "every pertinent rule of international law applicable in relations between the parties" ([68]). This represents a rule that allows to adapt the convention to the changes of the international law. It must not mislead. The principle of international law remains always that to attribute to terms the meaning that they had in the moment of conclusion of the convention (principle of contemporaneity), so the attribution of a different meaning is always the exception. It is also true, however, that this principle does not require necessarily a static interpretation. It is possible, indeed, that meaning of the terms is subject to an evolution in accordance with parties' expectations and intentions at the moment of conclusion of the treaty.

[68] G. MELIS, *Vincoli internazionali e norma tributaria interna*, cit., p.1129 e ss..

The most delicate problem, however, concerns changes to domestic legislations. The problem of the static or evolutionary interpretation concerned article 3, paragraph 2 of the OECD-MTC. This rule refers to the domestic law of the Contracting States to determine terms not defined in the same convention, with the problem to clarify if this reference is to the domestic law in force when treaty was concluded (static meaning), or when it is applied (ambulatory meaning). It is a theme linked to that of the treaty overriding; indeed, if domestic law is modified, there is the problem to verify if this change is sic et sempliciter a violation of the treaty or it may give rise to an evolutionary interpretation of the same. The problem cannot be solved radically in one sense or another, but it is indispensable to distinguish case by case. The ambulatory meaning may not represent an excuse for the treaty overriding.

Conventions about income or capital taxes, only incidentally, were concerned of this problem. So, for example, with the rule under which "convention will be applied also to taxes of identical or analogue nature that will enter into force after the date of ratification of this convention and that will be added to the current taxes or that will replace them" (article 2, par.4 of OECD-MTC).

This hypothesis was verified in Italy after the tax reform of 1973, when the introduction of new taxes pushed the tax authority to adopt an evolutionary interpretation of the treaty. This address has been reflected in the modification of article 3, paragraph 2 of the OECD-MTC which establishes that "as regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State (…)". In Italy, there is not a specific rule, permitting legally treaty override but currently it is not possible to doubt that evolutionary interpretation has to be preferred compared to the static interpretation, in order to not make inflexible conventions concluded by the State, also because of the high volatility of tax legislation. In some cases, the ambulatory interpretation is rather an obligatory choice. These are the hypothesis in which the reference to domestic law is natural, when it is inevitable that the meaning must be that existing at the moment of verification of the condition. Or cases in which domestic law has additional function of the international precept. It is clear, otherwise, that since international conventions on income taxes have the function to limit domestic prerequisites, they do not prejudice the power of different States relating the measurement of the taxation, so changes of domestic law in the level of the tax rate will be possible, with the only limit of the non-discrimination. So changes of domestic law are not forbidden, to the extent that do not substantially alter the conventional balance and as long as violation of treaty is expressly wanted by the State.

4.2. Dividends and interest expenses in the domestic law

4.2.1. Dividends

About outbound dividends, the applicable domestic rule is article 27, paragraph 3 of D.P.R. no. 600/1973, which requires the application of a withholding tax of 20% on profits paid to non-residents within the State, relating participations not referred to permanent establishments. This paragraph 3 establishes that this withholding tax has to be applied on profits paid to non-residents within the State, relating to participations, financial instruments referred to in article 44, paragraph 2, subparagraph a) and contracts of association in participation referred to in article 109, paragraph 9, subparagraph b), not relating to permanent establishments within the State. The withholding rate is also of the 20% for profits paid to savings shareholders.

Non-residents, different from savings shareholders, are entitled to reimbursement, up to four-ninths of the withholding, of the tax that can prove they paid abroad definitively on the same profits by certificate of the competent tax authorities of the foreign State. If the participation is directly afferent to a resident's permanent establishment, the withholding is not levied and this income element contribute to form the total income of the permanent establishment, also benefiting from tax credit ([69]).

About inbound dividends, these are dividends paid by a non-resident in Italy to a resident in Italy. In this case, Italy is the perceiver's residence State, while the other State is the source State of transnational dividends. The applicable domestic rules are: article 47 ITA relating capital income, if the perceiver is an individual

[69] C. Garbarino, *Manuale di tassazione internazionale*, cit., p.432 e ss..

not perceiving business profits; article 59 ITA, relating business profits if the perceiver is an individual perceiving business profits; article 89 ITA, if the perceiver is the IRES subject. These rules introduced the participation exemption. This system implies that dividends are taxed to the extent of 5%; the 95% is excluded from taxation.

The taxation of the 5% has to be connected to the deduction of inherent expenses. If it was established the total non taxation of dividends, inherent costs of management should be fully non deductible; instead, the actual costs of management are deductible, but quantified in a flat rate of 5% of dividends.

This system is applied also to remunerations perceived by IRES subject from securities and financial instruments similar to shares, or as associated in a contract of association in participation with capital contribution, because in these cases the perceived remunerations are treated as dividends.

Dividends perceived by individual entrepreneurs and by partnerships holder of a qualified participation are taxed for the 49,72% of their amount.

Dividends received by an individual not exercising a business activity and holder of a non-qualified participation are subject, pursuant to art. 27 of D.P.R. no. 600 of 29 September 1973, to a substitutive tax levied at 20% (which replaces the previous tax rate of 12,5%) starting from 1st January 2012 as a consequence of the amendments made by Law Decree no. 138 of 13 August 2011, converted into Law no. 148 of 14 September 2011. Such substitutive tax applies on the entire amount of the dividends received.

It is applied the cash principle, so dividends are taxed when they are perceived. It is important, moreover, to notice that when it is applied the transparency principle, subsidiaries' profits are attributed to members, regardless of the distribution of dividends; so distribution of dividends is irrelevant for tax. This is both for the participation in partnerships and for the companies' transparency system.

For the exclusion of the taxation, dividends must not come from a tax heaven. If the investee company has the head office in a State with a privileged tax regime, its income is not taxed or is taxed slightly: there is no reason for not taxing dividend in Italy ([70]), unless it can be demonstrated through a ruling request that the participation in such tax haven resident companies does not allow to localize the relevant income in said countries. Indeed, pursuant to art. 47, paragraph 4 ITA the profits "arising" from companies residing in the so-called tax havens are fully taxable.

4.2.2. Cross-border financing of businesses and domestic law

In the ITA, before being amended by the Finance Act 2008, there were three rules about deductibility of interest expenses: article 98 about thin capitalization; article 97 (about capital pro rata); article 96 (about interest expenses) ([71]). Article 98 was direct to avoid the deductibility of interest expenses on loans referred to shareholders exceeding a pre-defined minimum ratio between debt and equity; it adopted the form of a ratio whose numerator and denominator were respectively debt and equity, ratio expressing a coefficient of non-deductibility applied to statutory interest expenses. Article 97 was direct to avoid the deduction of interest expenses payable in respect of money borrowed to acquire shares likely to generate exempt capital gains; it adopted the form of a ratio whose numerator was an excess of investments pursuant to article 87 with respect to equity and whose denominator was a value equal to the total one of the assets less equity less trade debt., ratio expressing a coefficient of non-deductibility of the statutory interest expenses residual after the application of article 98. Article 96, paragraph 1, before being modified, was direct to avoid the deduction in presence of exempt interest and it had the form of a ratio whose numerator was the sum of revenues and other remunerations contributing to the formation of income, and whose denominator was the sum of revenues and other remunerations not contributing to the formation of income; this ratio expressed a coefficient of non-deductibility of statutory interest expenses residual after the application of article 98 and 97.

Finance Act 2008 restated rules about deductibility of interest expenses, repealing article 97 (about capital pro-rata) and article 98 (about thin-capitalization) and rewriting article 96 that are, starting from the 1 of January 2008, the main rule

[70] F. Tesauro, *Istituzioni di diritto tributario*, Parte speciale, cit., p.89.

[71] C. Garbarino, *Manuale di tassazione internazionale*, cit., p.1029 e ss..

about deductibility of interest expenses. The current system differs from the former ones since it significantly simplified the tax deduction regime, grounding the assessment of the adequacy of the debt's level and, consequently, the deduction of interest expenses from the business income on a criterion (the EBITDA) which is not linked to the taxpayers dimensions or to the holding of stock eligible for the participation exemption regime.

The aim of the new approach is that of favoring the capitalization of companies without affecting in an irreversible way those characterized by thin capitalization financial structure and without affecting the owners of participations recorded as financial assets benefitting from the participation exemption regime or in any case the owners of exempt income. Moreover, it positively directs businesses towards their capitalization or a debt restructuring to the extent that it allows to carry forward interest expenses which are not deductible in a single tax year without any time limitation. On the contrary, the former tax regimes set out a final impossibility, although limited, to deduct interest expense which was not eligible for deduction in a single tax year. In other words, while the thin capitalization rules and the *pro rata* (*patrimoniale* and *reddituale*) rules required to determine the amount of interest expenses which qualified as finally not deductible, the current system exclusively provides for a temporary non deductibility of interest expense ([72]).

The main feature of the new regime relies on the fact that the benchmark to be met to determine the amount of deductible interest expense is no longer the amount of the venture capital, but the amount of profits that can bear the cost of debt financing. Under the thin capitalization rule such latter element was only indirectly relevant to the extent that the taxpayer was allowed to demonstrate its own and independent ability to obtain credit which could justify the amount of the debt financing. For the purposes of such assessment the analysis of the company flow of profits were of course material. Moreover, the new rule differs from the DIT (Dual Income Tax) as it did not provide for any incentive purpose. It also differs from the thin capitalization rule which limited the maximum level of debt

[72] F. Marchetti e F. Rasi, *Raccolta di capitale di rischio e di capitale di debito:la disciplina italiana*, in *Studi Tributari Europei*, cit., p.19 e ss..

financing which could be borne based on the amount of the net worth; whilst the new rule just limits the amount of interest that may be deducted each year for tax purposes but does not limit the amount of debt financing.

The current system does not seem to be able to effectively counteract tax avoidance schemes put in place by taxpayers since it does not even identify them. In other words, the new rule applies in a too general manner, almost witnessing the existence of a quantitative relevance of the principle of inherence. It seems to set out a threshold (the amount of interest income and 30% of the EBITDA) up to which interest expenses are allowed to be deducted; whilst beyond such threshold they are no longer, although temporarily, relevant for tax purposes.

4.2.3. Interest expenses: the previous tax regimes

4.2.3.1. Dual income tax

The most relevant action against the thin capitalization of companies was pursued by the legislator through Legislative Decree no. 466 of 18 December 1997, the so-called "*Dual Income Tax*" (DIT). Under a tax perspective, the DIT did not distinguish among the various forms of business financing since it extended the advantages of debt financing also to equity financing, eliminating any discrimination between the regime applicable to debt and equity ([73]).The DIT was based on the assumption of dividing business income into two components to subject to a different tax regime: (i) a first one represented by the corporate capital subscribed by shareholders and kept at a company level and (ii) a second one defined as the difference between business profits (net of interest expenses) and business income sub (i).

Until the introduction of DIT such items of income were subject to taxation at the same rate, whilst under the DIT regime they become subject to a different tax rate. In a nutshell, pursuant to the DIT it was set out that the taxable income should be divided into two parts: a first one subject to a reduced tax rate of 19% and a second one subject to the then ordinary tax rate of 37%, provided that the overall tax burden was not, according to the original version of the provision, on average,

[73] F. Marchetti e F. Rasi, *Raccolta di capitale di rischio e di capitale di debito:la disciplina italiana*, cit., p.15 e ss..

lower than 27%. For the purposes of the application of the DIT, it was therefore necessary to determine the following items: (a) the "*upward adjustment of the equity invested with respect to that existing at the close of the year running on 30 September 1996*"; (b) the "*coefficient of ordinary remuneration*" (the so-called CRO).

Through this taxation mechanism the legislator addressed the issue of the neutrality of the forms of business financing by way of adopting a logic of rewards: the behaviours held by taxpayers and deemed to be virtuous (*i.e.* the use of equity rather than debt financing) were favoured by a reduced tax burden which arose from the reduction of the applicable tax rate. Therefore, the DIT system, although regulated outside the ITA, directly impacted on the amount of tax payable by subjects carrying on a business activities. Such system mitigated the effects of the then applicable art. 63 ITA through the application of a lower tax rate.

4.2.3.2. Thin capitalization

Before the Finance Act 2008, Italian domestic law provided for a rule, that was article 98 ITA, direct to avoid the thin capitalization, on the basis of a minimum pre-defined ratio between debt and equity, under which interest expenses on financing relating to shareholders are not deductible, if they exceed this physiological or allowed ratio ([74]). Article 98, paragraph 1 established the non deductibility, from borrower's income, of the remuneration arising from financing, directly or indirectly, granted or guaranteed by a qualified shareholder or one of his related parties. These represent inter-company financing. The rule of non-deductibility was applied also when ratio between the total amount of financing and the share of equity attributable to the financing partner or to his related parties was greater than the ratio of debt established in the amount of four to one (and for the first period in the amount of five to one). The original purpose of this rule was to avoid potential elusive arbitrages with non-resident enterprises, determined by the abatement of corporate profit as consequence of the deduction

[74] C. Garbarino, *Manuale di tassazione internazionale*, cit., p.1034 e ss..

of paid interest expenses and by the achievement of the corresponding income by financing partners, subject to taxation with more favorable rates.

In the final text of law , the definitive function of article 98 was to limit directly the thin capitalization and not more limiting use of rate differentials with erosion of the tax base of the residents. Article 98 had also other purposes of economic policy, such as to promote the capitalization of companies for the benefit of the competitiveness of the whole economy.

This article was, however, repealed by Finance Act 2008 and for the moment the only rules about deduction of interest expenses are articles 61 and 96 ITA.

4.2.4. Interest expenses: the current tax regime

Article 96, introduced by Law no. 244/2007, provides for rules direct to limit deduction of debt of companies and business entities resident in Italy, regardless of whether such debt is for the acquisition of shares or that is provided or guaranteed intercompany. Under article 96 non-deductibility of interest expenses depends on economic dynamics related to a book value defined as gross operating result. In order to guarantee compatibility with the principle of "ability to pay", limitation to deductibility is only temporary, being provided mechanisms of carry forward both of the non-deductible excess of a year and of the not used part of the gross operating result. This discipline is applied only to IRES taxable subjects because for the IRPEF taxable subjects, the discipline is that of pro rata provided for by article 61 ITA ([75]).

The IRES taxable subjects are resident companies and commercial entities, the non-resident companies and entities without a permanent establishment and the permanent establishments in Italy of non-resident companies and entities. The paragraph 5 of article 96 identified IRES taxable subjects excluded by this discipline. They are banks and other financial entities referred to in article 1 of Legislative Decree no. 87/1992; insurance companies and parent companies of

[75] Article 61 of ITA states that:

"*Interest expenses inherent to the exercise of the enterprise are deductible for the part corresponding to the ratio between the amount of revenue and other income that form the business income or which do not contribute since they are excluded and the total amount of all revenues and income.*

The part of interest expenses not deductible pursuant to paragraph 1 of this article does not give the right to deduct the tax provided for in subparagraphs a) and b) of article 15".

banking and insurance groups; consortia; project companies formed for the construction and operation of dry ports; companies whose capital subscribed mainly by public entities, that build or operate facilities for the provision of water, energy and district heating, as well as installations for the disposal and treatment.

Interest expenses borne by these subjects are deductible from the IRES tax base to the extent of 96% of their amount. It is a special rule introducing a generalized, definitive non-deductibility and released by economic and budget parameters of interest expenses, in the financial sector.

About operating mechanism, article 96 states that interest expenses and similar charges are deductible in every tax period up to the amount of interest income and similar income realized in the same tax period.

The negative excess of interest expenses is further deductible but within the limit of the 30% of the gross operating profit (EBITDA) deriving from the ordinary activities.

The EBITDA relevant to the test of deductibility is the difference between value and cost of production referred to in subparagraphs A) and B) of article 2425 c.c..

Any greater extent compared to 30% of the gross operating result of the same period is non-deductible in the accrual period. This excess is, however, only temporary.

Under paragraph 4 of article 96, the amount non-deductible in a tax period can be carried forward and deducted in subsequent tax periods to the extent that the EBITDA produced in those periods, net of interest expenses and similar charges, is roomy and allows the deduction. So the non-deductibility of a negative component has been transformed into a postponement of the deduction. The possibility to carry forward the excesses without any temporal limit encourages enterprises to reorganize their financial structure, allowing them the time necessary for a review of financing methods of the activity.

But the carry forward of the excess of interest expenses would have been of little significance without the provision, under which also the share of gross operating result not used during the accrual tax period can be taken to increase the gross operating results of the subsequent tax periods.

The paragraph 7 of article 96 allows to proceed, in the case of option for taxation on a national consolidated base, to compensation between exceeds of non-deductible interest expenses and not completely used EBITDA, produced by companies participating to the same consolidation.
In other words, in the national consolidation, the negative excess of non-deductible interest expenses of a company can be used to reduce the total income of the group with a consolidation adjustment, if and to the extent that the other consolidated subsidiaries submit, in the same tax period, a part of EBITDA not used to deduct their interest expenses. So, it is avoided the non-deductibility of interest expenses for the companies presenting an EBITDA equal to zero or negative, as the industrial holding.

4.3. Debt and Equity in the domestic law

The notion of debt and equity was contained in the repealed article 98 ITA, about thin capitalization. About debt, it was defined in article 98, paragraph 4, as composed by financing granted or guaranteed directly or indirectly by the qualified shareholder or by his related parties, arising from loans, deposits of money and from any other financial relationship.
About equity, it is defined, in article 98, paragraph 3, subparagraph e), as composed by the accounting net worth attributable to the shareholder and to his related parties, as reported in the financial statements relating the previous financial year. The criteria of demarcation is that debt indicates real liabilities, that are real debts that the company has contracted carrying out its activities, it is that shareholders' equity portion non-distributable during the life of society and it is composed by shareholders' contributions; instead, equity indicates financial liabilities that are used to ensure a balanced budget and it is the result of an easy operation: assets minus liabilities.

4.4. Hybrid or participating instruments

Art. 44 ITA in its paragraph 2, subparagraph a) qualifies similar to shares all securities and financial instruments the remuneration of which is entirely represented by the participation in the economic performance of the issuer company or of other companies within the same group or of the deal in relation to which they were issued. The category of securities treated as shares is therefore structured based on the nature of its remuneration and not based on the risk underlying the investment, which is the principle which grounds the definition of bonds ([76]).

Pursuant to art. 44, paragraph 2, subparagraph c) ITA, the following items qualify as similar to bonds: "*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* ". It follows that the new ITA does not resort to a unique criterion to describe the two categories under scrutiny, but simultaneously reverts to the criterion of return on investment and to the criterion of risk. To solve these issues, it must also be noted that art. 109, paragraph 9, subparagraph b) ITA provides for the non-deductibility from the issuer's business income of the remuneration of securities and financial instruments, however named, regulated by art. 44 ITA, in case they allow a direct or indirect participation in the issuer's economic results.

In conclusion, the effects of the provision set out in art. 109, paragraph 9, subparagraph a), ITA imply that the remuneration of securities and financial instruments are totally non deductible for tax purposes, for reasons of systematic coherence, such remuneration must be subject to the tax regime applicable on dividends, provided that it entirely consists in the participation to the economic performance of the company. So the qualification for tax purposes of the new financial instruments regulated by the new company law must follow one of the following criteria:

1. the remuneration and its reference amount;
2. the obligation to fully repay the principal;
3. the granting of participation rights.

[76] F. Marchetti e F. Rasi, *Raccolta di capitale di rischio e di capitale di debito:la disciplina italiana*, cit., p.22 e ss..

These criteria, however, do not operate on an equal level: the principle of remuneration must be applied in the first instance, as to allow a first distinction between securities similar to shares and not. This initial distinction is not exhaustive, since, within the category of securities not similar to shares, it is necessary to identify the boundaries of a narrower area that includes securities similar to bonds. The legislation only defines the second, therefore the first must be defined by difference: it covers securities that are not similar to shares nor to bonds. It is a residual category.

From the issuer's perspective, art. 109 ITA applies and it does not require to distinguish whether a security qualifies as atypical or not. Indeed, its scope of application is wider than that of art. 44 ITA. While the latter considers financial instruments as shares when their remuneration is "totally" represented by the participation in the issuer's economic performance, upon determination of the business income, the non deductibility for tax purposes operates not only for the remunerations linked to the economic results of the issuers, but also on a pro rata basis for those only partially linked to the performance of the business. Therefore, different regimes apply to the holder of a security (the remuneration of which is only partially linked to the profits of the company) for whom the same is not qualified as a share pursuant to art. 44 ITA and for the issuer for which, however, the related remuneration is only partially deductible.

About the tax regime applicable to income arising from the ownership of bonds, securities similar to bonds and atypical securities, of both domestic or foreign source, ordinarily consists in the application of a withholding at source or of a substitutive tax levied at a rate of 20% as of 1 January 2012 (instead of at the former 12.5% rate), following the amendments made by Law Decree no. 138 of 13 August 2011, converted into Law no. 148 of 14 September 2011.

Art. 2, paragraph 6 of the mentioned Decree provides that withholding taxes and substitutive tax applicable on interest, premiums and all other income regulated by art. 44 ITA and on the category “other income” governed by art. 67, paragraph 1, letters from c-*bis* to c-*quinquies*, ITA shall be levied at a rate of 20%.

The possibility of qualifying a security as a share, a bond or an atypical security has become totally irrelevant since, save for dividends arising from qualified participations, the remuneration of all other securities is subject to taxation at 20%; therefore it is no longer necessary to identify securities subject to tax at 12.5% (usually bonds) and those subject to tax at 27% (usually atypical securities). In the former regime, such different tax treatments gave rise to relevant tax planning.

However, the recent amendments did not remove the tax planning grounds in relation to the use of either debt financing or venture capital. It is true that the recipient is subject, except when it holds a qualified participation, to tax at 20%, but the topic concerning the deductibility for the issuer company of the amounts paid (profit or interest) remains unsolved.

A further open issue is that concerning capital gains, or rather capital losses. Reference is made to those conducts providing for the transfer of securities in order to obtain a tax relevant capital loss, circumventing the principle according to which capital losses should not be relevant. The mechanisms based on substitutive taxes are, indeed, applied to capital gains arising from the sale of the securities at stake, however, in such a case, also capital losses become relevant for tax purposes and they reduce the amount of the corresponding gains realized in the same tax year or in subsequent years.

5. CCCTB - Common Consolidated Corporate Tax Base

The proposal of a common consolidated corporate tax in the EU, officially presented by the European Commission on March of 2011, represents an epochal attempt to reform the direct taxation in the history of the European Union. For the first time since the birth of the European Union, a statutory act disciplines at the supranational level and evenly an essential element of the tax, the tax base, on which, together with the tax rate, depends the size of the tax levy ([77]).

The CCCTB method establishes the introduction of an only European tax law on optional basis, direct to replace the 27 national tax systems in force in the determination of the tax base of companies with transnational activity ([78]).

This method involves the calculation of business income on a consolidated basis, in application of common rules for all member States. The tax base so calculated is then apportioned among the concerned States, which apply their own rate.

5.1. The subjective scope

As regards the subjective scope of the proposal for a directive, the CCCTB discipline is applied to member States' companies listed exhaustively by the EU legislator in an annex to directive, when they are subject to corporate income taxes identified by the legislator in another annex.

Also the permanent establishments located within the EU territory may be subject to the CCCTB discipline.

This discipline is applies also to the companies with the registered office in third States, which have the same form provided for the EU companies and that are subject to the aforementioned corporate income taxes.

As part of a multinational group, for the purposes of the CCCTB, can be identified two different types of companies:

- companies controlled, directly or indirectly, in a percentage higher than 75%;

[77] D. Canè, *La proposta di Direttiva per una CCCTB: una analisi per principi*, in *Rass. trib.*, 2012, VI, p. 1511.

[78] P. Valente, *La proposta di direttiva sulla Common consolidated corporate tax base (CCCTB): il consolidamento della base imponibile*, in *Il fisco*, 2011, I, p.2207 e ss..

- companies in which the parent company exercises the right to vote in more than 50%.

The tax base is only applicable on an optional basis, being excluded any possibility of compulsory.

The option can be exercised for an initial period of five years and it may be renewed for successive periods of three years, unless notice of termination.

The option of consolidation becomes effective only from the next tax period.

Only companies in which the European parent company, directly or indirectly, controls more than 75% of the capital or more than 50% of the voting rights in the ordinary shareholders' meeting, have the right to opt for consolidation between their income and the income of the parent and of the other consolidating companies within the group. The requirement of the qualified control must persist for at least nine consecutive months.

5.2. The consolidation of the tax base

The consolidation is mandatory for all companies that opt for the CCCTB discipline and that hold a subsidiary or a permanent establishment in another EU State, satisfying conditions for the admission to EU consolidation ("*all in, all out*" principle).

The consolidation affects the totality of the tax base of each company admitted to the consolidated, regardless of controlling share held by the parent company.

For the application of the EU consolidation discipline, the group includes the EU parent, its subsidiaries and its permanent establishments with the registered office within the EU territory, regardless of whether the parent company with the registered office in the EU is in turn controlled by a company located in a third State. The group, moreover, can be constituted by more companies located in the EU that are controlled by a parent company resident in a third State.

The presence of a non-EU company in an intermediate position within a group of EU companies does not determine the interruption of the holding chain necessary for the implementation of the EU consolidation.

Also a taxpayer holding a permanent establishment within the EU territory represents a group.

A company, in order to be admitted to the consolidation, must be controlled, directly or indirectly, by more than 75%. The purpose is to ensure that all companies in which the parent controls, directly or indirectly, more than 75% of the capital are included in the scope of consolidation.

Where the percentage of the direct holding is less than or equal to 50%, it is considered equivalent to zero.

The holding requirement must exist throughout the tax year.

The following conditions must be satisfied also after the admission of the company to the consolidation, under penalty of exclusion:

- the minimum holding percentage of more than 75% held by the parent must be respected both in the beginning and in the end of the tax year;
- during the tax year, the percentage of voting rights must never fall below the threshold of 50%.

The CCCTB Working Group underlined that minor variations in the percentage of participation should not lead to the exclusion of the concerned company, provided that this percentage will not fall below 50%. This is provided to ensure the stability of the group and to avoid any manipulation of the consolidated companies.

Different solutions have been formulated about the moment in which the rules of the EU consolidation can be deemed applicable to the companies that enter or leave the group.

Solution suggested by the CCCTB Working Group states:

- the immediate consolidation of the companies that join the group;
- the immediate deconsolidation of that leaving the group.

The fact that a company joins or leaves the group during the tax year could affect the calculation of the factors that make up the sharing mechanism.

Article 58, paragraph 2 of the proposal of the directive establishes that a subject becomes member of the consolidated group when he reaches the holding requirement. This requirement must exist for at least nine consecutive months, under penalty of exclusion.

Profits and losses of the companies of the group are algebraically added and included in a unique tax base. This latter, if positive, is distributed according to a formula, defined “key allocation”, composed by three factors: sales, employment and assets. The concerned member States will apply their own tax rates on the portions of tax base allocated to them. The allocation mechanism consists of a predetermined mathematical formula combining the three factors which express, in mathematical terms, the contribution of every jurisdiction to a group’s total income. The result should reflect the real economic activity exercised in a State. Consequently, to the member State in which there is the most significant presence of productive factors (“income-creating factors”) is allocated the portion proportionally greater of tax base. In principle, this allocation formula is designed to be of simple application, difficult to manipulate, equitable and efficient in the distribution of the tax base. In practice, its balance is proving no simple undertaking.

Losses incurred by a company before the arrival in a group which applies the CCCTB discipline are not reportable to the group. These, however, can be used by the same company that registered them, which may deduct losses from the portion of tax base allocated to it on the basis of the applicable mechanism of allocation.

Losses incurred by the group may be carried forward to be offset with any future profits.

In the case of reorganization, for which one or more groups, or two or more members of a group, become part of another group “any unrelieved losses of the previously existing group or groups shall be allocated to each of the members (…) on the basis of the factors applicable to the tax year in which the business reorganization takes place, and shall be carried forward for future years”.

The admission to the consolidation involves the calculation of company’s income no longer on a single basis but it involves the identification of a group tax base. Tax is levied by the member State, applying its own rate, on the portion of the common tax base allocated to it.

5.3. Intercompany transactions

The sales of goods and the performances of services between the consolidated companies are neutral as regards taxation and the related fees are not covered by the consolidated tax base.

As a consequence there is the non-application of the domestic laws about transfer pricing, providing the principle of the normal value for the price applicable to the intercompany transactions.

5.4. The consolidation method

Companies belonging to a group subject to the CCCTB discipline are admitted to the EU consolidation if they satisfy the requirement of the holding percentage referred to in article 54 of the proposal of directive.

The application of the rules of the EU consolidation implies the tax neutrality of the intercompany transactions.

So the CCCTB Working Group presented two different approaches:

(1) according to the first approach, it is possible to avoid to compute profits and costs related to intercompany transactions, except those involving depreciable assets;

(2) according to the second approach, each company can compute profits and costs related to the intercompany transactions, which are "written off" when the consolidation is implemented.

Article 59 of the proposal of directive welcomes the principle according to which profits and losses deriving from intercompany transactions do not be considered to calculate the consolidated tax base. Moreover, no withholding tax may be applied with respect to the same transactions.

5.5. Dividends

The CCCTB discipline also influences the tax treatment of the income distribution. The economic and financial flows to which it is applicable the CCCTB discipline have been, by the CCCTB Working Group, so classified:

- distribution of major income between consolidating entities;
- distribution of major income between consolidating entity and non-consolidating entity (or belonging to another group);
- payment and perception of passive income between residents;
- payment and perception of passive income between resident and non-resident;

- distribution of portfolio income between residents;
- distribution of portfolio income between resident and non-resident.

In general, the CCCTB Working Group distinguishes between income deriving from third States and income deriving from an EU State.

About income deriving from third States, dividends from major shareholdings and from permanent establishment should be exempt.

Portfolio dividends and any other passive income would be subject to taxation with the recognition of a tax credit for the paid withholding tax.

About income deriving from a EU State, it is always attracted in the scope of the consolidation of the group if deriving from a permanent establishment. Dividends from major shareholdings are included in the consolidated tax base if the requirement of the holding of more than 75% is satisfied. Portfolio dividends and any other passive income are subject to the same discipline provided for the corresponding categories of income deriving from third States.

5.5.1. Treatment of dividends in the proposal of directive

The proposal of directive underlines that dividends should be exempt. Indeed, "in giving relief for double taxation most Member States exempt dividends since it avoids the need of computing the taxpayer's entitlement to a credit for the tax paid abroad, in particular where such entitlement must take account of the corporation tax paid by the company distributing dividends. The exemption of income earned abroad meets the same need for simplicity".

The exemption method is preferred to the credit method because it is easier to implement. The credit method would require recalculation of the profits of all subsidiaries according to the legislation of the member State granting the credit.

Coherently, in order to calculate the tax base, within the exempt income, article 11 of the proposal of the directive includes also distributions of dividends, while article 60 establishes that any withholding tax "or other source taxation shall be charged on transactions between members of a group".

Italy still does not provide any initiative to adopt the proposal of a Common Consolidated Corporate Tax Base, although this mechanism provides a flexible approach to solve existing problems of the apportionment of income and distributive criteria that could be implemented in double tax conventions from the point of view of a fair allocation of taxation rights.

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Fairness and taxation of residents and non-residents

Valentina Di Marcantonio

100793

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INTRODUCTION

Two different meanings can be attributed to the word “fairness”: it can be interpreted as a synonymous with “equality” or as a synonymous with “reasonableness”.

As regards the definition of “fairness”, Rawls referred to a “*well-ordered*” society as a “*society (…) designed to advance the goods of its members and effectively regulated by a public conception of justice*”; he had a “domestic” understanding of justice, which means that only those who belong to a local society are subject to certain principles. According to Rawls, two main principles of justice can be individuated: the first one regards the basic liberties and rights, which have to be guaranteed to everyone; the second one, includes the “fair equality of opportunity”, which ensures that any individual has an effective access to “offices and positions”, and the “difference principle”, according to which inequalities are only permitted if they are to the greatest benefit of the “worst-off” members of society. In a subsequent work , the “Law of Peoples”, Rawls enunciates eight fundamental principles, such as the respect of human rights, set out by the representatives of each of the peoples in order to regulate the terms of their association.

Dworkin has a different idea of “fairness”, which goes beyond the equality of opportunities and implies an equality of resources, and wishes for a progressive system of taxation, so that a “vertical equity” among the members of society is realized.

The concept of justice is differently interpreted by "*relationists*" and "*nonrelationists*"; the difference between the two streams of thought regards the "*grounds*" of justice[1]. The former limit the application of the principles of justice only to those who belong to a certain community, to those "*who stand in some essentially practice-mediated relation*"; the latter adopt a wider notion of justice, including all members of global population, "*regardless of what relations they share*".

Nowadays, in the context of globalization, the "cosmopolitan" idea of fairness seems to be the most appropriate, after that the financial crisis in 2008 has induced all the States to cooperate through, on the one hand, the taxation on consumption of global goods (such a natural resources), and, on the other hand, a more efficient exchange of information.

[1] M. RISSE, *On Global Justice*, Princeton University Press, 2012, p. 7.

CHAPTER 1

TYPE OF TAX SYSTEM

1.1 INDIVIDUALS

In Italy both residents and non-residents individuals are subject to individual income tax[2], which is regulated by Title I of the Income Tax Code[3].

Individuals are liable to tax in relation to six different types of income[4]: income from immovable property; income from capital investment; income from employment; income deriving from the exercise of a professional or artistic activity and business income. A residual category includes miscellaneous types of income which cannot be ascribed to the previous categories, such as capital gains or winnings in lotteries and games.

The income tax is levied on every item of income which is included in one of the categories and cannot be levied on those items that are not expressively mentioned; if the income is in kind, then its market value is taken into consideration[5].

The individual income tax is a “periodic” tax; for individuals the taxable period is the calendar year. The attribution of the income to the taxable period follows the rules regarding the category to which the income belongs[6]. Generally, business income is attributed to each taxable period according to the accrual principle[7], unless a different rule is established (for example for dividends and for directors’

[2] IRPEF, *Imposta sui redditi delle persone fisiche.*
[3] DPR 22nd December 1986, n. 917, *Testo unico in materia di imposte sui redditi.*
[4] Art. 1 of the Income Tax Code.
[5] The market value is defined by art. 9 of the Income Tax Code.
[6] Art. 7 of the Income Tax Code.
[7] Art. 109 of the Income Tax Code.

fees). Instead, items of income belonging to the other categories are determined on a cash basis.

Individual income tax is a progressive tax, in accordance with art. 53 of the Italian Constitution[8]. Five progressive tax rates are provided by Italian tax law[9]: 23% for slice of income up to EUR 15.000; 27% for slice of income between EUR 15.000 and 28.000; 38% for slice of income between EUR 28.000 and 55.000; 41% for slice of income between EUR 55.000 and 75.000; 43% for slice of income exceeding EUR 75.000.

In some cases, the taxpayer can opt for a separate taxation, which is a regime provided for particular items of income (for example indemnities deriving from the termination of an employment relationship or of an agency contract). In these cases, special rules are applied in order to individuate the tax rate[10].

The tax base varies according to whether or not the individual is resident in Italy, so that residents are taxed on the aggregate income, including both domestic and foreign income, and non-residents are liable to tax only in respect of the income produced in Italy.

Individual income tax is a "personal" tax, which means that personal reliefs are taken into account in order to determine an individual's tax liability.

Some personal expenses[11] can be deducted from taxable income, which include for example medical expenses, periodical payments made to the spouse, social security and welfare contributions and some donations.

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[8] Art. 53 of the Italian Constitution provides that:"*Tutti sono tenuti a concorrere alle spese pubbliche in regione della loro capacità contributiva. Il sistema tributario è informato a criteri di progressività*".

[9] Art. 11 of the Income Tax Code.

[10] Artt. 17, 18,19, 20, 20-bis, 21 of the Income Tax Code.

[11] Art. 10 of the Income Tax Code.

The taxpayer is also provided with some tax credits, amounts that can be deducted from the tax due, which can be divided into three groups[12]: credits for the spouse, children and other dependants; credits for individuals earning income from employment, business or professional activities or receiving pension, if the income does not exceed EUR 55.000; a 19% credit for certain expenses.

If the taxpayer is not resident in Italy, only some of these deductions and credits are granted[13].

1.2 CORPORATIONS

In Italy corporations are subject to corporate income tax[14], which is regulated by the Title II of the Income Tax Code (DPR 917/1986).

As established for individual income tax, corporate income tax is levied on both resident and non-resident companies[15] whose income, in money or in kind, is mentioned by article 6 of Income Tax Code[16].

The taxable persons are divided into four main groups.[17]

The first groups includes specific types of companies, that are joint-stock companies, limited liability companies, partnerships limited by shares, cooperatives, mutual insurance companies, European companies (RE 2157/2001) and European cooperative companies (RE 1435/2003).

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[12] F. TESAURO, *Istituzioni di diritto tributario*, Milano, 2012, p. 30.
[13] Art. 24 of the Income Tax Code.
[14] IRES, *Imposta sul reddito delle società*.
[15] Art. 73 of the Income Tax Code.
[16] Art. 72 of the Income Tax Code.
[17] Art. 73 of the Income Tax Code.

The second group is composed of private and public entities, other than companies, and trusts, resident in Italy, whose only or main business purpose is to conduct a business activity.

The third group consists of private or public entities, other than companies, and trusts, resident in Italy, whose only or main business purpose is not the exercise of a business activity.

Finally, the last groups includes companies and entities of any kind, public or private, with or without legal personality, that are not resident in Italy.

Corporate income tax has a flat rate of 27,5%[18]. An additional tax of 25% may be imposed if the income derives from the production, distribution or sale of obscene or violence-inducing material (so called "ethical tax")[19].

Corporate income tax is a "periodic tax" as well. The taxable period is the financial period of the company, that can be determined by the law or by the articles of incorporation. If the financial year is not determined neither by the law nor by the articles of incorporation, or it is of two or more years, the taxable period is the calendar year[20].

Just a few expenses con be detracted from the corporate income tax. In particular, art. 78 of the Income Tax Code provides that some types of donations can be deducted from the "gross" tax, within the limit of 19% of their amount.

Under certain conditions, companies mentioned by art. 73 let. a) (companies exercising a commercial activity) and limited liability companies owned by 10 individuals or limited liability cooperatives owned by 20 individuals can opt for the look-through regime. The "*all in, all out rule*" is applied", therefore the option

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[18] Art. 77 of the Income Tax Code.

[19] D.P.C.M. 13th March 2009, implementing D.L. 29th November 2008, n. 185.

[20] Art. 76 of the Income Tax Code.

has to be exercised by the participated company and all the shareholders. The adoption of this regime determines a transparent taxation of the participated company and the income produced by the "transparent" company is attributed to the shareholders and contribute to their taxable income, regardless of the effective distribution of dividends and proportionally to their shares of participation[21]. Within certain limits, losses are attributed to shareholders proportionally to their shares of participation; losses exceeding those limits can be used by the participated company, likewise losses suffered before the adoption of the regime[22]. Italian tax authority specified that the income is attributed to those who are shareholders of the company at the end of the financial year and that the acts that modify the shares of participation produce effects in the taxable period following the taxable period in which they were performed[23]. The objective of this circular is to avoid that the shares of participation are modified at the end of the year in order to attribute income to loss-making companies or to attribute losses to company with taxable income[24].

The option for the look-through regime can be exercised by companies participated by other companies holding a minimum stake of 10% and a maximum stake of 50%. The shareholders have to be resident in Italy for tax purposes or, in case they are not resident, they don't have to be subject to withholding taxes on dividends. In practice, the regime can be adopted by non-resident companies if[25] Directive 96/2011 ("Parent-Subsidiary", previous Dir. 435/1990) can be applied,

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[21] Articles 115 and 116 of the Income Tax Code.
[22] V. FICARI, *Profili applicativi e questioni sistematiche dell'imposizione "per trasparenza" delle società di capitali*, Rass. Trib., n. 1, 2005, p. 38.
[23] Italian Fiscal Administration circ. 22nd November 2004, n. 49/E.
[24] A. DODERO, *La tassazione per trasparenza delle società di capitali*, Corr. Trib., n. 48, 2004, p. 3822.
[25] F. TESAURO, *Istituzioni di diritto tributario*, cit., pp. 153-154.

so that States are obliged to avoid juridical double taxation by granting an exemption from withholding taxes. Also the participating companies that have a permanent establishment in the State can opt for the look-through regime as controlling companies, on the condition that the participation in the transparent company is recorded in the books of the permanent establishment. Companies that are resident in States with which Italy stipulated an international Convention to avoid double taxation that excludes the application of withholding taxes on dividends can be included in the regime as well.

The look-through regime cannot be adopted if the shareholders are subject to a reduced rate of corporate income tax, because it would cause a loss of revenue for the State. Other cases in which the regime cannot be adopted occur when a shareholder has already opted for consolidation (domestic or worldwide) either as controlling or as controlled company and when a shareholder is under an insolvency procedure.

The participated company is jointly liable with each shareholder for the payment of taxes, penalties and interest arising from the imputation of its income.

Italian Income Tax Code also provides a particular type of fiscal regime for groups of companies, that is consolidation. There are two different forms of consolidation: domestic consolidation[26] and worldwide consolidation[27]. Both domestic and worldwide consolidation are particular regimes, that may be adopted (they are not compulsory) by groups of companies or entities.

The main effects deriving from the adoption of domestic consolidation are the simplification in the determination of the tax base of the group and the reduction

[26] Articles 117-128 of the Income Tax Code.
[27] Articles 130- 142 of the Income Tax Code.

of double taxation[28]. Although the regime determines the creation of one tax base, each company maintains its own tax liability and has to fill out its own tax return.

Domestic consolidation can be adopted by companies and entities mentioned by art. 73, paragraph 1) lets. a) and b) (companies and entities exercising a commercial activity), on the condition that the parent company owns, directly or indirectly, the majority of the voting shares in the shareholders' meeting of the controlled companies. Non- resident companies or entities can opt for domestic consolidation, only as parent companies, if they are resident in a Country with which Italy stipulated a bilateral Convention to avoid double taxation and they conduct a business activity in Italy through a permanent establishment.

It is not necessary that all the companies belonging to the group are included in the consolidation; the option is exercised by the parent company with each controlled company[29].

Companies can opt for domestic consolidation if the financial year of the parent company coincides with that of each controlled company included in the consolidation. Each controlled company has to elect the consolidating company as its domicile for the purposes of the notification of acts relating to the taxable periods included in the option and the exercise of the option has to be communicated to the Revenue Agency.

Each company has to calculate its own taxable income, by applying the general rules regarding business income; then the tax base of the group is determined by adding up profits and losses of each company that is included in the consolidation.

[28] V. ARTINA, M. LAMPERTI, *Il consolidato fiscale nazionale*, Pratica fiscale e professionale, n. 15, 2007, p. 35.

[29] Art. 117 of the Income Tax Code.

Generally, in order to prevent thin capitalization, passive interest can be detracted within certain limits[30]. If domestic consolidation is adopted, it is possible to deduct the passive interest of a company exceeding those limits from the tax base of the group, on the condition that at least one company has a sufficient gross operating income (this is the "rectification of consolidation").

The adoption of worldwide consolidation, instead, determines the attribution of the income (profits and losses) produced by subsidiaries resident abroad to the parent company resident in Italy, proportionally to its shares of participation.

An advantage deriving from the adoption of worldwide consolidation is the deductibility of transnational losses; on the other hand, profits of non-resident subsidiaries are immediately taxable in Italy, which is an exception to the general rule according to which dividends are taxable on a cash basis[31].

Unlike domestic consolidation, the "*all in, all out*" rule is applied, so all the subsidiaries have to be included in worldwide consolidation. The option is binding for five financial years (subsequent renewals of the option are binding for three years). The option for the worldwide consolidation can be exercised only by the parent company whose securities are negotiated in stock markets and that is controlled by the State, by other public entity or by resident individuals who do not control other companies. Another condition is that the parent company owns the majority of voting shares in the shareholders' meeting and owns a share of participation to profits higher than 50%.

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[30] Art. 96 of Income Tax Code, passive interests can be deducted in the same measure as the active interests earned by the company and the exceeding part can be deducted within the limit of 30 % of the gross operating income.

[31] F. TESAURO, *Istituzioni di diritto tributario*, cit., p. 176.

The option can be exercised if the financial year of the parent company coincides with the financial years of the subsidiaries. It's also necessary that all the companies (included the parent company) are subject to compulsory audit and that the Revenue Agency expressed its positive opinion about the existence of all the conditions required by the law. Finally, the subsidiaries have to undertake to cooperate with the parent company in the determination of the tax base and to respond to the requests formulated by Tax Administration within 60 days from the notification.

Until 1 January 2004, in order to prevent economic double taxation of dividends, Italian tax system adopted the imputation system and granted the taxpayer a tax credit whose amount was equal to the amount of tax paid by the company. With the Legislative Decree 344/2003, entered into effect in 2004, Italy adopted the exemption system also for dividends distributed by resident companies. The exemption system follows different rules according to whether the person who receives the dividends is an individual or a company. In the first case, a further distinction has to be made: if the individual has a qualified participation, dividends are partially exempt, in the measure of 50,28 %; if the individual has a non-qualified participation, dividends are subject to a 20% withholding tax.

If the person receiving the dividends is a company, dividends are nearly totally exempt, in the measure of 95% (a 5% taxation is necessary to consent the deduction of costs) [32].

[32] Art. 89 of Income Tax Code.

CHAPTER 2

RESIDENTS AND NON-RESIDENTS

2.1 RESIDENTS AND NON-RESIDENTS: DIFFERENCES

Until the reform of 1971, Italian tax law was mainly based on "real" rather than "personal" criteria of taxation and citizenship was used to individuate the fiscal domicile of individuals. Currently, citizenship is no longer taken into account and residence plays a key-role, ensuring the "personality" and progressivity of the Italian tax system[33].

The main difference between residents and non-residents regards the determination of the tax base, which varies according to whether or not the person is resident in Italy, so that residents are taxed on their aggregate income, produced both in Italy and in the source state (worldwide income taxation), and non-residents are liable to tax only in respect of the items of income that are deemed to be produced in the State on the basis of a specific legislative provision (territorial approach)[34].

Since the worldwide income taxation may cause double-taxation, residents are provided with a tax-credit for the taxes levied by the source State.

The credit consists in a sum that can be deducted from the "net" tax due by the taxpayer and whose amount cannot exceed the part of the Italian tax corresponding to the ratio of the foreign income to the aggregate income. Italy is among those States that adopt the *country by country limitation*, so the deduction is made separately for each State.

[33] G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, Rass. Trib., n. 6, 1995, p. 1034.
[34] Art. 23 of the Income Tax Code.

Resident persons are granted a tax credit on the condition that[35] the income is considered produced abroad in accordance with article 23 of the Income Tax Code, the foreign income contributes to the aggregate income (thus the credit is not granted when the foreign income is subject to a withholding tax or a substitutive tax) and the foreign tax is a final tax. If the income is subject to a partial foreign tax, then the foreign tax credit is reduced proportionally.

In order to guarantee a fair division of taxation rights between the source State and the residence State, Italian tax law[36] provides non-residents with an exemption in respect of items of income deriving from capital investment, other than profits and interest deriving from bank and postal accounts and except for profits deriving from loans. The exemption is attributed to the beneficiaries of the income who are resident in a State with which Italy has stipulated an agreement regarding the exchange of information. The main purpose of this provision is to favor some financial operations and to attract foreign capital investments[37].

Another significant difference regards the attribution of personal-related deductions, which makes sure that the individual's personal conditions are taken into consideration for the determination of his or her tax liability. While resident individuals are granted a series of deductions related to their personal and familiar situation (for example, deductions for dependants), non-resident individuals can deduct from their taxable income just some expenses, which do not include personal reliefs. From this point of view, Italian tax law complies with the principles set out by the EU Court of Justice. In 1995, the Court stated that, in

[35] F. TESAURO, *Istituzioni di diritto tributario. Parte speciale*, Milano, 2012, pp.169-170.
[36] Art. 26-bis of DPR 29th September1973, n. 600..
[37] P. BORIA, *Riflessioni a margine dell'esenzione dalle imposte sui redditi per i non residenti prevista dall'art. 26-bis del D.P.R. n. 600/1973*, Rass. Trib. n. 2, 2005, p. 383.

relation to personal-related deductions, generally the position of non-residents cannot be assimilated to that of residents because "*income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence*"[38]; therefore the source State normally is not able to assess non-residents overall ability to pay.

A marginal difference regards the different ways of taxing income from independent work, that, if earned by residents is taxed on assessment, whereas, if produced by non-residents, is taxed through a final withholding tax.

2.2 WORLDWIDE INCOME TAXATION

Residence is a form of personal attachment to the state. If an individual can be considered resident in Italy , then he or she will be subject to individual income tax on his aggregate income, including both domestic and foreign income.

The aggregate income is calculated by adding up all the items of income owned by the resident, each of which is determined by applying the rules regarding the category to which the income belongs.

Losses deriving from the exercise of a professional or artistic activity can be deducted from the aggregate income, unlike losses deriving from business activity which can be carried forward for a maximum of five years (except for losses incurred in the first three years of a business activity which can be carried forward without time limits, if they relate to a new activity)[39].

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[38] C-279/93, *Schumacker*.

[39] Art. 8 of the Income Tax Code.

In any case, the tax base does not include exempt profits, profits subject to withholding taxes, income subject to separate taxation and some other elements mentioned in art. 3 of the Income Tax Code.

Personal reliefs[40] can be deducted from the "gross" tax base; through this deduction, the "net" tax base is determined.

By applying the tax rate to the net tax base, the "gross" tax is obtained, from which some expenses[41] (such as the expenses for dependants) can be detracted and the "net" tax is obtained[42].

Finally, the accounts made by the taxpayer, creditable withholding taxes and tax credits are deducted from the "net" tax in order to calculate the tax due by the taxpayer.

As regards resident companies or entities, the rules to apply in order to calculate the tax base vary according to the category to which the company or entity belongs.

All income earned by companies and entities by art 73 let. a) and b) (companies and entities exercising commercial activities), is treated like business income, independently from the source of it[43].

The aggregate income is determined on the basis of the profit and loss account, which needs to be modified in accordance with some tax law provisions. Companies adopting the International Accounting Standards introduced by RE 1606/2002 can apply the criteria provided by the IAS regarding the qualification,

[40] Those expenses indicated by Art. 10 of the Income Tax Code
[41] Indicated by articles 12, 13, 14 and 15 of the Income Tax Code.
[42] Art. 22 of the Income Tax Code.
[43] Article 81 of Income Tax Code.

time accrual and classification, even though they repeal in part the provisions of the Italian Income Tax Code.

The aggregate income of entities sub let. c) of art 73 (entities that do not exercise commercial activities), consists of: income from immovable property, income from capital investment, business income and other income.

In any case, the tax base does not include exempt profits and income subject to withholding taxes.

For resident partnerships, art. 5 of Income Tax Code provides a "transparent" system of taxation, which means that profits made by the partnership are attributed to the partners and contribute to the determination of their tax base.

2.3 TERRITORIAL APPROACH

Italian tax law adopts a territorial approach for the taxation of non-resident persons, who are subject to individual o corporate income tax in relation to income produced in Italy.

Different rules are applied in order to determine non-residents' taxable income[44].

Individuals are taxed on their aggregate income, composed of items of income which are considered to be produced in Italy in accordance with art. 23 of the Income Tax Code, and on income subject to separate taxation. Only some deductions are granted to non-residents.

Non-resident partnerships are subject to corporate income tax.[45]

[44] Art. 23, 73, 151, 153 of the Corporate Income Tax.
[45] Art. 73, subsection1, let. d) of the Income Tax Code.

Non- resident companies and entities exercising a commercial activity are taxed on their aggregate income, which is composed of all the items of income earned in Italy according to article 23 of the Income Tax Code.

Also companies and entities that do not exercise commercial activities are taxed on aggregate income, consisting of items of income produced in Italy, and the tax base is determined by applying the provisions of Title I, which regulates the taxation of resident individuals.[46]

2.4 THE ABILITY-TO-PAY PRINCIPLE

Article 53 of the Italian Constitution provides that everybody is obliged to contribute to public expenses by reason of their ability-to-pay.

When the principle was first introduced, it was criticized by some authors who regarded it as “an empty box”, a merely programmatic provision without a precise and concrete content. The conception of art. 53 changed when the Italian Constitutional Court stated that the ability-to-pay principle has a “preceptive”, and not merely programmatic, effect and can be used as a parameter to appreciate the constitutional legitimacy of ordinary laws.

The individuation of taxpayers’ ability to pay is strictly connected to the principle of territoriality. According a part of the Italian literature there are no limitations to a State’s fiscal jurisdiction (it’s only difficult for a State to enforce fiscal obligations in practice); other authors argue that tax liability should be based on a “genuine and reasonable link” to the territory of the State[47].

[46] Art. 154 of the Income Tax Code.
[47] The different positions are reported by G. MELIS, *Vincoli internazionali e norma tributaria interna*, Riv. Dir. Trib., fasc. 10, 2004, p. 1083.

Originally, according to the version of the principle enunciated by article 25 of the "Statuto Albertino"[48] the term "everybody" was referred to citizens, the only persons who benefited from the activities and services provided by the State; nowadays it means that there must be a connection between the State and the wealth that expresses the ability-to- pay of the taxpayer[49].

There are two types of connection: a "personal" connection and a "territorial" connection.

The former regards resident persons, who are obliged to contribute to the public expenses of the community to which they belong, in accordance with the principle of solidarity enunciated by art. 2 of the Italian Constitution[50].

The latter regards non-resident persons, whose tax liability is limited to the income produced in Italy. The levying of taxes on non-residents' income is legitimate when they have that economic allegiance to the State that demonstrates that they benefit from the public services offered by the State[51]. From this point of view, the territorial approach represents a good compromise between the obligation to contribute to public expenses, which regards all those who have an attachment to the State, and the principle of equality, which forbids the legislator to create discriminations by treating residents and non-residents in the same way[52]. In order to guarantee a fair application of the ability-to-pay principle, it is necessary that the legislator individuates types of connection to the State that indicate an actual and effective ability to pay of non-residents. As a consequence,

[48] The "Statuto Albertino" was the Constitution of the Kingdom of Sardinia-Piedmont adopted in 1848.

[49] P. RUSSO, *Manuale di diritto tributario. Parte Generale*, Milano, 2008, p. 48.

[50] Art. 2 of the Italian Constitution requires the fulfillment of duties of politic, economic and social solidarity.

[51] M. GAZZO, *Profili internazionali della residenza fiscale delle persone fisiche,* Riv. Dir. Trib., fasc. 6, 2002, p. 669.

[52] MANZONI, G. VANZ, *Il diritto tributario, profili teorici e sistematici,* Torino, 2008, p.31.

non-residents cannot be obliged to contribute to public expenses in relation to extraterritorial facts, which do not express that minimum and reasonable connection to the State that legitimates the fiscal levying[53].

The expression "by reason of their ability-to-pay" means, on the one hand, that taxation is legitimated by the presence of indicators of the ability-to-pay and that only those taxpayers who have ability-to-pay can be obliged to contribute to public expenses; on the other hand, it means that the levying has to be proportioned to the taxpayers' ability-to-pay. Therefore, the ability-to-pay principle represents at the same time the legitimacy, the parameter and the maximum limit of taxation[54].

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[53] P. TARIGO, *Capacità contributiva e doppio d'imposta internazionale*, Riv. Dir. Trib., fasc. 5, 2011, p. 553.

[54] G. FALSITTA, *Corso istituzionale di diritto tributario*, Milano, 2009, p. 71;

CHAPTER 3

TAXATION OF RESIDENTS

3.1 INDIVIDUALS

3.1.1 TESTS TO DETERMINE RESIDENCE

Italian tax law provides both formal and factual criteria in order to determine individuals' residence. According to article 2 of the Income Tax code, an individual can be deemed to be resident if he or she is registered in the civil registry of resident population or if he or she has in Italy his or her domicile or residence. According to the definitions provided by the Italian civil code, domicile is the "main centre of his affairs and interests", whereas residence is "the place of habitual abode"[55] .

3.1.1.1 REGISTRATION IN THE CIVIL REGISTRY OF RESIDENT POPULATION

The registration in the civil registry of resident population is the only formal criteria and the easiest to apply. The registration in the civil registry regards those individuals, families and cohabiting individuals who have their residence in a municipal district; if they do not have a habitual abode, their domicile is taken into consideration[56].

According to most authors and case law it is an absolute presumption, which means that the individual is not allowed to provide proof to the contrary; therefore, the sole registration in the civil registry is sufficient for an individual to be taxed

[55] Art. 43 of the Italian civil code.
[56] Art. 1 of L. 24th December 1954, n. 1228.

on his or her worldwide income[57]. Some authors wish for a change in the current legislation, so that the factual situation is taken into account in order to determine an individual's tax liability[58].

The prevalence of the form over the substance has raised doubts about the compliance of the rule with the ability-to-pay principle, which requires the effectiveness and actuality of an individual's ability to pay.

A part of the literature argues that the registration in the civil registry of resident population has a merely statistic function and enables the Public Administration to learn about the composition and the movements of the population[59].

Instead, the substance prevails over the form in case the individual obtains the registration in the Registry of Italians resident abroad; in this case, it is necessary to verify that the individual has not maintained the center of his or her economic and personal interests in Italy[60].

3.1.1.2 DOMICILE

According to case law[61] and part of the literature the notion of domicile adopted by tax law is wide enough to include economic, moral and familiar interests.

Italian Tax Administration took up position in favor of this interpretation, specifying that the domicile of an individual is deemed to be in Italy if there are

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[57] G. PEZZUTO, S. SCREPANTI, *Il nuovo regime della residenza fiscale delle persone fisiche*, Rass. Trib, n. 2, 1999, p. 424.
[58] S. CAPOLUPO, *La residenza fiscale*, Il Fisco, n. 40, 1998, p. 13001.
[59] G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, Rass. Trib., 1995, pp. 1034 ss..
[60] Cass. civ. Sez. V, 15 June 2010, n. 14434.
[61] Cass. civ. 12 February 1973, n .435.

elements revealing that the individual has maintained in Italy the centre of his familiar, economic or social interests[62].

Other authors, instead, believe that the concept of domicile is only referred to economic interest, because it is the concept of residence that refers to other types of interests. If the wider concept of domicile is adopted, the two criteria may overlap[63].

3.1.1.3 RESIDENCE

According to the definition provided by the civil code, residence is the place where an individual has his or her place of habitual abode. Case law underlines that it is necessary to verify that two requirements are met: an "objective" requirement, that is the maintenance of the habitual abode in a certain place continuously and a "subjective" requirement, represented by the intention of the individual to maintain his or her habitual abode in that place[64].

Case law and literature define the "abode" as the place where the "person is currently situated". Some authors argue that the concept of "habitual abode" is only referred to the place where the individual lives; according to others, it includes the place where the individual conducts his or her professional or business activity or the place where he or she is employed[65] .

A part of literature defines "habitualness" as "stability", an intentional non-temporariness; other authors define it as "habitude". Case law specified that the in

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[62] Italian Fiscal Administration, Resolution 14th October 1988, n. 8/1329.

[63] The different positions are reported by G. PEZZUTO, S. SCREPANTI, *Il nuovo regime della residenza fiscale delle persone fisiche*, cit..

[64] Cass. civ., Sez. II, 14 March 1986, n. 1738; Cass. civ., Sez. I., 1 December 2011, n. 25726.

[65] The different positions are reported by G. PEZZUTO, S. SCREPANTI, *Il nuovo regime della residenza fiscale delle persone fisiche*, cit..

order to determine whether an individual's place of habitual abode is in Italy or abroad, it is necessary to sum up all the periods of time spent abroad and then compare the result with the period of time spent in Italy[66] .

3.1.2 EXPATRIATION

Subsection 2-bis of art 2 of the Income Tax Code provides a legal presumption regarding Italian citizens who are no longer registered in the Italian Registry of resident population and who expatriated in States and territories with a favorable fiscal regime. In this case, the State presumes that the citizen is still resident in Italy; it's a *iuris tantum* presumption, so the citizen can provide proof to the contrary. The original version of art. 2 stated that the States and territories with a favorable regime had to be individuated through a Decree of the Ministry of Economy and Finance[67], the so called *black list*; a subsequent law[68] introduced the opposite rule, according to which the States and territories with a favorable regime are those that are not included in another Decree, containing the so called *white list*. Since the *white list* is yet to be issued by the Ministry, the original rule is still applied.

The legislative provision links the cancellation from the civil registry of resident population to the transfer of residence to a tax haven, which means, on the one hand, that the rule should not be applied if an individual already resident in a tax haven subsequently becomes an Italian citizen; on the other hand, it implies that

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[66] G. PEZZUTO, S. SCREPANTI, *Il nuovo regime della residenza fiscale delle persone fisiche*, cit.. See Cass., SS. UU., 28 October 1985, n. 5292.
[67] D.M. 4th May 1999.
[68] L. 24 December 2007, n. 244.

the rule could be "circumvented" by an individual who transfers his residence to a State with an ordinary fiscal regime and subsequently moves to a tax haven[69].

3.2 PARTNESHIPS

3.2.1 TYPES OF PARTNERSHIPS

In Italy, partnerships are legal entities without legal personality. Italian civil code individuates three different types of partnerships: the simple partnership, that cannot conduct a business activity and may be set up to exercise, for example, a professional activity; the general partnership; and the limited partnership[70].

3.2.2 SYSTEM OF TRANSPARENCY

Resident partnerships are subject to a transparent system of taxation, which means that the profits made by the partnerships are attributed to the partners and included in their tax bases. The attribution is made proportionally to the share of participation of each partner and regardless of the effective distribution of profits. The shares of participation of each partner can result from a formal act, otherwise they are considered proportionate to the value of the contributions made by the partners; if the value of contributions is not determined either, then the shares are presumed to be equal[71].

[69] G. MELIS, *Riflessioni intorno alla presunzione di residenza fiscale di cui all'art. 10 della L. 23 dicembre* 1998, n. 448, Rass. Trib., n. 4, 1999, p. 1077.
[70] Art. 2249 of the Italian civil code.
[71] Art. 5 of the Income Tax Code.

Also losses are attributed to partners proportionally to their share of participation. Losses made by a limited partnership and exceeding the capital of the partnership, are attributed only to general partners[72].

Simple partnerships can earn income from immovable property, income from capital investment, professional income and other income; some expenses and costs can be deducted either from the tax base[73] or from the "gross" tax[74].

General partnerships and limited partnerships can only produce business income and the partners own an income from participation, unless they are commercial companies or individual entrepreneurs (in this case, the partners' income is qualified as business income as well).

Withholding taxes levied on the partnership's profits are deducted from the tax due by the partners[75].

Non-resident partnerships, instead, are subject to corporate income tax in accordance with art 73, subsection 1, let. d) of the Income Tax Code, which includes among the persons liable to tax also "companies and entities of every kind, public or private, with or without legal personality, trusts included, that are not resident in Italy".

No special rules are provided by Italian tax law in order to prevent legal arbitrage or hybrid mismatch through foreign partnerships.

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[72] Art. 8 of the Income Tax Code.
[73] Art. 10, subsection 3, of the Income Tax Code.
[74] Art. 15 subsection 3, of the Income Tax Code.
[75] Art. 22, subsection 1, of the Income Tax Code.

3.3 COMPANIES

3.3.1 DETERMINATION OF RESIDENCE

For the individuation of companies' residence Italian tax law provides both formal and factual criteria and some presumptions, that are indicated by art. 73 of the Income Tax Code.

A company is regarded as resident in Italy if it has either its legal seat or its place of effective management or its main business purpose in the State.

Unless the proof to the contrary is provided, a company is presumed to be resident in Italy when it controls, directly or indirectly, in accordance with art. 2359[76] of the civil code, a company that is resident in Italy if[77] the non-resident company is managed by a board of directors, or a similar body, whose members are prevalently resident in Italy or if it is controlled, even indirectly, by a person resident in Italy.

A company is also presumed to be resident n Italy, unless the proof to the contrary is provided, when its assets are mostly invested in shares of closed-ended real property funds, and it is controlled directly or indirectly by a resident person.

3.3.1.1 THE LEGAL SEAT

The legal seat is quite easy to individuate, because it is indicated in the articles of incorporation, in accordance with art. 2328 of the civil code. However, it often represents a merely formal indication, given that the business activity of the

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[76] Art. 2359 of the civil code provides three forms of control: the first one occurs when a company owns the majority of the voting shares in the shareholders' meetings of another company; the second one occurs when a company owns a sufficient number of voting share to exercise a significant influence on the shareholders' meetings of another company; the third one derives from contractual relationships between the companies.

[77] Art. 73 of the Income Tax Code, subsection 5-bis.

company is effectively exercised in a place other than that indicated in the articles of incorporation[78].

3.3.1.2 THE PLACE OF EFFECTIVE MANAGEMENT

The determination of a company's residence on the basis of its place of effective management, instead, is more complicated. The expression "place of effective management", which is not defined by the Italian legislation, refers to the place where the company is managed, that is the place where the key-decisions are made and the entrepreneurial strategies are elaborated. It is the place where the meetings of the directors and the meetings of shareholders are set, whereas the place where the day-by-day decisions are made is not taken into account[79]. Another part of literature argues that the formal attribution of managerial powers and the place where the reunions of the board of directors are formally set are not relevant[80]. According to case law, the place of effective management is the place where administrative activities are effectively conducted and where the shareholders' meetings are set, that is the place steadily used for carrying out dealings and directing the activity of the company[81]. When a Convention to avoid double taxation has been stipulated, if the company is resident in both contracting States (so called dual residence), the tie-breaker rule of art. 4 par. 3 of the Convention is applied and the company is considered resident in the State where its place of

[78] A. BALLANCIN, *Note in tema di esterovestizione societaria tra criteri costitutivi della nozione di residenza fiscale e l'interposizione elusiva di persona*, Riv. Dir. Trib., fasc. 11, 2008, p. 975.
[79] A. BALLANCIN, *Note in tema di esterovestizione societaria tra criteri costitutivi della nozione di residenza fiscale e l'interposizione elusiva di persona*, cit..
[80] G. .MELIS, *La residenza fiscale delle società nell'IRES: giurisprudenza e normativa convenzionale*, Cor. Trib., n. 45, 2008, p. 3648.
[81] Cass. civ., Sez. V., 7 February 2013, n. 2869.

effective management is located, that is the place where the company's main and substantial business activity is conducted[82].

Some problems arise in case of the groups of companies, because of the significant influence exercised by the parent company. In this case, it is necessary to determine in what measure the administrative bodies of the controlled companies can be deprived of their managerial powers without the controlled companies being considered resident in the parent company's residence State [83].

As the communication technologies develop, the identification of the place of effective management becomes harder. Directors can meet and make managerial decisions in different countries on a rotational basis; otherwise the can deliberate through the web or other remote communication systems (e.g. conference calls)[84].

3.3.1.3 THE BUSINESS PURPOSE

The "business purpose" represents the main economic activity conducted by the company in order to achieve directly the main purpose indicated by the law or by the articles of incorporation[85]. The determination of the main business purpose may be complicated when the company operates in several countries. In this case, it is necessary to individuate the State where the company prevalently operates, on the basis of different criteria, such as the number of employees[86].

Another issue related to the main business purpose regards foreign companies whose only business purpose is represented by the participations held in resident

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[82] Comm. trib. prov. Reggio Emilia, Sez. IV, 11 August 2009, n. 197.

[83] A. BALLANCIN, *Note in tema di esterovestizione societaria tra criteri costitutivi della nozione di residenza fiscale e l'interposizione elusiva di persona*, cit.

[84] G. MELIS, *La residenza fiscale delle società nell'IRES: giurisprudenza e normativa convenzionale*, cit..

[85]. Art. 73, paragraph 4, of the Income Tax Code.

[86] G. MELIS, *La residenza fiscale delle società nell'IRES: giurisprudenza e normativa convenzionale*, cit..

companies[87]. Some authors argue that the non-resident company cannot be considered to be resident in Italy just on the basis of the residence of the participated company, not even when the holding company just holds the participations without exercising a financial activity[88]. According to some authors, the main business purpose of the company cannot be deemed to be located in the residence State of the participated companies but in the place where the main decisions concerning, for example, the disposal of the participations are made[89].

3.3.2 CORPORATE EMIGRATION

One of the fundamental freedoms deriving from UE Treaties is the freedom of establishment, which can be exercised in two ways: through the transfer of the legal seat, of the center of management or of the main business purpose (*primary establishment*); by setting up agencies, branches or subsidiaries in another Member State, (*secondary establishment*).

Some States adopt the *Real Seat Doctrine* or *Sitztheorie*, according to which companies are regulated by the law of the State where the central management is situated; that means that the emigration of national entities incurs in a winding-up and the company is forced to set up a re-establishment.

Other States adopting the *Incorporation Doctrine* or *Gründungstheorie*, recognize companies as entities set up in accordance with the legislation of the State of incorporation, irrespective of the place where the central management or the main

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87 G. MELIS, *La residenza fiscale delle società nell'IRES: giurisprudenza e normativa convenzionale*, cit..

88 G. MELIS, *La residenza fiscale delle società nell'IRES: giurisprudenza e normativa convenzionale*, cit..

89 A. BALLANCIN, *Note in tema di esterovestizione societaria tra i criteri costitutivi della nozione di residenza fiscale e l'interposizione elusiva di persona*, cit..

business purpose is. In this case, emigrating companies do not have to re-establish in the host State.

Italian law balances the two criteria, providing that companies, associations, foundations and any other entity, public or private, are regulated by the law of the State in which the entity was set up; however the criterion of incorporation is tempered by the rule according to which if a company transfers its legal seat abroad but maintains its centre of management or its main business purpose in Italy, Italian law continues to be applied[90]. In any case, the transfers of social address to another State and mergers with entities whose legal seat is located in another State are operative if they comply with the national legislations of the involved States.

Initially the Court of Justice of the European Union did not affirm the illegitimacy of the national legislations hindering the exercise of the freedom of establishment, and stated that "*unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning*" and that "*articles 52 and 58 of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State*" (C-81/87, *Daily Mail*).

Subsequently, the ECJ stated that "*where a company formed in accordance with the law of a Member State ('A') in which it has its registered office is deemed, under the law of another Member State ('B'), to have moved its actual centre of*

[90] Art. 25 of L. 218/1995.

*administration to Member State B, Articles 43 EC and 48 EC preclude Member State B from denying the company legal capacity and, consequently, the capacity to bring legal proceedings before its national courts for the purpose of enforcing rights under a contract with a company established in Member State B" (*C-208/00, *Uberseering).* A Member State has to recognize a company set up in another Member State as an entity with legal personality, even if it does not comply with the legislation of the State where its real seat is located. The national legislation of a Member State is not legitimate if it obliges a company that transferred its real seat to that State to re-establish in compliance with the legislation of the host State.

A subsequent decision (C- 210/06, *Cartesio*) limited the principles expressed with the *Daily Mail* decision, and stated that the national legislation that does not allow a company to transfer its seat to another Member State is legitimate, if the company intends to maintain its status of company governed by the law of the Member State of incorporation; that legislation is not legitimate if the emigrating company intends to adopt the *lex societatis* of the host State.

In compliance with the principles set out by the Court of Justice in these decisions, a part of the Italian literature[91] argued that the criterion of the real seat and art. 25 of L.218/1995 are not operative if they prevent a company from exercising its freedom of establishment within EU.

Italian Tax Administration, referring to the case of a Spanish company which moved to Italy, specified that the transfer of social address to Italy does not determine the winding-up of the company and does not impede to legal continuity

[91] G. PETRELLI, *Lo stabilimento delle società comunitarie in Italia*, Rivista del notariato, fasc. 2, 2004, p. 361.

of the entity, on the condition that also the law of the State in which the company was set up provides the same rule[92] .

3.3.2.1 ART. 166 DPR 917/1986: THE EXIT TAX

Art. 166 of the Income Tax Code regulates the so called “exit tax”, which is the tax levied on the company that transfers its social address abroad. This provision states that if a company transfers its social address to another State and is no longer resident in Italy for tax purposes, its assets are deemed to be “realized”, unless they are attributed to a permanent establishment in Italy. Therefore, the gains deriving from the transfer of assets are immediately taxable on the basis of the difference between the fair market value at the time of transfer and their tax book value. The same rule is applied if the assets are subsequently exported from the permanent establishment.

Tax-deferred reserves and provisions in the financial statement of the last financial year preceding the transfer are taxable in case they are not reinstated in the first balance sheet of the permanent establishment[93].

The transfer of social address does not determine the taxation of the members of the transferred corporation.

Following the decision of Court of Justice of the European Union in National Grid Indus (C-371/10), and after the start of an infringement procedure ex art. 285 TFUE (2010/4141), art. 166 of the Income Tax Code was amended by D.L. 24 January 2012, n. 1[94], which introduced subsections 2-quater and 2-quinquies.

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[92] Italian Fiscal Administration, resolution 17th January 2006, n. 9.
[93] Art. 166 of the Income Tax Code, subsection 2.
[94] D.L. 24th January 2012, n.1 was implemented by L. 24th March 2012, n. 27.

Thanks to these modifications, Italian tax law now complies with the principles set out by the Court of Justice in several decisions regarding the exercise of the right of establishment and exit taxation, such as *Daily Mail, Centros, Uberseering, Inspire Art,* and *Cartesio.*

According to the current version of art. 166 of the Income Tax Code, if a company transfers its residence to Member States of the UE or to States of the EEA indicated in the decree issued by the Ministry of Economy and Finance in accordance with art. 168-bis of the Income Tax Code and with which Italy reached an agreement on mutual assistance for the recovery of tax claims, the taxpayer may opt for the suspension of the payment of the exit tax until the latent gains are effectively realized.

The Decree issued by the Ministry of Economy and Finance on 2 August 2013 specifies that art. 166 subsections 2-quarter and 2-quinquies are also applied when a permanent establishment located in Italy is transferred to a Member State or to a State of the EEA and that the suspension is excluded in some cases. First of all, it cannot operate in respect of business profits[95], such as profits deriving from the sale of goods and services produced or traded by the company. Also tax-deferred reserves are excluded from the suspension, unless they are reinstated in the balance sheet of the permanent establishment.

Moreover, the suspension cannot operate in respect of the other elements, positive and negative, that contribute to the taxable income relating to the last period of residence in Italy if their deduction or imposition was deferred in accordance with the provisions of the Income Tax Code.

[95] The decree refers to the higher or lower values of the goods indicated by art. 85 of the Income Tax Code.

3.3.2.2 ART. 37-BIS OF DPR 600/1973

According to art. 37-bis DPR 600/1973[96], under certain conditions the transfer of social address of a resident company may be considered an elusive operation. In particular, the Italian tax authority may deem the operation elusive if it is carried out without valid economic reasons, it is meant to circumvent fiscal obligations and it is aimed at achieving either a reduction of the tax due by the taxpayer or a tax refund.

3.4 OTHER TAXABLE ENTITIES

3.4.1 TRUSTS

Taxation of trusts varies according to whether the beneficiaries of the trust are determined or not[97].

In case the beneficiaries are individuated, Italian lax law provides a sort of transparency; as a matter of fact, income deriving from the trust fund is attributed to the beneficiaries proportionally to their share of participation indicated in the trust deed or in other documents; if the shares are not determined, income deriving from the trust is equally attributed to the beneficiaries.

If the beneficiaries are not individuated, trusts are subject to corporate income tax.

Trusts set up in States with a favorable fiscal regime are presumed to be resident in Italy if at least one settlor and one beneficiary are resident in Italy for tax purpose and a resident transferred to the trust fund an immovable property or rights related to immovable property.[98]

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[96] Art. 37-bis of DPR 600/1973 was modified by art. 1, subsection 2, of the D. Lgs. 6th November 2007, n. 199.

[97] Art. 73 of the Income Tax Code, subsection 2.

[98] Art. 73 of the Income Tax Code, subsection 3.

3.4.2 NON-OPERATING COMPANIES

Non-operating companies are companies set up in order to benefit from the corporate veil (for example, to deviate assessment procedures) without exercising an effective business activity. To counteract the creation of non-operating companies, Italian tax law provides particular rules that determine the attribution of a fictional income to the company that doesn't comply with certain indicators of profitability. The fictional income is proportionate to the value of the patrimony of the company and is taxed with a higher rate of 10.5%.[99]

3.4.3 INVESTMENTS FUNDS, PENSION FUNDS AND ECONOMIC INTEREST GROUPING

Italian tax law provides a full exemption from the corporate income tax for the open-ended investments funds, closed-ended investments funds and SICAVs (collective investments vehicles whose capital amount is variable), even if they are formally subject to corporate income tax. A 20% withholding tax is levied on the income earned by the participants in the form of distributions or realizations of the investments.

Pension funds are subject to a substitute tax of 11% and neither corporate income tax nor IRAP are levied.

European groups of economic interest are subject to a "transparent" system of taxation, so that profits (regardless of their effective distribution), losses and

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[99] F. TESAURO, *Istituzioni di diritto tributario*, cit., p. 77.

withholding taxes are attributed to the members. The Group only has some formal obligations, such as presenting the final assessment and keeping the accounts.[100]

3.4.4 FAMILY ENTERPRISES

Income deriving from family enterprise is attributed for 51% to the entrepreneur, who earns business income, and for the remaining 49% to the family members performing their activity in the enterprise in a continuous and prevalent way. Losses are not imputed to the family members, whose income is assimilated to income from employment. Some formal obligations have to be fulfilled[101].

[100] Council RE n. 2137/85 of the 25th July 1985 was implemented through D.lgs. 23rd July 1991, n. 240.
[101] Art. 5 of the Income Tax Code.

CHAPTER 4

TAXATION OF NON-RESIDENTS

4.1 NON RESIDENTS' TAX LIABILITY

Article 23 of the Income Tax Code indicates the criteria that have to be applied in order to individuate non-residents' tax liability in respect of the several categories of income mentioned by art. 6 of the Income Tax Code. Income from independent work and income from capital investment are subject to a final withholding tax, whereas items of income that are not subject to a withholding tax are taxed on assessment[102].

Non-residents are liable to tax in Italy in relation to: income from immovable property that is located in Italy; income form capital investment, if profits are distributed by resident companies or by permanent establishments of non-resident companies, except for interests on deposits and current accounts; income from employment, when it derives from an activity exercised in Italy; professional income deriving from an activity exercised in Italy; business income deriving from an activity conducted through a permanent establishment located in Italy.

Other types of income are taxable in Italy when they derive from activities exercised in Italy or from assets situated in Italy, including capital gains arising from the disposal of participations in resident companies, with some exceptions.

Other items of income which are regarded as produced in Italy, if they are paid by resident persons or by permanent establishments of non-resident persons, are: pensions and indemnities deriving from the termination of an employment

[102] F. TESAURO, *Istituzioni di diritto tributario*, cit., p.180.

relationship; sums paid for the use of intellectual property, patents, trade marks, process, formulas; information concerning industrial, commercial or scientific experience; remuneration received by non-resident enterprises, companies or entities for artistic or professional activities performed in Italy on their behalf.

4.2 TAX BASE, TAX RATES AND DEDUCTIONS

4.2.1 INDIVIDUALS

Non-resident individuals are taxed on their aggregate income, including all the items of income that are produced in Italy in accordance with art. 23 of the Income Tax Code, and on income subject to separate taxation. Taxation of non-residents follows the same rules provided for residents (rules regarding tax rates included).

However, only some deductions are granted to non-residents, which mitigates the "personalization" of non-residents' tax base.

Some expenses can be deducted from the taxable income[103], such as costs related to the immovable property included in the aggregate income, contributions and donations to specific NGOs, indemnities for the loss of goodwill paid to the tenant in case of cancel of lease contract regarding urban immovable property and some other donations.

Within the limit of 19%[104], non residents can detract a number of expenses including: passive interest paid to persons resident in the State or in a Member State of the European Union or to permanent establishments of non-residents located in Italy in relation to agrarian loans; passive interest paid to persons resident in the State or in a Member State of the European Union or to permanent

[103] Art. 24, subsection 2, of the Income Tax Code.
[104] Art. 24, subsection 3, of the Income Tax Code.

establishments of non-residents located in Italy in relation mortgage guaranteed loans borrowed for the purchase of a main home; costs borne for the protection, upkeep or restoration of things of artistic or historic interest; some donations, such as donations to the State, Regions, political subdivisions of the State, public entities; the cost borne, or the fair value, of the goods that the taxpayer gave for free to some categories of subjects.

From the gross tax non-residents can also deduct the sums of money spent for the recovery of building patrimony and the energy requalification of buildings[105].

4.2.2 COMPANIES AND ENTITIES EXERCISING A COMMERCIAL ACTIVITY

Non- resident companies and entities exercising a commercial activity are taxed on their aggregate income, which is composed by all the items of income earned in Italy according to article 23 of the Income Tax Code.

The tax base varies according to whether or not the company or the entity operates through a permanent establishment.

If the company has a permanent establishment, the tax base is determined by applying the rules provided for companies and entities exercising a commercial activity, on the basis of a specific financial statement related to the management of the permanent establishment and to the other activities from which taxable income arises. Therefore, all items of income produced by the non-resident person are "absorbed" by the permanent establishment and treated like business income (so called force of attraction to the permanent establishment)[106].

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[105] Art. 16-bis of the Income Tax Code.
[106] Art. 152, subsection 1, of the Income Tax Code.

If the company or entity hasn't got a permanent establishment in Italy, the tax base in composed of all the items of income produced in the State, each of which is determined on the basis of the rules regarding the category to which the income belongs (so called isolated treatment)[107].

From the gross tax some expenses can be detracted in the measure of 19% . In particular, these expenses are: costs related to immovable property included in the aggregate income; contributions and donations to specific NGOs; passive interest paid to persons resident in the State or in a Member State of the European Union or to permanent establishments of non-residents located in Italy in relation mortgage guaranteed loans borrowed for the purchase of a main home; costs borne for the protection, upkeep or restoration of things of artistic or historic interest; some donations, such as donations to the State, Regions, political subdivisions of the State, public entities; the cost borne, or the fair value, of the goods that the taxpayer gave for free to some categories of subjects; finally, contributions made by the members to mutual aid companies whose purpose is to provide members with a subsidy in case of illness, inability to work or old age[108].

4.2.3 NON-COMMERCIAL COMPANIES AND ENTITIES

Also companies and entities that do not exercise commercial activities are taxed on aggregate income composed of items of income produced in Italy and the tax base is determined by applying the provisions of Title I, which regulates the taxation of resident individuals.[109]

[107] Art. 152, subsection 1, of the Income Tax Code.
[108] Art. 152, subsections 2 and 3, of the Income Tax Code.
[109] Art. 154 of the Income Tax Code.

Non-commercial entities are provided with the same deductions and detractions as entities exercising a commercial activity[110].

4.3 WITHHOLDING TAXES

4.3.1 DIVIDENDS

From January 2012, dividends distributed by resident companies to non-resident persons and that are not connected to a permanent establishment, are subject to a final withholding tax of 20% (previously the rate was 27%). The rate is of 11% for dividends distributed to pension funds set up in Member States and in States members of EEA included in the list contained in the decree issued by the Ministry of Economy and Finance in accordance with art. 168-bis of the Income Tax Code. A tax refund can be granted to the taxpayer, in relation to the final tax paid in the residence state, within the limit of one quarter of the withholding tax[111].

A final withholding tax of 1,375% is levied on dividends distributed to companies and entities subject to corporate income tax in a Member State of the European Union or in a State of the EEA indicated in the list contained in the decree issued by the Ministry of Economy and Finance in accordance with art. 168-bis of the Income Tax Code[112]. In this way, companies that are resident in Member States of the European Union are subject to the same rate as resident companies (whose effective rate is 27% of the 5% of the dividends received, because dividends are 95% exempt).

Art. 27-bis of DPR 600/1973, implementing EU Directive 435/1990, current Directive 123/2003 (Parent-Subsidiary Directive), provides parent companies

[110] Art. 154, subsections 2 and 3, of the Income Tax Code.
[111] Art. 27 of the DPR 600/1973, subsection 3.
[112] Art. 27 of the DPR 600/1973, subsection 3-ter.

detaining a participation of at least 10% in the subsidiary, with the right to get a refund of the withholding tax levied on dividends distributed by the subsidiary, on the condition that they were set up in one of the forms mentioned by EU Directive 435/1990, they are resident in a Member State of the European Union and they cannot be considered non- resident in the EU on the basis of a Convention against double taxation with a third Country. Moreover they have to be subject to one of the taxes indicated in the Directive 435/1990 in the residence state, without benefiting from exemptions or options that are not territorially or temporally limited and that the participation has to be held for at least one year.

4.3.2 INTEREST AND ROYALTIES

A final withholding tax is levied on interest payments made to non-resident persons. Since January 2012, the tax rate of withholding taxes levied on interest and each item of income that can be qualified like "income from capital investment" in accordance with art. 44 of the Income Tax Code is 20%[113], except for some cases. A 12,5% withholding tax is levied on income deriving from bonds issued by the State and bonds issued by the States included in the white list issued by the Ministry of Economy and Finance in accordance with art. 168-bis of the Income Tax Code.

Art. 84 of L. 244/2007 states that "the tax rate is 27% if the person who receives the payments is resident in a State that is not included in the white list issued by the Ministry of Economy and Finance in accordance with art. 168-bis of the

[113] D.L. 13th August 2011, n. 138, implemented by L. 14 September 2011, n. 148.

Income Tax Code". This rule will be applied from the first taxable period following the issuance of the white list.

Art. 26-bis of DPR 600/1973 provides some exemptions for non residents percipients.

Royalties paid to non-resident persons are subject to a final withholding tax of 30%[114] that is applied on the 75% of their amount, unless the recipient is not the author or the inventor and the right was acquired without consideration. In this case the tax is levied on the whole amount.

4.3.3 PROFESSIONAL INCOME

Fees paid to non-resident for independent work are subject to a final withholding tax of 30% [115], except for activities carried out abroad and for fees paid to permanent establishments of non-resident persons.

4.4 MEASURES FOR IMPATRIATION

4.4.1 L. 30 DECEMBER 2010, N. 238

According to the information provided by the Italian tax authority, the purpose of the law is to "*contribute to the development of the Country by enhancing human, cultural and professional experiences of European citizens who, after being in Italy continuously for at least twenty-four months, have studied, worked or specialized abroad and decide to come back to Italy*"[116].

Art. 1, subsection 2, of the law, in the original version, stated that the fiscal benefits are attributed from the entry into force of the law until the 31st of

[114] Art. 25 of DPR 600/1973, subsection 3
[115] Art. 25 of DPR 600/1973, subsection 2.
[116] Italian Fiscal Administration Circ. 4 May 2012.

December 2013. A subsequent law[117] extended the temporal limits of L. 238/2012 until 2015.

The beneficiaries of the measures are those persons who meet the requirements provided by art. 2 of L. 238/2010, which was implemented by a decree issued by the Ministry of Economy and Finance[118].

According to art. 1 of the decree, the fiscal benefits are attributed to "*European citizens born after 1 January 1969, who are employed or start a professional or business activity in Italy, transferring their domicile and residence to the State within three months since their employment or the beginning of their activity*", under certain conditions that vary according to whether the beneficiaries exercised abroad a post degree activity or they studied and achieved an academic qualification.

The beneficiaries belong to the first category if they have a degree, were resident in Italy continuously for at least 24 months, in the last two years were resident neither in their birth country nor in Italy and exercised continuously a professional or business activity or were continuously employed.

The beneficiaries belong to the second category if they were resident in Italy continuously for at least 24 months and in the last two years were not resident in Italy or in their birth country and graduated or got a post degree qualification.

The measures consist in a reduction of the taxable income. In particular, income from employment, business income and income from independent work earned by

[117] D.L. 29th December 2011, n. 216, implemented by L. 24th February 2012, n. 14.
[118] Decree, 3rd of June 2011.

individuals indicated by art. 2 contribute to their taxable income within the limit of 20% for women and 30% for men[119].

[119] Art 3 of L. 238/2010.

CHAPTER 5

PREVENTION OF TAX DEFERRAL AND TAX BASE EROSION AND PROFIT SHIFTING

5.1 CFC RULES

The CFC regime, regulated by art. 167 of the Income Tax Code, is a special regime regarding resident persons who control, directly or indirectly, another enterprise, company or entity that is resident or located in States or territories that do not guarantee a sufficient exchange of information or that have a lower level of taxation. The notion of control is defined by art. 2359 of the civil code and occurs when a company has most of the voting shares in the shareholders' meetings of another company or has enough voting shares to influence the shareholders' meetings of the other company. The control can also derive from contractual relationships between the companies.

When the CFC regime is applied, the profits made by the controlled company are attributed to the resident person proportionally to the share of participation and regardless of the effective distribution of dividends. This fiscal regime, which aims at preventing tax deferral, is an exception to the general rule, according to which dividends are taxed on a cash basis.

When these profits are attributed to an individual, they are subject to a separate taxation. The rate is the average rate applied to the aggregate income of the taxpayer; in any case it cannot be lower than 27%.

The same regime is also applied when a company owns, directly or indirectly, a participation of at least 20% or of at least 10%, if it is a listed company, in another company located in a State with a favorable level of taxation.

CFC rules are not applied when the taxpayer, through the procedure regulated by art. 11 of L. 212/2000 (so called Statute of the taxpayer), provides, alternatively, that the foreign enterprise, company or entity conducts an industrial or commercial activity effectively and prevalently in the State or territory where it is established, or that the foreign company receives its profits from companies or permanent establishments located in States with an ordinary fiscal regime, so that the taxpayer does not benefit from the favorable fiscal regime.

Art. 167 of the Income Ta Coe is also applied when the controlled person is not located in a “tax haven” if the controlled foreign company or entity is subject to a level of taxation that is lower, by more than 50%, than the level of taxation to which it would be subject if it was resident in the State or if the foreign controlled company or entity receives passive income or profits deriving from the intercompany operations.

The regime is not applied if the taxpayer proves that the foreign company is not an “artificial construction” aimed at achieving an undue fiscal benefit.

5.2 EXCHANGE OF INFORMATION

5.2.1 COUNCIL DIRECTIVE 2011/16/EU OF 15 FEBRUARY 2011 ON ADMINISTRATIVE COOPERATION IN THE FIELD OF TAXATION AND REPEALING DIRECTIVE 77/799/EEC

As a State Member of the European Union, Italy has to implement Directive 2011/16/EU, which repeals the previous Directive 77/799/EEC on the mutual assistance among the competent authorities of Member States in the field of direct taxation, VAT, excise duties and taxes on insurance premiums.

Directive 2011/16/EU regards taxes of any kind, levied by or on behalf of a Member State or its political subdivisions, except for value added tax, customs duties and excise duties that are regulated by other rules of the EU. Also social security contributions are excluded.

Art. 1 of the Directive states "*The Directive lays down the rules and procedures under which the Member States shall cooperate with each other with a view to exchanging information that is foreseeably relevant to the administration and enforcement of domestic laws of the Member States concerning the taxes referred to in Article 2*". The "*forseeably relevance*" clause aims at preventing Member States from requesting generic information or requesting information that probably does not regard taxpayers' fiscal issues.

The exchange of information involves individuals, entities with legal personality, associations without legal personality but able to perform legal acts and "*any other legal arrangement of whatever nature or form, regardless of whether it has legal* *personality, owing or managing assets, which, including income derived therefrom, are subject to any of the taxes covered by this Directive*”[120].

Directive 2011/16/UE provides three different forms of exchange: the exchange of information on request, which occurs when a Member State makes a request to another MS in relation to a specific case; the automatic exchange of information, that occurs when there is a systematic and periodic exchange of predefined information, without a prior request; and the spontaneous exchange of information, that refers to a non-systemic exchange of information, at anytime and without a prior request.

In case of exchange on request, the requested State has to communicate any information that it has in its possession or that it can obtain through an administrative enquiry. The information has to be provided as soon as possible and in any case within six months after the receipt of the request or two months if the tax authority already has the requested information.

In some cases the tax authorities involved in the exchange can agree upon different time limits.

When the authority that received the request is unable to provide the information or refuses to provide it in accordance with art 17 of the Directive, it has to communicate the reason of the refusal immediately and in any case within one month from the receipt of the request.

The request can contain a reasoned request of a specific administrative enquiry. If the requested authority believes that no administrative enquiries are necessary, it has to communicate the reasons of its opinion immediately.

[120] Art. 3 of Directive 2011/16/UE.

The mandatory automatic exchange of information regards specific categories of information, such as[121] income from employment, directors' fees, life insurance products not covered by other Union legal instruments on exchange of information and other similar measures, pensions and ownership of and income from immovable property.

The information has to be exchanged at least once a year, within six months following the end of the tax year of the Member State during which the information became available.

In order to favor the fight against tax fraud and tax evasion, European Commission made a proposal of Directive, COM(2013) 348 final, that will enter into force on the 1st of January 2015. The proposal introduces paragraph 3-bis in art. 8 of Directive 2011/16/EU, and extends the automatic exchange of information to dividends, capital gains, income deriving from assets held in a financial account, any amount in relation to which the financial entity is debtor or obligor, including redemption payments and account balances.

The last form of exchange, the spontaneous exchange, can operate if one of the following situations[122], occurs:

1. the competent authority of a Member State has grounds for supposing that there may be a loss of tax in another Member State;
2. a person liable to tax obtains a reduction of tax or an exemption which would determine his tax liability or an increase of tax in the other Member State;

[121] Art. 8 of Directive 96/2011.
[122] Art. 9 of Directive 96/2011.

3. business dealings involving a person liable to tax in a Member State and a person liable to tax in the other contracting State are so conducted as to determine a reduction of tax in one or in both Member States.
4. the competent authority of a Member State has grounds for supposing that a reduction of tax may arise as a consequence of artificial transfers within groups of enterprises;
5. the competent authority of Member State, following the communication of information by the competent authority of the other Member State, collects information that may be used to asses liability to tax in the latter Member State.

Paragraph 2 of the same provision states that :"*The competent authorities of each Member State may communicate, by spontaneous exchange, to the competent authorities of the other Member States any information of which they are aware and which may be useful to the competent authorities of the other Member State*".

The competent authority transmits the information as soon as possible and within one month from when the information became available.

Directive 2011/16/EU provides other forms of administrative cooperation: presence in administrative offices and participation in administrative enquiries and simultaneous controls.

The first of these two forms of cooperation requires an agreement between the competent authorities of the Member States. Under the conditions established by the requested authority, the officials of the requesting authority may "*be present in the offices where the administrative authorities of the requested State carry out their duties*" and "*be present during administrative enquiries carried out in the* *territory of the requested Member State*". In the latter situation, if it is allowed by the legislation of the requested State and provided by the agreement, the officials of the requesting State may interview individuals and examine records.

Two or more states can decide to conduct simultaneous controls[123], in their own territory, in respect of two or more persons of "*common or complementary interest to them*". The competent authority in each Member State identifies autonomously the persons that should be subject to simultaneous controls and communicates the decision to the competent authority of the other Member State involved, which has to decide whether to participate in the controls and communicate its decision to the proponing tax authority.

The competent authority of the requested State can refuse to provide the information if[124] the requesting authority has not exhausted the usual sources of information that could have been used without compromising the achievement of its purpose, the national legislation of the requested State does not allow the administrative enquiries or the collection of the requested information, when the requesting State cannot, for legal reasons, provide the same information, when the communication of the requested information would cause the disclosure of a commercial, industrial or professional secret or of a commercial process or when the disclosure would be contrary to public policy.

Art. 17, paragraphs 2 and 4, cannot be so interpreted as to permit a requested Member State to refuse the supply of information just because the information is

[123] Art. 12 of Dir 16/2011.
[124] Art. 17 of Dir. 16/2011.

held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person[125].

The information exchanged between the competent authorities of the Member States are covered by official secrecy and are granted the same protection provided for similar information by the national legislation[126]. It can be used in administrative and judicial proceedings that are started following the infringement of tax law and that may involve penalties, on the condition that the rights of defendants and witnesses relating to such proceedings are respected.[127]

As regards the exchange of information with extra-EU Countries, the Directive provides that "*where a Member State provides a wider cooperation to a third country than that provided for under this Directive, that Member State may not refuse to provide that wider cooperation to any other Member State wishing to enter into such mutual wider cooperation with that Member State*"[128].

The competent Authority of a Member State receiving from a third country information that is foreseeably relevant for the tax Authority of another Member Stat, can transmit that information to the competent Authority which may be interested in that information and to any other requesting Authority, on condition that the transmission is allowed by an agreement reached with the competent Authority of the third State[129].

The competent Authorities of Member States can transmit any information received on the basis of Directive 2011/16/EU to a third Country, in accordance with domestic law regarding the communication of personal data to third

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[125] Art. 18, paragraph 2, of Directive 2011/16EU.
[126] Art. 16, paragraph 1, of Directive 2011/16EU.
[127] Art. 16, paragraph 3, of Directive 2011/16EU.
[128] Art. 19 of Directive 2011/16EU.
[129] Art. 24, paragraph 1, of Directive 2011/16EU.

Countries, if the competent Authority of the Member State that provided the information consents to the transmission and if the third Country involved has undertaken to cooperate in order to collect the elements necessary to demonstrate the irregularity or the illegality of operations that appear to be contrary or break tax law[130].

5.2.2 COUNCIL REGULATION NO 904/2010 OF 7 OCTOBER 2010 ON ADMINISTRATIVE COOPERATION AND COMBATING FRAUD IN THE FIELD OF VALUE ADDED TAX

Council Regulation No. 904/2010, which substituted RE No. 1798/2003, regulates the exchange of information and cooperation among Member States in order to guarantee a correct assessment of VAT, monitor the application of VAT and combat VAT fraud[131].

Two mechanisms of exchange of information are provided: exchange on request and exchange without a prior request.

As regards the exchange on request, the requested authority has to provide the information as soon as possible and within three months from the date of the receipt of the request. If it already has the information, the time limit for the communication is one month[132]. The requested authority has to conduct any administrative enquiry necessary to collect the requested information[133].

Information can be exchanged without a prior request if: taxation is deemed to take place in the Member State of destination and the information provided by the

[130] Art. 24, paragraph 2, of Directive 2011/16EU.
[131] Art. 2, paragraph 1, of RE 904/2010.
[132] Art. 10 of RE 904/2010.
[133] Art. 7 of RE 904/2010.

Member State of origin is necessary for the effectiveness of the control system of the Member State of destination; a Member State has grounds to believe that a breach of VAT legislation has been committed or is likely to have been committed in the other Member State; there is a risk of tax loss in the other Member State.

The exchange of information without prior request can be automatic, in respect of the categories of information individuated through a particular procedure (that is also used to determine the frequency and practical arrangements of the automatic exchange[134]) or spontaneous, when a Member State spontaneously provides information that may be useful to the competent authorities of the other Member State.

The requested authority has to supply the information on condition that the collection of that information does not impose an excessive administrative burden and that the requesting authority has exhausted the usual sources of information which could have been used to obtain it[135]. The requested authority is not obliged to supply the information if its legislation does not allow the conduction of the necessary enquiries or the collection or use of the requested information[136]. In any case, the requested tax authority is not authorized to deny the supply of information regarding a taxable person identified for VAT purposes in the Member State of the requesting authority for the sole reason that the requested information is held by a bank, other financial institution, nominee or person acting in an agency or fiduciary capacity or because it relates ownerships interests in a legal person[137].

[134] Art. 14 of RE 904/2010.
[135] Art. 54, paragraph 1, of RE 904/2010.
[136] Art. 54, paragraph 2, of RE 904/2010.
[137] Art. 54, paragraph 5, of RE 904/2010.

Other forms of cooperation provided by the Regulation are the presence in administrative offices and participation in administrative enquiries and simultaneous controls.

By agreement between the requested authority and the requesting authority, officials authorized by the requesting authority can be present in the administrative offices or in the place where the officials of the requested authority carry out their duties and may be present during the enquiries carried out in the territory of the requested State. The officials of the requesting State do not have the same inspective powers as the officials of the requested authority, but have access to the same premises and documents[138].

Members States can conduct simultaneous controls when such controls are considered to be more effective than those carried out by a single State. Each State can individuate the taxable persons that should be subject to simultaneous controls, and communicate its intention to the other Member State, which has to communicate its decision within two weeks or one month at the latest[139].

In order to promote and facilitate multilateral cooperation in the fight against tax fraud, RE 904/2010 establishes the Eurofisc, defined as a "*network for the swift exchange of targeted information between Member States*".

Within the framework of the Eurofisc, Member States have to establish a multilateral early warning mechanism for combating VAT fraud, coordinate the swift multilateral exchange of targeted information in the "Eurofisc working fields" and coordinate the work of the Eurofisc liaison officials of the participating Member States in acting on warnings received.

[138] Art. 28 of RE 904/2010.
[139] Arts. 29 and 30 of RE 904/2010.

Member States can choose the Eurofisc working fields in which to participate and can decide to end their participation.

5.2.3 CONVENTION OF THE OECD OF 25 JANUARY 1988 ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

The Convention of the OECD of 25 January 1988 on Mutual Administrative Assistance in Tax Matters regulates the mechanisms through which the Parties shall provide: their assistance in the exchange of information (including simultaneous tax examinations and participation in tax examinations abroad); assistance in recovery, including measures of conservancy; and service of documents[140]. The Convention covers a wide range of taxes: taxes on income or profits, taxes on capital gains, taxes on net wealth levied by a State or on its behalf by a political subdivision; compulsory social contributions payable to general government or social security institutions established under public law; estate, inheritance or gift taxes; taxes on immovable property; general consumption taxes, such as VAT or sales taxes; excise taxes and other specific taxes on goods and services; taxes on the use or ownership of motor vehicles or other movable property. A residual clause includes "any other taxes", except for customs duties[141].

The Convention authorizes the Parties to exchange the information that is *foreseeably relevant* for the administration or enforcement of the domestic law of

[140] Art. 1 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.

[141] Art. 2 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.

the requesting State and provides different forms of assistance regarding the collection of information.

Each Party is allowed to request information regarding particular persons or transactions and the requested State has to provide the information requested, taking all the necessary measures if the information already available is not sufficient[142];

Automatic exchange of information is regulated by the rules that two or more Parties establish by mutual agreement[143].

Spontaneous exchange of information is allowed when: a Party has grounds to believe that there may be a loss of tax in the other State; a person liable to tax obtains a reduction or exemption that would give rise to or increase his tax liability in the other State; two persons liable to tax in different States conducted business dealings in such a way that a saving in tax may result in one or both States; a State has grounds to believe that a transfer of profits within a group of enterprises may determine a saving in tax; a State received from another State information that enabled the collection of information that may be useful to assess the tax liability in the latter State[144].

The Convention authorizes the Parties to carry out simultaneous examinations, in relation to the situations of common interest. For the purposes of the Convention, a simultaneous examination is "*an arrangement between two or more parties to examine simultaneously, each in its own territory, the tax affairs of a person or*

[142] Art. 5 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.

[143] Art. 6 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.

[144] Art. 7 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.

persons in which they have a common or related interest, with a view to exchanging any relevant information which they so obtain"[145]. The Parties, upon request of one of them, have to discuss together the cases and procedures for the examinations and each of them may decide whether to participate or not[146].

Representatives of the requesting state may be authorized by the competent authority of the requested State to be present during the *appropriate part* of a tax examination in the requested State[147].

If a Party has information about a person's tax affairs which appears or be in conflict with the information supplied by the other Party, it has to inform the other Party[148].

As regards the assistance in recovery, the Convention imposes to the requested State to do what is necessary to recover the tax claims of the requesting State "*as if they were its own claims*", on condition that the tax claims at stake form the subject of an instrument permitting their enforcement in the applicant State and, unless the States establish a different rule, are not contested[149]; the measures of conservancy, instead, have to be taken even if the tax claims are contested or is not yet the subject of an instrument permitting enforcement[150].

[145] Art. 8, paragraph 2, of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.
[146] Art. 8 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.
[147] Art. 9 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.
[148] Art. 10 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.
[149] Art. 11 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.
[150] Art. 12 of OECD Convention on Mutual Administrative Assistance in Tax Matters of 25 January 1988.

5.2.4 BILATERAL CONVENTIONS

All of the bilateral Conventions stipulated by Italy regulate the exchange of information. Most of them contain a provision that substantially recalls, wholly or partly, art. 26 of the OECD Model[151].

The Convention with Cyprus[152] states that the competent Authorities of the contracting States have to exchange all the information that is forseeably relevant for carrying out the provisions of the Convention or for the administration or enforcement of tax laws concerning the taxes of every kind levied by or on behalf of a contracting State or its political subdivision. The information obtained by one of the contracting States has to be treated as a secret information, likewise the information obtained in accordance with domestic law. The requested State is not obliged to supply the information if the collection of it does not comply with its law or administrative practice, if the other contracting State requires an information whose collection is not allowed by its domestic law and if the communication of the information would determine the disclosure of a business, industrial, commercial or professional secret.

The Convention with Ex-Soviet Union[153] calls on the Authorities of the Contracting States to exchange all the information that is necessary to carry out

[151] These provisions are: Art. 28 of the Convention stipulated with Latvia, Lithuania, Romania. Art. 27 of Convention stipulated with: Albania, Algeria, Argentina, Armenia, Azerbaijan, Belarus, Denmark, Ecuador, Russia, France, Georgia, Ghana, Germany, Greece, India, Island, Israel, Luxembourg, Macedonia, Moldova, Norway, The Netherlands, United Kingdom, Slovenia, Sri Lanka, Sweden, Ukraine, Uganda, Hungary, Uzbekistan.; Art. 26 of the Convention stipulated with Saudi Arabia, Australia, Austria, Bangladesh, Belgium, Brazil, China, South Korea, Croatia, Egypt, Arabian Emirates, Estonia, Ethiopia, Finland, Japan, Jordan, Indonesia, former Yugoslavia, Kazakhstan, Kuwait, Lebanon, Malaysia, Mauritius, Mozambique, Oman, Pakistan, Poland, Qatar, Czech Republic, Slovakian Republic, San Marino, Senegal, Syria, United States, South Africa, Turkey, Venezuela, Vietnam.; Art. 25 of the Convention stipulated with Bulgaria, Canada, Ivory Coast, Philippines, Ireland, Malta, Mexico, New Zealand, Portugal, Singapore, Spain, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Zambia; Art. 24 of the Convention with Morocco.

[152] Art. IV of the Convention, which substituted previous art. 26.

[153] Art. 16 of the Convention.

the provisions of the Convention or of the national laws, in relation to the taxes covered by the Convention, within the limits of the national legislations and on the condition of reciprocity.

5.2.5 FATCA AGREEMENT BETWEEN ITALY AND USA

On January the 10th, Italian Minister of Economy and Finance and American ambassador signed an intergovernmental agreement to implement FATCA, which regulates the exchange of financial information between The Government of the United States of America and the Government of the Republic of Italy.

According to art. 2 of the agreement, each party shall obtain and exchange on an automatic basis all the information specified by paragraph 2 of the same provision, in respect of all Reportable Accounts.

In the case of Italy, with respect to each U.S. Reportable Account of each Reporting Italian Financial Institution, the information to be obtained and exchanged is:

the name, address, and U.S. TIN of each Specified U.S. Person that is an Account Holder of such account and, in the case of a Non-U.S. Entity that, after application of the due diligence procedures set forth in Annex I, is identified as having one or more Controlling Persons that is a Specified U.S. Person, the name, address, and U.S. TIN (if any) of such entity and each such Specified U.S. Person; the account number (or functional equivalent); the name and identifying number of the Reporting Italian Financial Institution; the account balance or value (including, in the case of a Cash Value Insurance Contract or Annuity Contract, the Cash Value or surrender value) as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during such year, immediately before closure;

In the case of any Custodial Account, the information to be exchanged regards the total gross amount of interest, the total gross amount of dividends, and the total gross amount of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and the total gross proceeds from the sale or redemption of property paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the Reporting Italian Financial Institution acted as a custodian, broker, nominee, or otherwise as an agent for the Account Holder.

In the case of any Depository Account, the information to be collected and exchanged regards the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period.

In the case of any account not described in subparagraph (5) or (6) of this paragraph, the total gross amount paid or credited to the Account Holder with respect to the account during the calendar year or other appropriate reporting period with respect to which the Reporting Italian Financial Institution is the obligor or debtor, including the aggregate amount of any redemption payments made to the Account Holder during the calendar year or other appropriate reporting period.

In the case of the United States, with respect to each Italian Reportable Account of each Reporting U.S. Financial Institution, the information to be supplied includes the name, address, and Italian TIN of any person that is a resident of Italy and is an Account Holder of the account; the account number (or the functional equivalent); the name and identifying number of the Reporting U.S. Financial

Institution; the gross amount of interest paid on a Depository Account; the gross amount of U.S. source dividends paid or credited to the account; and the gross amount of other U.S. source income paid or credited to the account, to the extent subject to reporting under chapter 3 of subtitle A or 61 of subtitle F of the U.S. Internal Revenue Code[154].

The information has to be exchanged within nine months after the end of each calendar year to which the information relates and is subject to confidentiality and other protections provided by the Convention between the Government of the United States of America and the Government of the Republic of Italy for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fraud or Fiscal Evasion of 25 August 1999.

5.3 TRANSFER PRICING

5.3.1 ART. 110 T.U.I.R.

Art. 110, subsection 7, of the Income Tax Code states that the prices related to intercompany operations are determined on the basis of the *fair value* of the goods sold and services performed and goods and services received, if a higher income of the resident companies results from the application of the criterion of fair value.

The provision aims at avoiding that prices related to intercompany operations are so manipulated as to transfer profits from a resident company to a non-resident company and is applied when a resident company directly or indirectly controls, or is controlled by, a foreign company or when the residents and non residents companies are both controlled by a third company.

[154] Art. 2 of the FATCA agreement between Italy and USA.

The same provision is also applied when it determines a lower income of the resident company, in accordance with the agreements concluded with the competent authorities of other States following the start of a mutual agreement procedure, regulated by the international conventions to avoid double taxation[155].

As regards the concept of "control", art. 110 does not recall art 2359 of the civil code; for this reason, Italian Tax Authority has adopted a wide notion of control, which includes every "*case of economic influence, actual or potential, inferred from single circumstances*"[156].

Profits and costs relating to the operations indicated by subsection 7 are determined on the basis of their "fair value", defined by art. 9 of the Income Tax Code as "*the price or remuneration for goods and services similar or of the same kind, at the time and in the place where the goods or services were traded, or in the nearest place and time*".

In defining the criterion of determination of the fair value, Italian lax law reflects the *arm's length principle* suggested by the OECD in a report of 1979. The main methods to apply in order to determine the transfer price are the comparable uncontrolled price method, the resale price method and the cost plus method.

Italian tax law does not regulate the burden of proof. If the general rules regarding the burden of proof are applied, then the Tax Authority will have to prove the "positive" elements of income, whereas the taxpayer has to prove the effective bearing of costs. Some authors[157] argue that the taxpayer does not have to prove

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[155] Art. 110, subsection 7, of the Income Tax Code.
[156] Italian Fiscal administration, circ. n. 32, 1980.
[157] A. BALLANCIN, *La disciplina italiana del transfer price tra onere della prova, giudizi di fatto e l'(in)esistenza di obblighi documentali*, Rass. Trib., n. 6, 2006, p. 1982.

that the costs are in keeping with the fair value of goods and services, since it is up to the tax authority to prove that the criterion of fair value was not applied.

5.3.2 DOCUMENTARY COMPLIANCES: ART. 26 D.L. 78/2010

Art. 26 D.L. 78/2010 provides the type of documentation that the taxpayer can prepare in order to avoid the application of administrative sanctions in case the prices are rectified by the Italian Tax Authority. The documentation has to demonstrate the conformity of the prices with the fair value of the goods and services and has to be shown during the access, inquiry, inspection or other investigative activity conducted by the Tax Authority. The taxpayer is required to indicate in the documentation the mechanism through which the transfer price was determined and reason why that price was deemed to be in keeping with the fair value of the good or service.

Two types of documentation can be prepared: a *masterfile*, containing the information regarding the group to which the enterprise belongs, and the so called *national documentation*, in which the taxpayer provides detailed information about the enterprise[158]. In case the Italian company is a holding or a subholding, both types of documentation have to be prepared; if the Italian company is a participated company, it only has to prepare the national documentation.

5.3.3 INTERNATIONAL RULING

Art. 8 of the D.L. 30 September 2003, n. 269, provides the enterprises operating at an international level with a particular procedure, the international ruling, through

[158] A.M. GAFFURI, *La nuova disciplina in tema di documentazione dei prezzi di trasferimento*, Rass. Trib., n. 6, 2011, p. 1444.

which the taxpayer and the Italian Tax Administration can reach an agreement upon the regime of transfer pricing, dividends, royalties and interest. The agreement is binding in the taxable period during which it is concluded and in the two following taxable periods, unless the factual or juridical circumstances resulting from the agreement change.

The Italian Tax Authority has to send a copy of the agreement to the tax authority of the State where the other company involved in the operation is resident or established.

5.4 TAX HAVENS

5.4.1 DEDUCTION OF COSTS

Italian tax law does not allow the deduction of costs deriving from operations carried out with enterprises located in extra-EU States with favorable fiscal regimes. With the expression “States with a favorable fiscal regime” art 110, subsection 10 of the Income Tax code refers to those States indicated in the decree issued by the Ministry of Economy and Finance that have a considerably lower level of taxation or do not guarantee a sufficient exchange of information.

To obtain the deduction of these elements of income, the taxpayer has to prove that the enterprise exercises an effective and prevalent business activity, or that he has an economic interest in the operation, and that the operation was actually carried out.

These rules are not applicable to the transactions made with persons who are subject to art. 167 and 168, which regulate a special regime regarding controlled foreign companies.

5.4.2 DIVIDENDS

According to the general rule, dividends contribute to the aggregate income of the company in the measure of 5%, because Italian tax lax provides an exemption of 95% in order to prevent economic double taxation. However, if the dividends are distributed by a company located in a State with a favorable level of taxation or that does not guarantee a sufficient exchange of information, they are wholly included in the taxable income, unless the taxpayer proves that the company distributing the dividends receives most of its profits from companies situated in States with an ordinary level of taxation[159].

As regards individuals, normally dividends are partially exempt and contribute the tax base in the measure of 49,72%. Nevertheless, if dividends are distributed by a company with a favorable fiscal regime, they are wholly included in the individual's tax base, unless the taxpayer proves that the detention of the participations did not shift the profits to a State with a favorable fiscal regime[160].

5.4.3 CAPITAL GAINS

As well as the exemption of dividends, D. Lgs. 344/2003 introduced a particular exemption, in the measure of 95%, for capital gains deriving from the disposal of participations that meet the requirements indicated by the Income Tax Code. One of these conditions is that the participated company is not established in one of the States with a favorable fiscal regime indicated in the list issued in accordance with art. 167, subsection 4[161]. The exemption can operate if the taxpayer can prove that

[159] Art. 87, subsection 4, of the Income Tax Code.
[160] Art. 47, subsection 4, of the Income Tax Code.
[161] The other conditions are that the participation is accounted for as a long-term investment, the company conducts an effective business activity and the participation is held for at least one year.

the foreign company receives its profits from companies located in a State with a an ordinary level of taxation[162].

A similar rule is provided for individuals. Normally, capital gains realized by selling substantial participations[163] are partially exempt and contribute to the individual's tax base in the measure of 49,72%. However, if the capital gains derive from the disposal of participations and other financial instruments issued by companies that are resident in States with a favorable fiscal regime they are wholly included in the tax base, unless the taxpayer proves that the detention of the participations did not shift the profits to a State with a favorable fiscal regime[164].

Capital gains realized by individuals within the conduct of a business activity are exempt in the measure of 50,28%, if they have been accounted for as a long-term investment and have been held for a minimum period of one year, on the condition that the company in which the participation is held conducts an effective business income and is not resident in a State with a favorable fiscal regime. The exemption can operate if the taxpayer proves that the holding of the participations in the company resident in a tax haven did not determine the localization of the income in a State with a favorable tax regime[165].

5.5 DIGITAL GOODS AND SERVICES

5.5.1 THE WEB TAX

5.5.1.1 ART. 33 OF L. 27 DECEMBER 2013, N. 147

[162] Art. 87 of the Income Tax Code.

[163] A participation is defined substantial when it attributes more than 2% of the voting rights or 5% of capital in listed companies or 20% of the voting rights and 50% of the capital in the other companies.

[164] Art. 68, subsection 4, of the Income Tax Code.

[165] Art. 58 and 87 of the Income Tax Code.

L. 27 December 2013, n. 147 introduced in the Italian tax law the so called "web tax".

Art. 33 of L. 147/2013 stated that persons subject to VAT were obliged to purchase advertising services and sponsored inks from persons with a VAT number issued by the Italian Tax Authority. Also the banner ads and sponsored links appearing in the pages of the results of search engines, which can be seen on the Italian territory by visiting a web site or by using an online service, had to be purchased only through the owners of an Italian VAT number, issued by the Italian Tax Authority.

This provision was recently repealed by a Decree issued by the Italian Government[166].

5.5.1.2 ART. 177 OF L. 27 DECEMBER 2013, N. 147

Art. 177 of L. 27 December 2013, n. 147 provides a particular rule regarding the determination of business income related to the intercompany operations carried out in accordance with art. 110, subsection 7. In order to determine the value of those operations, companies operating in the field of online advertising and auxiliary activities have to use indicators of profitability other than those regarding the costs borne to carry on their activity.

This provision is aimed at preventing that business income of these companies is underestimated, given that the costs related to this kind of activities are generally quite low.

[166] Art. 2, lett. a), of D.L. 6 March 2014, n. 16.

Anyway, those companies can start the procedure of international ruling provided by D.L 30 September 2003 n. 269.

5.5.1.3 ART. 178 OF L. 27 DECEMBER 2013, N. 147

In order to guarantee a higher level of transparency in the determination of web companies' turnovers, art. 178 L. 27 December 2013, n. 147 provides that online advertising services and auxiliary activities can be purchased only by bank or postal transfer, which has to show the beneficiary's identifying information, or by other means of payment which guarantee the traceability of the operations and transmit the VAT number of the beneficiary.

5.6 THE BENEFICIAL OWNER CLAUSE

5.6.1 IN THE BILATERAL CONVENTIONS

Most of the bilateral Conventions stipulated by Italy contain the beneficial owner clause and, therefore, limit the taxation rights of the source State only when the person resident in the other contracting State is the beneficial owner of the flows of income. The same limitation can also operate when there is an intermediary between the debtor and the beneficial owner, on the condition that the beneficial owner is resident in the other contracting State.

The concept of "beneficial owner" is defined by section 8 of the Protocol related to the Convention concluded by Italy and Germany in 1989, which states that "*the person receiving dividends, interest and royalty is considered the beneficial owner if he owns the rights to which those flows of income relate and if the income has to* *be attributed to that person in accordance with the legislations of the two contracting States*".

The Protocol related to the Convention stipulated with Turkey in 1990 states that the beneficial owner clause has to be interpreted in the sense that the benefits provided by the Convention for dividends, interest and royalties are not attributed to a resident in a third Country, but that limitation does not regard the residents of the Contracting States

Italian Tax Authority defines the beneficial owner as the "person to whom the income is attributable for tax purposes[167]". This definition was reaffirmed in a subsequent resolution of the Ministry of Economy and Finance[168].

A slightly different notion of beneficial owner results from circular n. 47/E of 2 November 2005 "in order for a company to be considered the beneficial owner of the flows of income, in accordance with Dir. 2003/49/CE, it is necessary that the company receiving the interest or royalties benefits economically from the operation" and that "considering the anti-avoidance purpose of the clause, the company is considered the beneficial owner when it owns and has the income at its disposal".

5.6.2 IN THE ITALIAN TAX LAW

Italian tax law does not adopt the beneficial owner clause, except for those particular clauses introduced by D.lgs. 18 April 2005, n. 84 and D.Lgs. 30 May 2005, n. 143, implementing respectively Directive 2003/48/CE and Directive 2003/49/CE.

[167] Circ. 23 December 1996, commenting upon D.Lgs. n. 239/1996 regarding the fiscal regime of interest and other income from bonds and similar instruments.
[168] Italian Fiscal administration, resolution 6th May 1997, 104/E.

Art. 37, subsection 3, of DPR 600/1973 could be deemed to be a beneficial owner clause, since it provides that during assessment procedures the items of income seemingly attributable to a person are imputed to the taxpayer who is proved to be the effective owner of the income. However, it is certain that the provision is only referred to the "fictional interpositions", whereas the beneficial owner clause also applied in case of "real" interposition, where the interposed subject is the real part of the transaction[169].

5.7 TRANSPARENCY: THE COOPERATIVE COMPLIANCE PROGRAM

Implementing OECD recommendations, the Italian Revenue Agency, launched a pilot project whose objective is to define a new relationship between Large Business Taxpayers and the Italian Tax Authority. According to the program, Large Business Taxpayers shall grant more transparency and disclosure, by providing spontaneously or upon request complete and timely information about those transactions which may be deemed "risky" from a fiscal point of view. In exchange for more transparency, the Italian Tax Authority shall commit to resolve any issues effectively and in a reasonable lapse of time.

To take part in the project, the taxpayer needs to qualify as a "Large Taxpayer". An enterprise is deemed to be a "Large Taxpayer" when its operating revenues or turnover are higher than EUR 100 millions[170].

Another condition is that the enterprise has adopted an organizational model, according to D.L. 231/2001, or a Tax Control Framework", to manage tax risks.

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[169] A. BALLANCIN, *La nozione di beneficiario effettivo nelle Convenzioni internazionali e nell'ordinamento tributario italiano*, Rass. Trib., n. 1, 2006, p. 209.

[170] Art. 27, paragraph 10, of D.L. 185/2008, as converted by L. n. 2/2009.

5.8 MEASURES AGAINST HYBRID ENTITIES AND INSTRUMENTS

5.8.1 ART. 89 AND 44 OF THE INCOME TAX CODE

Italian tax law provides some rules that forbid the deduction of costs that can be deducted by the payer. Art. 89 of the Income Tax Code states that the 95% exemption of dividends is granted only if the profits are linked to the economic result of the issuer or of a company belonging to the same group or to the specific business activity for which financial instruments were issued and are not deductible in the foreign State by the issuer.

These condition must result from a statement of the taxpayer or from certain and precise elements.

5.8.2 ART. 2, PARAGRAPH 2, OF THE LEGISLATIVE DECREE N. 461/1997

In accordance with art 2, paragraph 2, of the Legislative Decree n. 461/1997, in the case of Repurchase agreement and Securities lending and similar transactions, Italian tax law grants the Italian borrower receiving dividends, interest or other profits a foreign tax credit only it those benefits would have been given to the beneficial owner of those profits (that is, it is necessary that the lender is subject to the same fiscal regime of the borrower. In substance, the borrower can be given a foreign tax credit only if the lender is an Italian entity or a foreign entity with a permanent establishment.

CHAPTER 6

CITIZENSHIP

6.1 GLOBAL CITIZENSHIP

"*Globalization denotes the process that erode the political and economic importance of national boundaries and increasingly affect life chances through the system of rules that constitute the global order*".[171]

A first form of globalization dates back at the early '30s of XX century, when the phenomenon ended up in the first World War. Today's globalization is different, because following the financial crisis of 2008 the States decided to cooperate. The same year also marked the start of the global governance of G20, which is composed by those Countries that represent most part of the world's GNP and whose decisions are not merely "programmatic" but can affect the tax systems of the whole world.

In this context, the concept of *transnationality* and *fiscal governance* became relevant.

The first one, created in the '50s, refers to those situations in which international organizations, public and private, play an important role on the international scene, together with the States.

The second one refers to a kind of government that is directed towards a specific objective. The starting point is the concept of "good governance", that was introduced by the EU in 2001, in a White Paper that individuated the main characteristics of "good governance" in openness, participation,

[171] M. RISSE, *On Global Justice*, Princeton University Press, 2012.

accountability, effectiveness and coherence; in 2009, EU adopted a Communication promoting good governance in tax matters and the concept of “fiscal governance” was elaborated in relation to the fight against evasion and avoidance of multinationals, money laundering and corruption. More in general, it refers to all the main fiscal issues that are beginning to be examined at a global level. Also the BRICS have begun to deal with some important issues, such as “opacity” and transfer pricing.

The peculiarity of the global debate on these fiscal issues is that the main instrument on which it is based is soft law. Soft law generates obligations that are not legally binding but have an effect of “moral suasion”; if a State does not fulfill that obligations, it will be excluded from future expectations and advantages. The main problem arising from the adoption of soft law is the lack of democracy, because the countries of G20 conclude agreements and elaborate strategies that are executed through structures and organizations, like OECD, that do not represent the whole world but only the participating Countries.

Some of the standards elaborated by the OECD regard the exchange of information as the main instrument to use in the fight against the “opacity” of tax havens and off-shore centers. Many measures regarding the exchange of information have been taken at a national and international level.

The UK has proposed the introduction of public registries for beneficial owners, in order to guarantee a higher level of transparency. Against the trend of guaranteeing a more efficient exchange of information, UK stipulated an agreement with Switzerland (the Rubik agreement) which allows the Swiss tax authority to preserve the bank secrecy in exchange for the application of a final withholding tax on British taxpayers' future investment income and gains on assets and previously untaxed assets.

In the USA , two main measures have been elaborated:

1. FATCA agreements, which impose to U.S. persons to report their financial accounts held abroad and to the financial institutions to report to the Internal Revenue Service (IRS) about their American clients. Born as a measure unilaterally adopted by USA, FATCA agreements are gradually becoming a global standard and are bound to play an extremely significant role in the future.
2. the Extractive Industries Transparency Initiative (EITI), that ensures the openness and accountable management of revenue deriving from the exploitation of natural resources. EITI standards aims at guaranteeing a higher level of disclosure of taxes and other payments made by companies extracting minerals, oil and gas.

In 2003 the European Union issued the "Savings taxation directive", that introduces a system of automatic exchange of information among European tax administrations so that all the payments of interest made by a person resident in a Member State to an individual resident in another Member State are automatically communicated to the tax authority of the latter Member State. Some European Countries[172] are allowed to levy a withholding tax instead of communicating the information during a temporary period, that will last until Switzerland, Liechtenstein, Andorra, Monaco and San Marino

[172] Austria, Luxembourg and, until 2010, Belgium.

undertake to guarantee a sufficient exchange of information regarding the payments of interest.

In 2013, the EU issued two Directives amending Dir. 112/2006 that adopts some measures to counteract tax avoidance in the field of VAT. The first one [173] provides the reverse charge as a *quick reaction mechanism* against VAT frauds; the second one[174] regards the optional adoption by Member States of the reverse charge system in those sectors (like the sector of telecommunication) in which VAT frauds are more frequent.

In order to guarantee more transparency in the financial markets, the Financial Stability Board of G20 constituted the Legal Entity Identifier (LEI), that is a reference number used to uniquely identify the parties of financial transactions worldwide. The LEI is an important instrument which can ensure a more effective measurement and monitoring of systemic risk.

In the era of global fiscal transparency, the creation of transnational networks makes sure that tax information can circulate among the States and enables national tax administrations to cooperate with each other and enforce their national tax laws in respect of multinational enterprises, ensuring the taxation of their worldwide income.

In this context, the concepts of “global citizenship” or “fiscal citizenship” have been elaborated and the distinction between “residents and non-residents is no longer as relevant as it once was, since each State has at its disposal data and information regarding all those who produce income on its territory, irrespective of the place where they are resident.

[173] Dir. 2013/42/EU of 22 July 2013.
[174] Dir. 2013/43/2003 of 22 July 2013.

6.2 SYSTEMIC TAXES

The concept of systemic taxes began to be elaborated in the early years of 2000, when the United Nations introduced the concept of *financial innovation* and when a Commission of the UN was charged to deal with the first global fiscal reform, regarding the automatic exchange of information and the so called formula apportionment, which is a method used to distribute profits among the countries where multinational enterprises operate. Following the financial crisis of 2008, the idea of systemic taxes was brought forward by G20.

Based on a "*macroprudential*" principle, a macroeconomic policy inspired by precaution and prudence, systemic taxes differ from traditional levies because they generate revenue for the State but their main function is to intervene on those behaviors and activities which may affect the rest of the world .

Systemic taxes realize what Pigu called the "internalization of negative externalities", because they make sure that the costs deriving from a harmful activity are borne by the persons exercising that activity and not by the other members of society. The levying of systemic taxes also makes sure that the agents causing the failure of a sector (for example, agents causing the financial crisis) take on their *responsibility failure*, without "off-loading" their responsibilities onto the others.

Four main sectors characterized by "systemic risk" can be individuated: financial and bank sector; environmental and climatic change; multinational enterprises; the Internet.

6.2.1 THE FINANCIAL AND BANK SECTOR

One of the objectives pursued through the introduction of the so called Tobin Tax is to make sure that the costs deriving from the recent economic crisis are borne by the main sector responsible for causing it, that is the financial sector.

The "Tobin tax" owes its name to James Tobin, who in the '70s proposed the introduction of a tax on financial transactions, whose function was to stabilize financial markets.

In 2011, the European Commission presented a proposal of Council Directive[175] regarding the introduction of a common tax on financial transactions. In the explanatory memorandum the Commission points out that the financial sector has played an important role in the recent economic crisis, whose costs were borne by governments and European citizens, and that "*there is a strong consensus within Europe and internationally that the financial sector should contribute more fairly given the costs of dealing with the crisis and the current under-taxation of the sector*".

The main objectives pursued by the European Commission with the proposed Directive are:

- the harmonization of legislation in the field of taxation of financial transactions;
- ensuring that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis and guaranteeing the same level of taxation as the other sectors.

[175] COM (2013) 71 final; a previous proposal made by the Commission dates back at 28 September 2011 (COM 2011-594), following the Communication of 7 October 2010.

- discouraging the financial transactions that do not contribute to the efficiency of financial markets.

Italy introduced a tax on financial transactions in 2012[176]. The Italian tax is levied on financial transactions of shares and similar financial instruments, on derivative financial instruments and other securities and on high frequency transactions.

6.2.2 ENVIRONMENTAL AND CLIMATIC CHANGE

One of the most discussed environmental taxes is the so called "carbon tax", that is a tax on CO_2 emissions.

The carbon tax is an expression of the "polluter pays" principle, according to which "*National authorities should endeavor to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment*"[177] . In other words, the principle means that the polluter doesn't have to "externalize" the costs deriving from polluting activities, which should be borne by the polluter and not by the other members of society.

The levying of carbon tax can also raise revenue for the State and determine an increase in employment by shifting tax burden from direct taxes (income

[176] L. 228/2012.
[177] Rio Declaration, 1992.

tax, social contributions) to taxes on polluting activities and products (so-called "double dividend")[178].

In Italy the carbon tax was introduced in 1998[179] through a series of provisions regarding, on the one hand, the modification of excise duties on mineral oils and, on the other hand, the introduction of a tax on the consumption of carbon, petrol coke and natural bitumen emulsified with 30% of water.

The introduction of a tax on the emission of CO2 was a significant move toward the control of the global warming and of the climatic changes due to gas emissions, which was one of the main objectives defined during the international conference held in Kyoto in 1997[180].

6.2.3 MULTINATIONAL ENTERPRISES

The results of a research carried out by some authors[181] show that the systemic risk in this sector is due to the fact that 40% of the world trade is controlled by 147 powerful transnational corporations. If precautionary measures are not taken, the failure of one of these enterprises will affect the others or the whole sector.

During the early '20s, the League of Nations recognized that the transactional character of multinational enterprises enabled them to free themselves from national borders and operate as supranational enterprises without being

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[178] European Environment Agency, *Environmental taxes: recent developments in tools for integration*, November 2000.

[179] L. 23 December 1998, n. 448.

[180] C. VERRIGNI, *La rilevanza del principio comunitario "chi inquina paga" nei tributi ambientali*, Rass. Trib., n. 5, 2003, p. 1614.

[181] S. VITALI, J.B. GLATTFELDER, S. BATTISTON., *The network of global corporate control.*, 2011.

subject to fiscal controls and audits. In this context, the States only had partial taxation rights.

In that period the entrepreneurial organization of multinationals was seen as an unitary organization exercising an international activity and all the States could levy partial taxes on the part of the international activity that was conducted on their territory through a permanent establishment. If the book-keeping was not reliable, then the States had to reach an agreement upon the division of taxation rights on the basis of some criteria, such as sales, salaries and number of employees.

In the same period, USA and United Kingdom began to elaborate a system of taxation that determined the attribution of taxation rights to capital exporting Countries, on the assumption that the remuneration of the capital invested in the source State had to be taxed in the residence State.

Capital exporting and capital importing Countries adopted different notions of permanent establishment: according to the first ones, subsidiaries and independent agents couldn't be considered permanent establishments; the latter ones, in order to preserve their taxation rights, adopted a wider notion of permanent establishment, which included branches, subsidiaries and independent agents.

Moreover, capital exporting and capital importing Countries adopted different methods to determine the profits attributable to the permanent establishment. Capital exporting countries applied the arm's length principle to the negotiations between the permanent establishment and the head office, as if they were independent enterprises; capital importing Countries based the determination of the profits of the permanent establishment on the “formula apportionment” method and proposed to split the profits among the Countries where the multinationals operated.

In 1933 Michael Carrel also introduced the idea of separate book-keeping. According to Carroll’s idea, there’s no need to consider the unitary organization, because each State levies tax on the profits resulting from the book-keeping of the subsidiary located on its territory.

Capital exporting countries finally managed to impose their model of taxation. However, the system they elaborated turned out to be unsuccessful because nowadays multinational enterprises escape and avoid taxes both in the source State and in the residence State, giving rise to what is called “double non-taxation” by exploiting the loopholes, mismatches and overlapping principles of national legislations. In this context, the market of intangibles represents one of the main strategies used to shift profits through intercompany operations, since it is difficult to find a suitable parameter to determine the market value of this kind of goods.

One of the main problems is that usually multinational enterprises do not reveal what activities they carry on, how many profits these activities generate and how much tax is paid in the single States; that’s why one of the solutions proposed was the introduction of a country-by-country report, which could guarantee a higher level of transparency and disclosure.

6.2.4 THE INTERNET

During the World Conference on International Telecommunications (WCIT) convened by the International Telecommunication Union (ITU)[182] in Dubai in December 2012, 89 Countries out of 144 signed the new International Telecommunications Regulations (ITRs), which serve as a binding global treaty applied around the world "*designed to facilitate international interconnection and interoperability of information and communication services, as well as ensuring their efficiency and widespread public usefulness and availability*".

The review of the previous treaty showed the intention of several Countries, such as Russia and UAE, to extend the control over the Internet, on the assumption that "equal rights to manage the internet should be granted to all of 193 countries" members of the ITU. A more democratic concept of "internet governance" arises, a governance which is no longer in the hands of a few countries but is shared among governments, the private sector and civil society.

The costs related to the creation of the necessary infrastructures should be financed through the taxation of the top earning multinational companies operating in the field of electronic commerce.

[182] The ITU is the United Nations specialized agency for information and communication technologies, *whose objective is to "allocate global radio spectrum and satellite orbits, develop technical standards that ensure networks and technologies seamlessly interconnect and strive to improve access to information and communication technologies to undeserved communities worldwide*".

6.3 NATIONAL CITIZENSHIP AND RESIDENCE

Citizenship and residence are different ways of defining the concept of "belonging" to the State.

During the period of liberalism, in the context of the one-class State, there was a conception of "belonging" strictly connected to the sovereignty of the State that was the element that legitimated the fiscal levying. Citizens were taxed because they were subject to the sovereign State.

This idea of "belonging" began to change with the stream of thought elaborated by some authors . According to the new conception, "belonging" is no longer a mere subjection to the State and taxes have to be paid by citizens in exchange for benefits and services offered by the State[183]. A tax is fair if it is levied in order to guarantee the right functioning of the State.

The new way of conceiving the idea of "belonging" leads to the concept of residence and to the distinction between "personal attachment", that individuates a particular connection between the citizen and the State that legitimates the levying of personal taxes, and "economic attachment" that legitimates taxation on income arisen in the State in accordance with the principle of territoriality.

The concepts of personal belonging and residence were crucial in Anglo-Saxon tax laws in the first decades of XX century. Such relevance was due to the fact that in that period USA and United Kingdom were important capital exporting countries and therefore their tax systems were so structured as to tax most part of the profits in the residence State, leaving a residual part of the taxable income to the source State.

[183] GRIZIOTTI, *Il principio di capacità contributiva*, Riv. dir. fin. sc. fin., I, 1948, p. 15.; F. MAFFEZZONI, *La capacità contributiva nel diritto finanziario*, Torino, 1970.

In Italy, the different ways of conceiving "belonging" reflect in the different ways of interpreting art. 53 of the Italian Constitution and the ability-to-pay principle. Some authors, like Berliri, argued that the term "everybody" contained in the constitutional provision meant "every citizen", because it refers to a political belonging, which is connected to the sovereignty of the State; this interpretation recalled art. 25 of the "Statuto Albertino", which stated that the citizens subject to the sovereign State had to contribute to public expenses. According to others, like Maffezzoni, "everybody" means all those who demonstrate to have ability-to-pay and therefore only those who have an attachment (personal or economic) to the State are liable to tax in Italy ; that means, on the one hand, that foreigners may be taxed in Italy if they are resident or produce income in the State, and, on the other hand, that not every Italian citizen is subject to taxation in Italy.

Until the reform of 1971, Italian tax system used citizenship to determine individuals' liability to personal taxes (complementary taxes and corporation tax)[184], given that art. 9 of the Consolidated direct taxes code of 1958 differentiated Italian citizens from foreigners for the determination of fiscal domicile[185]. In that context, the progressivity of the tax system was based on a complementary tax, which was levied on "individuals, Italian and foreign citizens"[186]. However, for the purposes of the complementary tax, the notion of fiscal residence[187] was relevant because while the tax base of resident individuals included also items of income produced abroad (unless International Conventions

[184] G..MELIS, Il *trasferimento della residenza fiscale nell'imposizione sui redditi*, Roma, 2008, p. 29.
[185] G. PEZZUTO, S. SCREPANTI, *Il nuovo regime della residenza fiscale delle persone fisiche*, cit..
[186] Art. 131 L. 645/1958.
[187] An individual was considered resident f he had his or her abode in Italy for over a year, although he or she was not registered in the civil registry.

provided different rules), non-residents were subject to complementary tax only in respect of items of income produced in Italy[188].

Nowadays citizenship is no longer relevant and residence plays a key-role in the determination of tax liability, both for individuals and companies, because it can express that economic and social connection between the person and the State that legitimates the fiscal levying more effectively than citizenship, which refers to a "political" belonging to the State and implies a series of juridical situations (rights and obligations), some of which are not attributed to non-citizens[189].

[188] G. MELIS, *La nozione di residenza fiscale delle persone fisiche nell'ordinamento tributario italiano*, cit..
[189] C. GARBARINO, *Manuale di tassazione internazionale*, cit., p. 261.

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