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"Impact of the digital economy on 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 Barcellona dal 9 al 16 aprile 2015 – il tema "Impatto dell'economia digitale sulla fiscalità", così articolato:

1. i concetti di "residenza fiscale" e "stabile organizzazione" alla luce dell'economia digitale;
2. attribuzione dei profitti alla stabile organizzazione e prezzi di trasferimento;
3. qualificazione del reddito;
4. incentivi fiscali, erosione della base imponibile ed allocazione artificiosa dei profitti;
5. IVA, imposte sui trasferimenti e altre imposte (indirette);
6. profili procedurali.

I lavori della delegazione italiana – che in questo documento si presentano – sono stati redatti da: Gilda Natoli (Subtopic 1), Sara Sabbatini (Subtopic 2), Federica D'Autilia (Subtopic 3), Edoardo Diotallevi (Subtopic 4), Francesco Capogrossi (Subtopic 5) e Marco Masi (Subtopic 6).

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

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

Elenco dei contributi

1. Place of residence and PE concept in the light of digital economy;

2. Profits allocation to PEs/Transfer Pricing (arm's length principle, formulary apportionment);

3. Characterization of income (e.g., influence of intellectual property law, commercial law, digital goods and services, bundled contracts, criteria to distinguish, e.g., business income, royalties, other income, capital gains);

4. Tax incentives and base erosion and profit shifting;

5. VAT, sales tax, other (indirect) taxes;

6. Procedural aspects.

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Place of residence and PE concept in the light of the digital economy

Gilda Natoli

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INTRODUCTION

The concepts of residence and permanent establishment are very important in every tax system, because on their basis the taxing power of the States is determined.

The Italian tax system is based on the world-wide taxation principle for the residents in the territory of the State, regardless to the citizenship. So, it is necessary the correct individuation of the place of residence, as for the individuals, as for the companies. The concept of permanent establishment is equally important to determine the taxing power of the State, where it is set. In fact, it means a fixed place of business through which the business of a non-resident enterprise is wholly or partly carried on in the territory of the State. So, the income attributable to the permanent establishment have to bear the tax burden in the State where the establishment is located. For these purposes, in the chapter 1 we are going to deal with the domestic regulation of the permanent establishment, with wide references also to the OECD Model and in the light of the Italian case law. In the following chapter 2 we are going to analyze the regulation of the residence provided for by the Italian Tax Income Act, with a specific reference to the OECD Model (in particular to the tie-breaker rules provided for by Article 4). A focus will be made also on the relocation of revenues abroad and on the specific rules in case of foreign subsidiaries and groups. The regulation of the so-called foreign tax credit (as unilateral measure to avoid international double taxation) will be the subject of a specific paragraph. Moreover, in the following work, we are going to descript and analyze the impact of the digital economy on the concepts of residence and permanent establishment. Probably, the ordinary regulation of these concepts should be rethink in relation to the so-called "*new economy*". In fact, the rules provided for by the domestic and tax treaty law can appear inadequate to regulate the digital economy. Consequently there is the risk of fiscal evasion by the enterprises which carry on e-commerce activities, with a loss of taxing power by the States. Finally, in the third chapter, we will focus on the European tax system and in particular on the concepts of residence and permanent establishment in the light of the most relevant Directives in the field of tax law.

CHAPTER 1

1. The permanent establishment under Italian law

The permanent establishment is a particular fiscal concept that indicates the "rootedness" in a State of a non-resident company. It was born thanks to the study of international organizations in the field of international double taxation. In fact, the League of Nations has used for the first time the concept of "permanent establishment" in the article 5 paragraph 1 of the Model Convention of 1927. The concept is very important to determine the correct exercise of taxing power by the States, in fact this notion is the basis for the imposition of an economic activity carried out by a subject in a country other than that its state of residence. From this point of view, the permanent establishment represents the "minimum threshold" which the allocation of taxing powers between the State of the source (of income) and the State of residence (of the company) are based on. Once integrated this "minimum threshold", the source State is entitled to tax the income produced there by the non-resident company.

So, the permanent establishment is conventionally the minimum connecting criterion to justify the State of source's taxing power. This principle is also contained in the Italian tax law. Article 23 paragraph 1 letter e) of the Italian income tax act[1] provides that "*for the purposes of non-residents' taxation are considered as earned in the State territory: the business income arisen from activities carried on in the State territory through permanent establishments*". Only in this case, in fact, the foreign enterprise can actually be considered as a participant to the economic life of our country and therefore deserves to be taxed here. For this reason it is essential, for the purposes of identification of a permanent establishment, the existence of a real "rootedness" of the foreign

[1] Presidential decree n. 917 of 22 December 1986.

company in the State territory, such as to consider the foreign enterprise as involved in the "*economic life*" of the State[2].

In Italy, until 2004 there wasn't a legislative definition of permanent establishment. The legislator introduced a general definition in our law system whit the article 4, paragraph 1, letter a), of the law 8/2003, which has instructed the Government to define the concept of permanent establishment "*on the basis of the criteria defined by international agreements against double taxation*". Today, the definition of permanent establishment is provided for by Article 162[3], that recalls Article 5 of the OECD Model. This Article, being a national provision, is now both applied in absence of conventional norms and when, despite the existence of the Treaty, such provision is more favorable than the conventional rule applicable to the same case. The concept of permanent establishment is referred to two distinct economic phenomena:

a) the exercise of an activity abroad through a series of material means directly organized and managed by the operator (physical p.e.);

b) the presence of the company abroad without a direct exercise of the activity, but through a broadly speaking representative (personal p.e.).

As aforementioned, the notion of physical permanent establishment is outlined in the first four paragraphs of Article 5 of the OECD Model and the notion of personal permanent establishment is outlined in paragraphs 5 and 6 of the same Article. To establish whether or not a permanent establishment exists, it is necessary to check if the concrete case falls under the four paragraphs of the said Article 5; in this case, it is not required to take into account paragraphs 5 and 6 of that Article 5 and is irrelevant if the person in charge to the physical permanent establishment is independent or has the authority to conclude contracts on behalf of the enterprise. If a permanent establishment does not exist, pursuant to paragraph 1 and 2, because of the absence of a fixed place of business, it is necessary to examine the same case with reference to the personal profile (i.e., under paragraph 5 and 6 of Article 5)[4].

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[2] Valente P.; Mattia S, *Residenza fiscale e stabile organizzazione: possibili soluzioni dalla legge delega*, in *Il Fisco*, n.22, 2014.
[3] Hereinafter only referred to as "*Article 162*".
[4] Leo M., *Le imposte sui redditi nel testo unico*, Bologna, 2014.

Well, the concept of permanent establishment outlined by the aforesaid Article 162 is fully aligned with the definition provided for by Article 5 of the OECD model, which identifies three types of permanent establishment:

1) the so-called physical permanent establishment (basic clause);
2) the so-called permanent establishment "*of building site*";
3) the so-called permanent establishment "*of agent*" (agent clause).

These three kinds of permanent establishment will be further analyzed in the following paragraphs.

1.1. The physical permanent establishment

Article 162 starts dealing with "physical" permanent establishment. According to paragraph 1, "*for the purposes of the income tax, permanent establishment means a fixed place of business through which the business of a non-resident enterprise is wholly or partly carried on in the territory of the State*". The paragraph recalls the paragraph 1 of Article 5 of OECD Model, which provides that: "*for the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*" So, the necessary requirements for the presence of a "physical" permanent establishment are:

- the existence of a "*place of business*";
- this place of business must be "*fixed*";
- the enterprise must carry on its business through this fixed place of business.

With reference to the first requirement, a "*place of business*" can be integrated by facilities such as premises or, in certain cases, by machinery or equipment. The term "*place of business*" refers to any premise, facility or installation used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose.

A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is irrelevant whether the premises, facilities or installations are owned or rented by the enterprise, therefore the title under which they are at the disposal of the enterprise is irrelevant. A place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (*e.g.* for the storage of dutiable goods).

Again, the place of business may be situated in the business facilities of another enterprise, e.g. this may be the case of the foreign enterprise which has at its constant disposal certain premises or a part thereof owned by the other enterprise. The mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business.

No formal legal right to use that place is therefore required. Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business[5]. From this point of view, physical presence is not necessary to create a permanent establishment, if the personal requirement is not expressly required by activities carried out in the place of business.

A permanent establishment can exist even if the activity of the company is exercised mainly through automatic machineries (e.g. "*vending machines*" or gaming machines) which the staff of the enterprise manages only the assembly, the operation and the maintenance. In the same sense, the Italian tax administration, in the resolution number 282/E of 11 December 1995, has considered as a permanent establishment the railway line of a Swiss company in the Italian territory[6].

According to the definition of physical permanent establishment, the place of business has to be "fixed". First of all this requirement must be intended in a "spatial" sense. A link between the place of business and a specific geographic point is required, but this does not mean that the equipment constituting the place of business has to be actually fixed to the soil where it stands. It is enough that such equipment remains on a particular site[7]. The requirement of fixedness must also be intended in a "temporal" sense. So, a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency,

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[5] Paragraph 4 of the commentary of the article 5 of the OECD Model.

[6] Resolution of Agenzia delle Entrate, number 282/E of 11 December 1995. Even before the introduction of the legislative definition, the concept of permanent establishment has been object of attention by the Revenue Agency.

[7] Paragraph 5 of the commentary of the article 5 of the OECD Model.

i.e. if it is not of a purely temporary nature[8]. This serves to exclude from the list of permanent establishments the facilities used for the occasional activities such as the exposures, or itinerant ones, such as the music concerts or the circus shows, with short periods permanence in territory of the State.

Neither the OECD Model Convention nor Article 162 provide for a minimum time threshold ("*de minimis rule*"), over which it is certain that a permanent establishment occurs. However, experience has shown that permanent establishments normally have not been considered as existing when a business had been carried on in a country through a place of business that was maintained for less than six months. One exception occurs when activities are of recurrent by nature; in such cases, each time period during which the place is used has to be considered in combination with the number of times during which that place is used (which may extend over a several years).

The fixity of the headquarters is an element that must be verified on objective bases: where a place of business which was, at the outset, designed to be used for a short period of time (so that it would have not constituted a permanent establishment) is in fact maintained for such a period (so that it cannot longer be considered as a temporary one), it becomes a fixed place of business and thus — retrospectively — a permanent establishment.

A place of business can also constitute a permanent establishment notwithstanding it existed, in practice, for a very short period of time; it happens if, in special circumstances (*e.g.* death of the taxpayer, investment failure), it is prematurely liquidated. Another exception concerns business that is carried on exclusively in one country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with it is stronger[9].

The fact that Article 162 explicitly deals with the temporal profile (with regard to the specific hypothesis of construction sites, assembly or installation and its supervision) not providing for the configurability of the permanent establishment where the carried business does not exceed a certain period of time (3 months), means that the fixity of the installation must be judged on the basis of more

[8] Paragraph 6 of the commentary of the article 5 of the OECD Model.
[9] Paragraph 6 of the commentary of the article 5 of the OECD Model.

factual circumstances, such as the time; it must be related to the technological complexity of the installation, depending on the activity to be carried on, by concluding that there might be permanent establishment also in the case of a short term installation, set up with specialist staff and complex means, to tackle an emergency[10].

Temporary interruptions of activities do not imply that a permanent establishment ceases to exist. The temporary interruptions of the business are not relevant even if the activities are restarted into a different place other than where they were interrupted. With regard to the third requirement, for a place of business to constitute a permanent establishment the enterprise must wholly or partly carry on its business through it. So it is absolutely necessary the so-called "instrumentality" of the place of business, regardless of the type of the performed activity. The activities to be performed through the place of business must belong to the whole business carried on by the parent. There is not a specific provision listing the activities to be carried out (except for the exclusion of preparatory and auxiliary activities), but they must have a productive character, *i.e.* they must generate profits for the enterprise[11]. The Italian tax administration, in fact, said that the activities carried out by the permanent establishment must consist in "*a complete cycle of entrepreneurial activity with its own economic result, independent of that earned by the head office*"[12]. For example, the purchase of a building is not in itself suitable to constitute a permanent establishment, but it becomes a permanent establishment whether the company opens an office. The term "*business*", according to the first paragraph of Article 162, refers generically to activities directed outside of business establishment, although not aimed at the market or at the public.

In any case, the activity carried on through the permanent establishment must be qualitatively lower than the one carried on in the residence country of the company; in fact if the Italian facility was the main propulsive center of economic activities carried out by the company, the foreign entity, which the permanent

[10] Pennesi M., *Stabile organizzazione. Aspetti critici ed evoluzioni sul tema*, Milano, 2014.
[11] Papotti R.A., *Ancora sulle proposte di modifica al Commentario Ufficiale alla Convenzione tipo dell'OCSE all'articolo 5*, in *Riv. Dir. Trib*., n.202, 2002.
[12] Resolution of Agenzia delle entrate, number 9/2398 of 10 February 1983

establishment belongs to, would be resident in Italy with consequent absorption of the profile of the permanent establishment, pursuant to Article 73 of Italian Income Tax Act, which will be more widely analyzed in the following chapter. Article 162 provides also for a "*positive list*" and a "*negative list*", like Article 5 of OECD Model.

1.1.1. The positive list

As mentioned above, the paragraph 2 of the said Article 162 contains the "*positive list"*, with the same formulation of Article 5 of the OECD Model. It states: "*the expression "permanent establishment" includes especially:*

a) a place of management;

b) a branch;

c) an office;

d) a workshop;

e) a laboratory;

f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, even in areas outside the territorial waters referred to, in accordance with customary international law and national legislation relating to exploration and exploitation of natural resources, the State may exercise rights with respect to the seabed, its subsoil and natural resources."

This paragraph contains a list of examples, by no means exhaustive, *prima facie* regarded as constituting a permanent establishment. Anyway, even in such cases, the requirements of a material permanent establishment, fixed by the paragraph 1, must be verified.

Please find below a brief analysis of the aforementioned cases.

a) Place of management: this is normally considered as the place where activities of enterprise's direction are carried on (e.g. managing activities). It is not necessarily coincident with the so-called "head office" and it is distinct from the "*place of effective management*", which is instead the element to determine the residence of a company. In fact, if the place of management is the place where coordination and direction activities are carried on and this particular "place" is relevant for residence, not for the concept of permanent establishment. The term “place of management” has been mentioned separately because it is not necessarily an “office”. It can also be represented by a space of minimum dimensions. The factory that will likely be influential is the presence of persons with authority to make important decisions concerning the corporate activity, as such activities traditionally associated with management.

b) Branch: this term defines the place where a segment of the business takes place. It is therefore a place physically and geographically detached from headquarters, having a certain independence from an economic-commercial point of view. The term has a broader meaning than the “*secondary office with stable representation*”, provided for in Article 2197[13] of the Civil Code. So, there could be branches configurable as permanent establishments although these are not equipped with any power of representation. Both in international conventions and in the internal discipline, the term branch is not however used to indicate the subsidiaries of the parent, as will be broadly explained in the following paragraph 1.4.

c) Office: the distinction between the branch and the office is not clear and it is linked to the size of the installation. According to the Court of Cassation, also the rely to a fixed installation, by a multinational company, of the functions of control and coordination of the business itself constitutes an office[14]. When the activity carried on through the office has the sole purpose of exposure and delivery or of purchase of goods or of information collection or with preparatory or auxiliary activities, the seat should not be considered as a permanent establishment.

d) Workshop: it is an industrial or handicraft implant where productions are made or assemblies, repair services, overhauls and maintenance operations, in the

[13] Article 2197 of Civil Code : “*The entrepreneur who sets up secondary office with a stable representation in the territory of the State must, within thirty days, request the registration to the office of the register of companies of the place where the head office of the company is located. At the same time the request must be made at the office of the place where the secondary office is established, indicating the head office, the last name and the name of the representative in charge of the secondary office. The provision of the second subparagraph shall also apply to the entrepreneur who has the head office of the company abroad. The entrepreneur who sets up secondary offices with stable representation abroad must, within thirty days, request the registration to the office of the register in whose district is its head office*”.

[14] Judgment of the Supreme Court of Cassation n.7682, 25 December 2002.

context of mechanical constructions, are performed. The factory is the site dedicated to strictly productive processes.

e) Laboratory: it means a room equipped to carry out experimental, technical or manufacturing activities or to perform scientific research, aimed specifically at actual or potential clients of the company. If the laboratory is used only for internal purposes of scientific research, it cannot be qualified as a permanent establishment.

f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources: unlike the similar formulation of the paragraph 2 of the article 5 of the OECD Model, Italy exercised the option to extend the scope of the letter f) to areas located outside the territorial waters (the disposition of OECD Model is more circumscribed: "*f) mine, an oil or gas well, a quarry or any other place of extraction of natural resources*"). This forecast constitutes a derogation from the general principle on the taxation of non-residents for income received in the territory of the State, as defined by Article 23 of the Italian Income Tax act ("*principle of territoriality*"). This particular provision recalls the International Convention of Geneva on the continental shelf[15]. So, in this case the fixed installation is configured as permanent establishment, even if it is not physically linked to Italian State.

1.1.2. The negative list

The negative list is provided for by the paragraph 4 of Article 162 and by Article 5, paragraph 4 of the OECD Model. The formulation of the two provisions is very similar. In particular the internal disposition states: "*a fixed place of business, however, is not considered a permanent establishment if:*

a) an installation is used solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

[15] The continental shelf is defined as *"the sea bed and subsoil of the submarine regions adjacent to the coasts but located outside the territorial sea, to a depth of 200 meters or, beyond that limit, up to the point where the depth of water above allows the exploitation of the natural resources of the said regions"*. The importance of the continental shelf derives from the possibility of hydrocarbon extraction, now generally accepted, provided that they do not affect the condition of high seas of the water above.

b) *the goods or the merchandise belonging to the enterprise are stored solely for the purpose of storage, display or delivery;*

c) *the goods or the merchandise belonging to the enterprise are stored solely for the purpose of being processed by another enterprise;*

d) *a fixed place of business is used solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise;*

e) *a fixed place of business is used solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.*

f) *a fixed place of business is maintained solely for any combination of activities mentioned in subparagraphs from a) to e), provided that the overall activity of the fixed place of business resulting from this combination has preparatory or auxiliary character."*

This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which are not permanent establishments, even if the activity is carried on through a fixed place of business. The common feature of these activities is that they are, in general, preparatory or auxiliary activities[16]. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not such a character. The decisive criterion is whether or not the activity of the fixed place of business itself constitutes an essential and significant part of the activity of the enterprise as a whole[17]. So the preparatory or auxiliary character must be assessed case by case, both in quantitative and qualitative terms.

The *ratio* of the provision is to deny the existence of a permanent establishment in the absence of a connection of the same activity with the productive activity of the enterprise.

Analyzing the individual cases, subparagraph *a)* relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. With reference to the first storage activity, the rule is obviously referring to the case of warehouses, at the disposal of the foreign enterprise and used for storage of their goods. If the "fixed place" is also used for the collection of orders or directly for the sale of goods or merchandise of the

[16] Paragraph 24 of the commentary of the article 5 of the OECD Model.
[17] Paragraph 21 of the commentary of the article 5 of the OECD Model.

enterprise, as well as for repairs of goods or after sales support, with a possible supply of spare parts, a permanent establishment could arise. An identical qualification as a permanent establishment might occur if the spaces are dedicated to accommodate third party goods, at least for the part of activities related to such use, if it can be separated from the remaining activities.

With reference to the second activity provided by the legislator, this concerns the cases where the foreign company uses a space for exhibition purposes – as in the case of a stand at a trade show – obviously, under the condition that in the same place it does not proceed to the collection of orders or to the sale of goods. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair.

Finally, in the matter of the third activity included in the subparagraph *a),* namely "the *delivery of goods or merchandise belonging to the enterprise*", the expression used by the legislator refers to the warehouse used by the foreign enterprise only for the delivery of goods to customers and not for the collection of orders and, more generally, for the sale of goods. With reference to the use of the installation for the only purpose of delivery of goods or merchandise of the enterprise, the place where the goods or merchandise are delivered is irrelevant. A permanent establishment could also arise if an enterprise maintains a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers where, in addition, it maintains or repairs such machinery, as this activity goes beyond the pure delivery mentioned in subparagraph *a)* of paragraph 4. Since these after-sale organizations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones[18]. Also the ancillary activities to the storage, the display or the delivery, like for example the confection, do not integrate the hypothesis of permanent establishment.

Subparagraph *b)* relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. The distinction with the hypothesis of paragraph *a)* is not easy. Relying on the literal meaning, while the

[18] Paragraph 25 of the commentary of the article 5 of the OECD Model.

subparagraph *a)* concerns to the facilities used as a storage and/or as a place of exposure by the enterprise to which those goods and the merchandise belong, the subparagraph b) concerns the activity of grouping of goods in an installation (possibly used also by other companies) for storage, display or delivery. Alternatively it can be said that subparagraph *a)* intends to clarify how the use of the installation for the purpose of storage, display or delivery is not a permanent establishment (dynamic phase), and subparagraph *b)* provides that also the stock, which is formed as a result of storage for these purposes, does not constitute a permanent establishment (static aspect).

Subparagraph *c)* covers the case in which a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise, on behalf of, or for the account of, the first-mentioned enterprise. In this case, the premises where the goods are stored belong to the enterprise, which provides for the storage to conduct its processing activity. So they do not constitute a permanent establishment of the first enterprise. A similar exclusion is valid for the foreign enterprise, in the case in which the goods are stored at the warehouse of a third subject. In doctrine was observed that the activity of processing can however relate both the physical characteristics of goods and their outward appearance[19]. On the contrary, if the same enterprise owns the goods, to proceed to their processing, the hypothesis of the "physical" permanent establishment occurs, since the activity is part of the normal production process.

Once examined the exclusion cases concerning storage of goods and merchandise, the subparagraph *d)* of paragraph 4 of Article 162 mentions a further hypothesis that does not constitute a physical permanent establishment, namely the case of the fixed place "*used solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise*". As for the so-called "purchasing office", it is important to underline that this fixed place deals exclusively with the purchase of goods, without being directly involved in other activities, such as, for example, the commercialization of goods, as well as their transformation[20]. The destination of the goods purchased is irrelevant, these can also be sent to the

[19] M. Cerrato, *La definizione di "stabile organizzazione" nelle Convenzioni per evitare le doppie imposizioni*, in *Materiali di diritto tributario internazionale*, Milano, 2002, pag.126

[20] M. Leo, *Le imposte sui redditi*, 2011, pag. 2498.

"parent", for their commercialization or subsequent processing, or be assigned to a permanent establishment of the foreign establishment, located in the same territory. As for the collection of information, essentially assimilated to the purchase of goods and merchandise, the OECD commentary refers, by way of example, the case of the newspaper bureau which has no purpose other than to act as one of many "*tentacles*" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "*mere purchase*"[21]. Also the representative offices can perform the propaedeutic activity of information collection, relatively, both to the market and to the potential customers. This is the case, for example, of representative offices of foreign banks, instituted only for the purposes of advertising, as well as the collection and provision of information[22]. Conversely, where this research activity constitutes the main object of the foreign company, the fixed place should integrate a physical permanent establishment.

Subparagraph *e)* provides that a fixed place of business through which the enterprise exercises solely an activity which has preparatory or auxiliary character is deemed not to be a permanent establishment. The preparatory or auxiliary activities are those that:

- do not allow to attribute income to the fixed place of business through which they are exercised. It is recognized that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realization of profits that it is difficult to allocate any profit to such a fixed place of business. Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character[23];
- do not constitute an essential and significant part of the activity of the enterprise as a whole. Even the Italian Tax Authority has considered that a permanent establishment, to be characterized as such, must conduct "*a complete*

[21] Paragraph 22 of the commentary of the article 5 of the OECD Model.
[22] Marco Piazza, *Guida alla fiscalità internazionale*, 2004, pag. 219.
[23] Paragraph 23 of the commentary of the article 5 of the OECD Model.

cycle of entrepreneurial activity with its own economic result, independent from the head office's one"[24];

- are directed exclusively to the enterprise. The activities of the fixed place of business must be carried on for the enterprise. A fixed place of business which renders services not only to its enterprise but also directly to other enterprises, for example to other companies of a group to which the company owning the fixed place belongs, would not fall within the scope of subparagraph *e)*[25]. According to the doctrine, episodic activities towards third parties should nevertheless be tolerated[26].

If, at the same time, a fixed place of business carries on both preparatory and auxiliary activities and activities that can reveal the existence of a permanent establishment, the entire fixed place is considered a permanent establishment as a whole. A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeding this level. If enterprises with international ramifications establish a so-called "*management office*" in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and coordinating functions for all departments of the enterprise located within the region concerned, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2.

Where a big international concern has delegated all management functions to its regional management offices, so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as "places of management" within the meaning of subparagraph *a)* of paragraph 2. The function of managing an enterprise, even if it only covers a certain area of the relevant operations, constitutes an essential part of the business operations of the enterprise and therefore cannot in any way be regarded as an activity which has a

[24] Resolution of Agenzia delle entrate, number 9/2398 of 10 February 1983.
[25] Paragraph 26 of the commentary of the article 5 of the OECD Model.
[26] K.Vogel, *On Double taxation Conventions*, 1996, pag.321.

preparatory or auxiliary character within the meaning of subparagraph *e)* of paragraph 4[27].

At last, according to subparagraph *f)* of paragraph 4, the fact that one fixed place of business combines any of the activities mentioned in the subparagraphs from *a)* to *e)* of paragraph 4 does not mean itself that a permanent establishment exists. Such combinations should not be viewed on rigid lines, but should be considered in the light of the particular circumstances.

The criterion "preparatory or auxiliary character" is to be interpreted in the same way as is set out for the same criterion of subparagraph *e)*. Subparagraph *f)* is not important in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a)* to *e)*, provided that they are separated from each other locally and organizationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists.

Places of business are not "*separated organizationally*" where each of them performs in the State complementary functions, such as receiving and storing goods in one place, distributing those goods through another, etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity[28].

As for the hypothesis of the combination of several preparatory or auxiliary activities, the prediction of Article 162 of the TUIR differs from the Conventions against double taxation initialed from Italy, which do not contain "*rules of closure*" of this type. The introduction of an internal rule that denies the character of a permanent establishment also to the structures appointed for combined exercise of auxiliary activities, however, enables the taxpayer to invoke the application of the more favorable legislation, pursuant to Article 169 of the Italian Income Tax Act (pursuant to which "*the provisions of the Italian Income Tax Act can be applied, if they are more favorable, notwithstanding the international agreements against double taxation*").

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[27] Paragraph 24 of the commentary of the article 5 of the OECD Model.
[28] Paragraph 27.1 of the commentary of the article 5 of the OECD Model.

1.2. Permanent establishment of a building site

The paragraph 3 of Article 162 of the Italian Income Tax Act provides the so-called permanent establishment of a building site. This paragraph states: "*a building site or construction or assembly or installation, or the exercise of supervision activities related to it, is considered a permanent establishment only if that site, project or activity lasts more than three months*".

The doctrine stated that, in the case of permanent establishment of a building site, the requirement of stability would be automatically insured by the required temporal condition[29]. In any case, the presence of a permanent establishment should be excluded when only preparatory or auxiliary activities are carried on in such a site.

A similar provision is contained in the paragraph 3 of Article 5 of the OECD model. It was observed that the displacement of the conventional clause relating to building sites in an autonomous paragraph of the OECD Model has the effect of clarifying that the building sites lasting less than that, provided for by agreement, may however not concretize the case of permanent establishment[30]. But between the two provisions, there are two major differences.

In fact, Article 5 of the OECD Model does not provide separately the supervision activities and then there is a so-called "*duration clause*" wider than the one provided for in the OECD model (12 months).

The fixing of a term particularly reduced for the occurrence of the permanent establishment in Italy (only 3 months) can be retained as a provision to counter abusive practices aimed at using companies resident in low-tax states, which Italy does not have a treaty with, to perform the activities referred to in the third paragraph of the article 162[31].

Moreover, Italian law expressly mentions the activities of supervision, however, resumed in the Commentary to the OECD Model: on-site planning and

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29 S.Mayr, *Società estera con cantiere in Italia: vi è stabile organizzazione?*, in *Corr. Trib*., 1990, pag. 2280 ss.

30 M. Cerrato, *La definizione di "stabile organizzazione" nelle Convenzioni per evitare le doppie imposizioni*, in *Materiali di diritto tributario internazionale*, Milano, 2002

31 Bracco, *National report of Italy, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions*, the *Hague*, 2010.

supervision of the erection of a building are covered by paragraph 3[32]. For these particular purposes, it was told that the wording of Article 162 is in line with the changes to the OECD commentary of 2003, with the result that also an activity of supervision carried on by a third party, other than the subject that manages the site, would complement the conditions of permanent establishment, provided that such activity is connected to the site[33].

According to the Commentary, the term "*building site or construction or installation project*" includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipe-lines and excavating and dredging. Additionally, the term "*installation project*" is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors[34].

It was also clarified that, if the building site contains one of the facilities provided in the *"positive list"*, under the paragraph 2 of Article 5 of the OECD Model and under the similar paragraph 2 of the article 162, which does not exceed the expected *"duration clause"*, this does not integrate the requirements of physical permanent establishment. Where, however, such an office or workshop is used for a number of construction projects and the activities performed therein go beyond those mentioned in paragraph 4, it will be considered a permanent establishment if the conditions of the Article are otherwise met, even if none of the projects involve a building site or construction or installation project that lasts more than twelve months. In that case, the situation of the workshop or office will therefore be different from that of these sites or projects, none of which will constitute a permanent establishment, and it will be important to ensure that only the profits properly attributable to the functions performed through that office or workshop, taking into account the assets used and the risks assumed through that office or workshop, are attributed to the permanent establishment. This could include profits attributable to functions performed in relation to the various construction

[32] Paragraph 17 of the commentary of the article 5 of the OECD Model.
[33] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, pag.317.
[34] Paragraph 17 of the commentary of the article 5 of the OECD Model.

sites but only to the extent that these functions are properly attributable to the office[35].

As to the *"duration clause"*, once outlined the difference with the provision of Article 162, the commentary to the OECD model provides several clarifications about it.

First of all, as mentioned, the temporal requirement replaces the requirement of stability required for the physical permanent establishment. The duration test applies to each individual site or project. To determine how long the site or project has existed, no account should be taken of the time previously spent by the contractor concerned on other sites or projects which are totally unconnected with it. A building site should be regarded as a single unit, even if it is based on several contracts, provided that it forms a coherent whole commercially and geographically. Subject to this provision, a building site constitutes a single unit even if the orders have been placed by several persons (*e.g.* for a row of houses)[36].

As to the *dies a quo* relevant to the resort of the minimum duration foreseen by law, the commentary to the OECD model specifies that a site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, *e.g.* if he installs a planning office for the construction[37]. From a practical perspective, the opening of the construction site would coincide, as a rule, with the sending of the first employee or, if earlier, with the sending of the necessary material to the project. Once passed the minimum term provided by law, the site is considered a permanent establishment of building site retroactively, since its opening.

It was also noted by the doctrine that the continuation of an activity of construction or installation for a period longer than the minimum duration expected by the *"duration clause"* would be decisive for the configurability of a permanent establishment, even if that minimum period has not been satisfied in a single tax period[38]. This is the case of the building sites opened between two tax periods. I

[35] Paragraph 16 of the commentary of the article 5 of the OECD Model.
[36] Paragraph 18 of the commentary of the article 5 of the OECD Model.
[37] Paragraph 19 of the commentary of the article 5 of the OECD Model.
[38] K.Vogel, *On double Taxation Conventions,* 1996, pag.307.

n general, the site continues to exist until the work is completed or permanently abandoned. A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage of material or labor difficulties[39]. Also in this case, from a practical perspective, the cessation of construction site coincides, as a rule, with the abandonment of the site by employees and by the removal of materials and machinery used.

If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. The subcontractor himself has a permanent establishment at the site if his activities there last more than the *"duration clause"*[40]. If instead, the building site, lasting more than the *"duration clause"* consists of several enterprises and some of those participate in the execution of the works for a shorter period, it must be concluded that the site does not constitute a permanent establishment for the latter. However, the repeated presence of such enterprises in the construction site, for periods that on the whole exceed the *"duration clause",* determines the configurability of a permanent establishment from the period in which these enterprises have exceeded their own presence in the site and for the relative income.

In any case, the differences between domestic rules and conventional norms need to be resolved in accordance with the principle of prevalence of the Conventions, unless the domestic rule if more favorable (pursuant to the abovementioned article 169 of Italian Income Tax Act).

1.3. The personal permanent establishment: the agent clause

[39] Paragraph 19 of the commentary of the article 5 of the OECD Model.
[40] Paragraph 19 of the commentary of the article 5 of the OECD Model.

In Italian legislation, the notion of personal permanent establishment is outlined under paragraphs 6 and 7 of Article 162.

According to paragraph 6 of the said Article, *"notwithstanding the provisions of the preceding paragraphs and except as provided in paragraph 7, the person, resident or non-resident, who habitually concludes contracts in the State in the name of the enterprise other than the purchase of goods constitutes a permanent establishment of the company referred to in paragraph 1"*.

Also in this case, the Italian legislator recalled the OECD Model, but with same differences.

In line with the OECD provisions, the legislator, in particular, connected the existence of the personal permanent establishment to the circumstance that the foreign enterprise has, in the territory of the State, a person that habitually concludes contracts, different from the purchase of goods, in the name of the non-resident enterprise. For this particular purposes, the type of the personal permanent establishment must not be confined under the figure of the business intermediary, rather having to report to the subject who acts on behalf of another subject[41].

In the case of the personal permanent establishment, the requirement of the *"fixed place of business"* is substituted by the habitual conclusion of contracts by the agent, as an autonomous requirement. In doctrine, it was observed that the two cases of the physical permanent establishment and personal permanent establishment have been considered as alternatives, also in order to prevent the abuses that would occur if the power of the source State was subject only to the presence of a physical fixed place[42].

It is a generally accepted that an enterprise should be treated as having a permanent establishment in a State if there is, under certain conditions, a person acting for it, even though the enterprise may not have a fixed place of business in that State within the meaning of paragraphs 1 and 2. This provision intends to give to the State the right to tax in such cases[43]. So, the case of the personal

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[41] M.Pennesi, Stabile organizzazione, aspetti critici ed evoluzioni sul tema, 2012, pag.35

[42] M. Cerrato, *La definizione di "stabile organizzazione" nelle Convenzioni per evitare le doppie imposizioni*, in *Materiali di diritto tributario internazionale*, Milano, 2002

[43] Paragraph 31 of the commentary of the article 5 of the OECD Model.

permanent establishment would find his reason in the aim to avoid that a foreign entity, placing itself outside of the requirements for the qualification of a material permanent establishment, avails of a configuration similar to the latter, in which the facilities and staff are made available by third parties[44]. In these terms, in both cases of material and personal permanent establishment, the characteristic trait in common would be represented by the stability of the instrument adopted to operate in the foreign country.

As to the differences contained in Article 162 with respect to the OECD Model, the Italian legislator excluded the existence of a personal permanent establishment in the only case in which the agent concludes contracts, in the name of the foreign enterprise, to purchase goods, thus not tolerating the auxiliary or preparatory activities. On the contrary, Article 5 of the OECD model denies the qualification of permanent establishment when the agent's activities are limited to preparatory or auxiliary activities[45]. According to a part of the doctrine, the exclusive reference to contracts for the purchase of goods and not to those relating to the acquisition of services may lead to the conclusion that the acquisition of services implies the existence of a permanent establishment in the case where a person concludes contracts for the purchase of service[46]. The conclusion of these contracts, moreover, would be part of the preparatory or auxiliary activities and, so, it should be irrelevant, when the contracts are related to the service's supply of a representative office (e.g. telephone consumption, premises cleaning, energy supply).

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[44] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, pag.327.

[45] Paragraph 4 of Article 5 of OECD Model: "*Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph".*

[46] G.B.Lombardo-D.Ceccarelli, "*L'introduzione di una definizione di stabile organizzazione*" in (a cura di R. Lupi) "*La tassazione delle società nella riforma fiscale*", Milano, 2003; A.Stesuri ,"*La riforma della tassazione societaria. Disciplina ed aspetti operativi*", 2004, note 21; C. Gaffuri, "*La stabile organizzazione nella nuova Ires*", *Rivista dei dottori commercialisti*, 2004, pag. 297.

Overestimate the literal meaning of the law might be unreasonable, because it should be said that the person that carries on the above-mentioned operations should be considered a permanent establishment, while the one that stipulates contracts for the purchase of instrumental goods, such as real estate, should not be so. Thus, it is necessary an evaluation case by case, but the relevance of contracts for the purchase of services must be excluded, in any case, when it refers to services related to the activation or the operation of a mere representative office[47].

Italian legislation, defining the personal permanent establishment, used a formula of synthesis and omitted the requirements expected by the OECD model, for which the agent must act "*on behalf of an enterprise*" and must have "*an authority to conclude contracts in the name of the enterprise*". This way, the Italian provision focuses its attention on the activities carried on by the subject, not on his characterization, based on the powers given to him.

As regards to the conditions that must be met for the existence of a personal permanent establishment, they are the following two ones:

1) the usual conclusion of contracts in the name of the enterprise, by the agent;

2) the circumstance that the agent is not an independent broker, acting in the course of his normal business.

As to the conclusion of contracts, the requirement of the "*habitualness*" replaces the requirement of the "*stability*", provided for the physical permanent establishment. It was observed in doctrine as the ascertainment of "*habitualness*" of the agent in the negotiation should be made case by case, having in particular regard the nature of the contracts and the activity of the principal[48]. In any case it is not necessary that the agent is physically present with the character of "*habitualness*" or that he has his residence in Italy.

The expression used by the legislator -"*in the name of the enterprise*"- seems to refer to cases of direct representation, that is when the representative spends the name of the represented. The stipulation on behalf of the non-resident enterprise is to be understood in a wide way and it includes not only the cases in which the stipulation occurs in the name of (and on behalf of) it, but also in all the other

[47] M.Leo, "*Le imposte sui redditi nel testo unico*", 2004

[48] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, pag.335.

cases in which the agent is able to bind such enterprise for the performance of contracts, although not concluded in his name[49]. Such power must also be *"exercised habitually and not occasionally because only thus we can say that the enterprise carries on a trade through the considered person"*[50].

As a further requirement for the personal permanent establishment, i.e. the status of dependency of the agent who acts on behalf of the enterprise, its reconstruction is based, "*for exclusion*", on the definition of independent agent contained in the following paragraph 7 of Article 162. According to the mentioned paragraph: "*a non resident enterprise shall not be deemed to have a permanent establishment merely because it carries on business in the territory of the State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business".*

The independence of the intermediary should be appreciated both in *"legal"* terms and in *"economic"* terms.

From a "*legal*" point of view, whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vis the enterprise. An independent agent will typically be responsible to his principal for the results of his work but not subject to significant control with respect to the manner in which that work is carried out. He will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an indication of independence[51].

From an "*economic*" point of view, an important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents. The provision of a fixed remuneration or a guarantee by the principal, to cover possible losses suffered by the intermediary, proves the absence of a status of independence.

Another factor to be considered in determining independent status is the number of principals represented by the agent. Independent status is less likely if the

[49] Avery, *Agent as a permanent establishment under the OECD Model tax convention,* in *Dir. Prat. Trib.*, 1993, p.1399 ss.
[50] Del Giudice, *Le stabili organizzazioni*, in *Il Fisco* n.10/1983.
[51] Paragraph 38. 3 of the commentary of the article 5 of the OECD Model.

activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative[52]. Persons cannot be said to act in the ordinary course of their own business if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations[53]. In deciding whether or not particular activities fall within or outside the ordinary course of business of an agent, one would examine the business activities customarily carried out within the agent's trade as a broker, commission agent or other independent agent rather than the other business activities carried out by that agent[54]. In any case, possible acts committed outside of the ordinary course, occasionally, should not integrate themselves the existence of a personal permanent establishment.

1.4. Permanent establishment and corporate control

On the basis of the provisions of paragraph 7 of Article 5 of the OECD Model and of the main Conventions against double taxation signed by Italy, also the Italian legislator specified that the situations of corporate control are not in themselves sufficient to integrate the hypothesis of a permanent establishment. In particular, according to the paragraph 9 of Article 162: "*the fact that a non-resident enterprise, with or without a permanent establishment in the territory of the State, controls, or is controlled by a resident company, or that both enterprises are controlled by a third subject that exercise or not a business activity, does not constitute itself a sufficient reason to consider one of this enterprises as a permanent establishment*".

This is a principle shared in the international agreements, too[55]. According to the OECD Model, in fact, it is generally accepted that a subsidiary itself does not constitute itself a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company

[52] Paragraph 38. 6 of the commentary of the article 5 of the OECD Model.
[53] Paragraph 38. 7 of the commentary of the article 5 of the OECD Model.
[54] Paragraph 38. 8 of the commentary of the article 5 of the OECD Model.

[55] P.Baker, *Double taxation Conventions and International Tax Law*, Londra, 1994, pag. 150; K.Vogel, *On Double taxation Convention*, 1996, pag.352

constitutes an independent legal entity. Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not determine that the subsidiary company is a permanent establishment of the parent company[56].

It was observed in the doctrine that the autonomy of the subsidiary is the distinctive character of multinational groups, which avail of subsidiary companies, compared to the so-called unitary multinational groups, which instead avail of permanent establishments[57]. The function of paragraph 9 of Article 162, like the similar provision contained in the OECD model, would be to make clear that the control relationships within the groups not alternate the criteria to be used to determine whether or not there is a permanent establishment[58].

Compared to the similar provision contained in the OECD model, Article 162 refers more generally to the associated enterprises – so, not only, to companies - and also takes into account the companies controlled by the same subject. According to the Commentary of the OECD Model, a parent company may, however, be found, under the rules of paragraphs 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraphs 3 and 4 of Article.

Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent, unless these activities are limited to those referred to in paragraph 4 of Article or unless the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of Article applies[59].

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[56] Paragraph 40 of the commentary of the article 5 of the OECD Model.
[57] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, pag.339.
[58] C. Garbarino, *Manuale di tassazione internazionale*, Milano, 2008, pag.1383.
[59] Paragraph 41 of the commentary of the article 5 of the OECD Model.

So, the purpose of the regulation is to avoid the cases where the resident enterprise is enslaved to the performance of an activity actually referable to another enterprise of the group.

It should also be pointed out that a company can configure itself which a permanent establishment of a group as a whole. The determination of the existence of a permanent establishment under the rules of paragraphs 1 or 5 must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State[60].

Still with reference to permanent establishment and intercompany relationships, the Commentary on the OECD Model clarifies that the performance of "*management services*" within multinational groups does not imply the hypothesis of permanent establishment, since, as a rule, the premises of the company which performs the services cannot be considered at the disposal of the user enterprise[61].

Some modifications have been made to the OECD commentary, following the decision rendered by the Italian Supreme Court in the case "*Philip Morris*", with reference to the so-called “*multiple permanent establishment* “ (see paragraph 1.8.1 of the paper).

1.5. Formal requirements

The regulation of the accounting and procedural fulfillments that each foreign company with an Italian permanent establishment must follow depends on a prior verification of the traceability of the foreign company under one of the types provided in our system.

If the foreign company is ascribable to a social type provided for in the Civil Code, the permanent establishment is subject to the disposition on the acts’ publicity laid down in Article 2508 of the Civil Code[62]. In the opposite case, the

[60] Paragraph 41.1 of the commentary of the article 5 of the OECD Model.
[61] F.Aramini, *Le Proposte OCSE*, in *Dialoghi tributari*, 2008, pag.868 ss.; Paragraph 42 of the commentary of the article 5 of the OECD Model.
[62] Article 2508 of the Code Civil: “*companies incorporated abroad, which set up one or more secondary offices with permanent representation in the territory of the State, are subject, for each office, to the provisions of Italian law on advertisement of company documents. They must also*

relevant rule is Article 2509 of the Civil Code[63], according to which the secondary office of a foreign company is subject to the regulation of such fulfillments provided for the joint stock company.

Articles 2508 and 2509 contain the minimum requirements to protect third parties who are in contact with the company through the permanent establishment, ensuring their access to several information[64]. The acts subject to the publication are the deed of incorporation, the articles of incorporation and the financial statements of the foreign company.

According to the regulation, only the companies incorporated in the European Union, which set up more branches in the territory of the State, can carry out the publication of the above-mentioned social acts in the register of companies of only one branch, depositing in the other ones only the declaration of the executed publication. Therefore, the companies of third countries will be obliged to publish such documents in the office of the register of each branch.

In addiction, the tax rule requires book-keeping duties for the permanent establishment, in order to determine the profits attributable to it and taxable in Italy. In particular, Article 14, paragraph 5, of Presidential Decree of 29 September 1973 n. 600 provides that non-resident companies, entities and entrepreneurs, who carry on business in Italy through a permanent establishment, must notice separately its management facts in the accounting. The presence in Italy of a permanent establishment involves that the non-resident subject must operate, as withholding agent, the withholding taxes and the related balances required by Article 23 and next ones of Presidential Decree of 29 September 1973 n. 600.

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publish, in accordance with the same provisions, the name, first name, date and place of birth of the people who represent them permanently in the State, with details of their powers.

To the third parties who have made transactions with the secondary office can not be opposed that the acts published pursuant to the preceding paragraphs are different from those published in the State where the head office is located.

The companies incorporated abroad are also subject, as regards the secondary offices, to the provisions that regulate the exercise of the company or that subordinate it to the compliance of certain conditions".

[63] Article 2509 of the Civil Code: "*Companies incorporated abroad, who are different from the types regulated in this Code, are subject to the rules of the joint stock company, as regards obligations relating to enrollment of social acts in the register of companies and directors' liability*".

[64] L. Enriques, *Società costituite all'estero*, Bologna e Roma, 2007.

In accordance with the principle of attraction, all income presumably related to the activities carried on by permanent establishment of a foreign company are subject to taxation in the State of production. Pursuant to Article 152 of Italian Income Tax Act, the permanent establishments in Italy must determine, on the basis of a separate income statement, the total income calculated in accordance with the usual accounting principles applicable to resident companies. Therefore, the jurisprudence recognizes to the permanent establishment the nature of autonomous center of allocation of tax relations related to the non-resident subject [65].

1.6. International ruling

The companies with international business may use a procedure of international standard ruling, with main reference to the system of transfer pricing, interests, dividends and royalties. The international standard ruling, introduced into the Italian tax by Article 8 of Decree. 269 2003[66] and disciplined in details by the Act of July 23, 2004 of the Director of the Revenue Agency, was formally activated in 2004, but has actually started in the month of February 2005, following the favorable opinion expressed by the European Commission about it. It is addressed to "*companies with international activity*"[67] who want to define in advance with the Italian Financial Administration:

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[65] P. Valente e S. Mattia, *La stabile organizzazione italiana è centro autonomo di imputazione della madre estera, in Il Quotidiano Ipsoa*, 8 settembre 2011.

[66] Article 8 of Decree. 269 2003: "*1. Companies with international business have access to a procedure of international standard ruling, with main reference to the system of transfer pricing, interests, dividends and royalties; 2. The procedure ends with the stipulation of an agreement between the competent office of the Revenue Agency and the taxpayer, and binds for the tax period during which the agreement is stipulated and for the two subsequent tax periods, unless there are changes in the circumstances of fact or of law, relevant to the aforementioned methods and resulting from the agreement signed by the taxpayers; 3. According to Community legislation, the tax authorities sends a copy of the agreement to the competent tax authority of the Member States of residence or establishment of companies with which taxpayers are engaged in their operations; 4. For the tax years referred to in paragraph 2, the tax authorities exercises the powers referred to in Articles 32 and following of the decree of the President of the Republic September 29, 1973, n. 600, only in relation to matters other than those covered by the agreement; 5. The request for ruling is presented to the competent office, of Milan or Rome, of the Revenue Agency, as determined by the head of that agency.*"

[67] According to Article 1 of Act of July 23, 2004 of the Director of the Revenue Agency: "*For "companies with international activity" must be intended: 1. any company resident in the State, qualified as such under the provisions in force with regard to taxes on income, which alternatively or jointly: - is compared to non-resident companies, in one or more of the conditions specified in*

- methods of calculation of normal value of the operations referred to in paragraph 7 Article 110 of Italian Income Tax Act;

- the application to a real case of rules, including treaty law, concerning the payment to non-residents or the perception by non-residents of dividends, interest, royalties or other income components;

- the application to a real case of rules, including treaty law, concerning the attribution of profits or losses to the permanent establishment in Italy of a non-resident or to the permanent establishment in another State of a resident enterprise.

The international ruling is a procedure that takes place between the Tax Authorities and the taxpayer and does not end with a unilateral decision of the financial Administration, but with an agreement between the parties concerning complex transnational operations, in matters of Article 2 of Act of the Director of the Revenue Agency.

The institute ties fully in the process of tax compliance, designed to develop the dialogue between taxpayers and tax authorities and, consolidating itself over the years, brought to the creation of information symmetry between the taxpayer and the Administration, in a context of transparency and collaboration. Moreover, the recourse to the institute helps to ensure legal certainty in relations between the parties involved, preventing evasion, deflating any contentious with an uncertain outcome and mitigating the risk of international double taxation[68].

Article 7 of Law Decree 145/2013 recently issued by the Government extends the possibility of recourse to an international standard ruling also to obtain a preliminary evaluation on existence or not of a permanent establishment in Italy of a non-resident. It is a significant opportunity for many international groups, starting with those operating on internet. Thus, also in this field, an agreement between the tax authorities and the international company, on the nature of the settlement of the foreign company in Italy, is possible.

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paragraph 7 of Article 110 of Presidential Decree December 22, 1986, n. 917; - whose assets, funds or capital is participated by non-residents, or participates in the assets, fund or capital of non-residents; - paid to or received from non-residents, dividends, interest or royalties; 2. or any non-resident company which carries on its activity in the territory of the State through a permanent establishment, qualified as such under the provisions in force with regard to taxes on income"

[68] Agenzia delle Entrate, Bollettino del ruling di standard internazionale – II edizione, 2013

The international ruling until now was used almost exclusively in the field of "*transfer pricing*". But the dispute between international companies and financial administration is not just about this topic. It happens frequently that the Tax Police and the Revenue Agency retrain Italian subsidiaries of non-resident companies in permanent establishments in Italy of non-resident companies. This involves, in the first instance, that is assessed the VAT evasion by the foreign company and the lack of the tax return of the permanent establishment; the incomes are often made to coincide with the revenues already declared by the Italian company since, in the opinion of the offices, they have been declared by the wrong subject. The possibility to appeal the international ruling is a significant step towards the relaxation of relationships between foreign investors and Italian tax authorities. In almost all cases, foreign investors do not resolve to achieve tax advantages, but they just need to avoid "surprises"[69].

1.7. Concept of permanent establishment in the field of electronic commerce

Paragraph 5 of Article 162 deals with the important issue of the permanent establishment in electronic commerce. According to such paragraph: "*in addition to the provisions of paragraph 4, the availability of electronic computers and the related auxiliary facilities, that allow the collection and transmission of data and information, in order to sell goods and services does not constitute a permanent establishment*".

The phenomenon of electronic commerce, characterized by the "*dematerialization*" of business activities, creates problems in relation to the traditional definition of permanent establishment. Article 162 is in line with the developments emerged at the international level. In range of the OECD, the issue of e-commerce was object of study by the *Technical Advisory Group*, since 1999, until to arrive to the final report of 2000, and to the consequent modification of the commentary to the OECD model. The OECD examined separately the three elements that constitute the so-called *"basic rule"* contained in Article 5,

[69] M. Piazza, *Ruling internazionale esteso alla stabile organizzazione*.

paragraph 1, of the Model *("a fixed place of business through which the business of an enterprise is wholly or partly carried on").*

On the first point, it is excluded that a *web site* could constitute a permanent establishment: in fact, an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a "place of business" as there is no "facility such as premises or, in certain instances, machinery or equipment" as far as the software and data constituting that web site is concerned.

On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a "*fixed place of business*" of the enterprise that uses that server[70]. As for the "*fixity*", the OECD clarified that computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1[71]. It is relevant an economic/functional link.

As for the third element, the question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed[72].

With respect to the content provider, instead, we can hypothesize two cases. In the first one, the IPC does not have a power of control over the server. In this case, having the website immaterial nature, it must exclude the existence of a permanent establishment. In the second case, instead, the IPC has the control over the server, and the connection between web site and server can give rise to a permanent establishment of the ICP[73].

[70] Paragraph 42.2 of the commentary of the article 5 of the OECD Model.
[71] Paragraph 42.4 of the commentary of the article 5 of the OECD Model.
[72] Paragraph 42.5 of the commentary of the article 5 of the OECD Model.
[73] G.Melis, *Commercio elettronico nel diritto tributario*, in *Digesto*, 2008

In the circumstance that the elements of the basic rule are integrated, it's necessary the exam of the nature of the activity carried on. In reason of the reference to the "*negative list*" referred to in paragraph 5 of Article 162, the Italian legislator intended to understand the purely preparatory or auxiliary character of the activity of collecting and transmitting information with respect to the separate sale of goods, even when it is exercised by means of computers and accessory equipment, as in the case of a *server*. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment[74]. Such exclusion cannot, however, be related to the situation in which the business of the enterprise, that has the equipments, is just the collection and transmission of data[75].

A permanent establishment exists even when the computers allow the transport of digital data, finalized to any activities of exchange of goods and services, so that the server becomes the means for the marketing of products or services of the enterprise. In this case, it is necessary the presence of the requirement provided for the physical permanent establishment. In the electronic commerce, this condition is realized not only when the server, existing in the territory of the state, is used to perform the so-called direct electronic commerce, i.e. allows not only to conclude but also to perform commercial transactions (delivery of goods and payment of the price) through electronic computers (in the case of all digitalized products as music, videos, literary works, software, etc.); such a condition is met even when the same server is used to give life to the so-called indirect electronic commerce, i.e. that allows to conclude only the transaction through electronic computers (thus the delivery of the goods does not occur in a digital way), and also in the case of the not resident enterprise that, in addition to having a server in the Italian territory with an attached web site, in Italy has also the material organization for the delivery of goods.

Finally, with regard to the personal permanent establishment (the so-called "agent clause" in Article 5, paragraph 5 of the OECD Model) the OECD raised the

[74] Paragraph 42.7 of the commentary of the article 5 of the OECD Model.

[75] M.Manca, *La stabile organizzazione nell'ordinamento italiano ed il commercio elettronico,* in *Il Fisco,* 2003, pag.7532

question whether the ISP can constitute a permanent establishment of the ICP. Since, however, the requirements provided for by the OECD Model are: (a) the execution of the business activity of the foreign enterprise through a person; (b) the fact that such person has and habitually exercises an authority to conclude contracts on behalf of the foreign, the OECD opted for a negative conclusion[76]. The ISPs will not constitute agents of the enterprises to which the web sites belong, because they will not have authority to conclude contracts in the name of these enterprises and will not regularly conclude such contracts or because they will constitute independent agents acting in the ordinary course of their business, as evidenced by the fact that they host the web sites of many different enterprises. It is also clear that since the web site through which an enterprise carries on its business is not itself a "person" as defined in Article 3, paragraph 5 cannot apply to deem a permanent establishment to exist by virtue of the web site being an agent of the enterprise for purposes of that paragraph[77].

The Italian Tax Office was specifically interested in the e-commerce in an action related to an instance (in order to know the correct meaning of some relevant Italian tax provisions) issued by a French company, active in the field of video games for personal computers on-line, through the subscription formulas to a catalog of titles or the purchase at the time the game is loaded on the personal computer[78]. In order to reduce connection costs and facilitate its connection with customers, the company had installed two servers, for exclusive use, at an Italian Internet Service Provider (ISP). The server management, the applications installation and the dispatch of games to customers, occurred in France. The company procured its service, in Italy, directly to the final consumer, operating under its own brand, and received directly payment, electronically, on its website or, in the case of connection by the Italian Internet Service Provider, through the latter. The Tax Office, in this case, said that if the computer equipment "*are owned and are in the exclusive use of the non-resident company, which were installed for an indefinite time in Italy and its business activity is carried on*

[76] G.Melis, *Commercio elettronico nel diritto tributario,* in *Digesto,* 2008

[77] Paragraph 42.10 of the commentary of the article 5 of the OECD Model.
[78] Resolution of Agenzia delle entrate of 28 may 2007, number 119/E.

through them, the services guaranteed to Italian customers have to be considered provided by a permanent establishment in Italy and, as such, subject to tax in the State". This conclusion is corroborated by the circumstance that, through the server, "*the non-resident subject carries on an activity of direct electronic commerce, characterized by the provision of goods or services for download, directly by the electronic computer (for example photos, videos, music, software) and that all stages of the contract, including the acquisition of the product and of the payment, are realized by electronic way".*

1.7.1. Anti-abuse measures

Many European States have not remained silent against international triangulations implemented by the so-called OTT (Over-the-top content) to transfer profits in offshore jurisdictions and, therefore, to evade the corporate tax in the country of source. The problem is to find tools to force the OTT to pay taxes in the countries where they produce and sell services.

An interesting initiative was that of Great Britain, born by comparison with Amazon and Google on their tax strategies. From April 2015 the so-called *Diverted Profits Tax* should be adopted. This tax is applied in two cases. The first is when a company makes significant operations in the UK, avoiding the creation of a permanent establishment. The anti-elusive rule applies, in other words, to non-residents who make supplies of goods and services for the benefit of users resident in the UK, in all cases in which "*it is reasonable to assume that its economic activity is intended to avoid the application of the rules on income produced by the permanent establishment ".* The second hypothesis of the application of the tax is that in which a resident company or a non-resident company, but who pursues an activity for which is subject to taxation in the UK, enjoys a tax advantage by using agreements devoid of economic substance. An adequate national tax, to apply to businesses of digital economy (without a identifiable permanent establishment), might just be the *British Diverted Profits Tax*. What would counts for the application of this tax would exclusively the breaches of the rules on permanent establishment, pursued through legal transactions for elusive purposes.

Consequently, still assuming that the transactions took place in the territory of the state, the tax base would be formed by the profits that would have been put in place through a permanent establishment, applying the eluded domestic rules. The tax authorities should apply the same assessment techniques currently used for the reconstruction of the income of occult permanent establishments.

Thus, the stateless income would become the prerequisite of the tax, regardless of its formal roots in the territory. The positive feature of the tax is that it is limited to protecting the right of states to protect their tax bases, without questioning the economic freedoms.

As shown by Professor Franco Gallo in a recent speech at the Chamber of Deputies, Italy could be interested in introducing a very similar measure in future[79].

1.8. Italian case law

As mentioned above, the definition of permanent establishment was introduced in the Italian tax system only in 2004. However the concept of permanent establishment was used by the legislator until the introduction of the tax of movable wealth, for the purpose to identify the sufficient and necessary subjective requirement for the taxation of an economic activity, carried on in the territory of a State (i.e. Italy) by a person resident in another State[80]. It is therefore appropriate to pay attention to the most important judgments of the Supreme Court of Cassation, in order to identify the legal arguments that have filled with content the concept of permanent establishment, before 2004. This is particularly important for the function performed by the Court of Cassation, the supreme organ of justice, that ensures the exact observance and the uniform interpretation of the law and the unity of the national law.

The concept of permanent establishment was introduced in the legal system as a result of a debate started in the twenties, which aimed to determine the legitimated

[79] F. Gallo, *Regime fiscale dell'economia digitale*, in *Indagine conoscitiva sulla fiscalità nell'economia digitale*, 2015.

[80] Article 145 of the Law 29 January 1958, n.645 stated: *"the tax condition is the possession of assets or income paid by a person taxable on the basis of balance sheet as well as by foreign companies and associations, operating in Italy through a permanent establishment, although not taxable according to the balance sheet"*.

State (other than that of residence) to tax the income of an enterprise resident in another State. The issue was to determine whether the State legitimized to tax the income was that of residence or the state in which the income was materially produced (i.e. State of the source). The debate saw to prevail the thesis that assigned to the source State the power to tax the income attributable to a material or personal organization, that was the connection element between the taxation of income and place of production of the same (i.e. permanent establishment). The Italian legislator has adopted the above-mentioned approach both at national level and international level by adopting the OECD model (in its formulation of 1963) in the stipulation of the international Conventions against double taxation with third states.

The lack of a legislative definition of permanent establishment until 2004 has been filled by the intervention of the jurisprudence, which referred to Article 5 of the OECD model.

Initially the concept of permanent establishment was superimposed on the concept of a secondary office, as defined by the Civil Code. This assimilation was probably introduced by the mechanisms of application of the tax on movable wealth that distinguished between foreign entities that were taxed according to the balance sheet in Italy (albeit in reference only to a secondary office) and foreign entities that did not have the obligation to present a balance sheet. Later, with the judgments of 27 November 1987, n. 8815 and 8820, the Supreme Court recognizes that the concept of permanent establishment cannot be exactly coincident with the definition of secondary offices "*which constitute only a typical species of permanent establishments*". In particular, the Supreme Court defined the essential elements of a permanent establishment: "*a) the organization must be instrumental to an activity that the foreign entity habitually carries on in Italy. b) the organization must be stable, such as can be used in a enduring manner. c) the facilities created for an occasional activity (e.g. an expository stand) are devoid of the concept of stability and the size and the structural aspect of the organization are irrelevant, it is sufficient that it constitutes a center of imputation of the activity carried on by the foreign entity. d) the activity of the permanent establishment may be secondary or instrumental respect to that of the foreign* *entity and the purpose can be also non-economic; as it is not required that the organizational structure is in itself productive of income or provided with managerial or accounting autonomy"*[81]. In the judgments n. 8815 and 8820, the Supreme Court held that the purchase and possession of properties in Italy can integrate the notion of permanent establishment, when the possession does not indicate a mere holding of the property but the same is instrumental in a business activity or it is the subject of a business activity.

Still in matter of ownership of property, in the judgment n. 11079 of 7 May 2008 the Court of Cassation engages the issue of the existence of a permanent establishment constituted by the possession of lands by a Dutch company, which stipulated, with foreign citizens, contracts upon payments for renewal of "surface rights", that allowed them to maintain the lands or build bungalows thereon. The Regional Tax Commission had considered that such contracts did not allow the identification of any organizational mechanism in Italy. The Supreme Court holds that the consideration about the no-existence in Italy of a permanent establishment can be shared, but censures the tax consequences arising by the lack of permanent establishment. In fact, the Court, accepting the request by the financial administration, believes that the no-existence of a permanent establishment may not include the no-taxation in Italy also of the proceeds deriving from the sale of the surface rights, considering that Article 112 (now, Article 153) of Italian Income tax Act provides for the liability to tax in Italy also of the capital gains of goods related to the commercial activities in the territory of the State, although they are not achieved through permanent establishments[82].

1.8.1. The concept of "multiple permanent establishment"

In recent years, the Italian Supreme Court has repeatedly dealt with cases regarding the notion of PE. It is quite difficult to precisely define a trend in this respect: if in some cases the Court seems to take positions not in line with interpretations widespread both at the domestic and the international level, in other cases the statements of the same Court are coherent with internationally

[81] Judgments of 27 November 1987, n. 8815 and 8820 of Supreme Court of Cassation.
[82] Judgments of 7 May 2008, n. 11079 of Supreme Court of Cassation.

accepted standards and the jurisprudence of other OECD member countries. The controversial character of the Italian Supreme Court jurisprudence regarding PE matters is not new: it is worth recalling, in this respect, the very well-known *Philip Morris* case[83].

In such judgments, the Tax Administration contested to various companies belonging to the Philip Morris group the existence of a permanent establishment (as defined in Article 5 of the Treaty between Italy and the United States), at the Italian subsidiary Intertaba. In particular, the Tax Administration contested that the contracts signed by Intertaba with foreign companies of the Philip Morris group had solely the aim of concealing the real activities that Intertaba, as a permanent establishment, performed, on behalf of the same group, on Italian territory. The activities, which were obvious symptom of the existence of a permanent establishment in Italy according to the Financial Administration, can be divided in several areas: (i) as to the strategic-decision area, there was a mix of activities, offices and functions performed on behalf of Philip Morris and the associated companies, in particular Philip Morris exercised a dominant position towards Intertaba; (ii) as to the executive area, there were many interventions of Philip Morris towards Intertaba in relation to agreements on price, the terms of surrender and payment of raw materials for the production of filters and in relation to the management accounting, the acts and documents of the enterprise; (iii) as to the personal area, the numerous directors of Intertaba depended by the managers of other companies of the group and had the task of pursuing the strategies and objectives of Philip Morris. The companies of Philip Morris group defended themselves by contesting the existence of a permanent establishment in Italy, on the basis of the last paragraph of Article 5 of the OECD Convention[84] and on the fact that the coincidence between the general policy of the group and the accounting and administrative choices of Intertaba, depended from belonging to the same enterprise group.

[83] Judgments n.3367, 3368 and 3369 of 7 March 2002, n.7689 of 25 May 2002, n.10925 of 25 July 2002, n. 17373 of 6 December 2002.

[84] Paragraph 7 of Article 5 of OECD Model: "*the fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other*".

On the light of the parties' arguments, the Italian Supreme Court ruled that an Italian company belonging to the Philip Morris group, devoted to the manufacturing and distribution of cigarette filters as its main business, was a permanent establishment of foreign companies belonging to the same group. Based on the fact that the Italian company participated in the negotiations and supervised the execution of the licensing agreement concluded between the Italian Tobacco Administration and the German resident parent company (Philip Morris Gmbh) regarding the production and supply of cigarettes and tobacco products with the Philip Morris trademark, and performed promotional activities in relation to sales of Philip Morris products in "*duty-free*" areas, the Supreme Court took the view that the Italian resident company constituted a multiple permanent establishment of the foreign companies in the group, since it was involved in the business activities of the same group without having any autonomy[85]. As regards this specific judgment, also the reactions from the OECD and the counter-reactions from Italy are very well-known: while the former clarified that the existence of a permanent establishment in the context of multi-national groups has to be ascertained separately for each company in the group, Italy made an observation on Art. 5 of the OECD Model Commentary, clarifying that "*its jurisprudence is not to be ignored in the interpretation of cases"* regarding permanent establishment and multi-national groups of companies.

The Supreme Court of Cassation stated the same in the judgment n. 20597 of October 7, 2011, in which the Financial Administration contested to a company from San Marino to possess several permanent establishments in Italy. The C.I.D. LTD used Italian offices to negotiate with the students who wanted to access the academic support program "*Cepu*". The contracting party was the company of San Marino, to which the students were paying the pre-established price. The individual Italian companies had the sole function of office through which the students stipulated the contract and received educational materials from the C.I.D. The foreign company defended itself by arguing that, pursuant to paragraph 7 of Article 162, "*a non resident enterprise shall not be deemed to have a permanent establishment merely because it carries on business in the territory of the State*

[85] A. Persiani, *Some Remarks on the Notion of Permanent Establishment in the Recent Italian Supreme Court Jurisprudence, Intertax*, 2012.

through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business". However the Cassation did not accept this argument because, in compliance with the previous case law, *"the verification of the requirements of the permanent establishment, including the participation in concluding contracts, or only to negotiations, in the name the foreign company, must be conducted not only on the formal level, but also, and especially, on a substantive level"*[86]. What it is important is not the direct or indirect representation, but the independence of the general commission agent from the foreign entity and the further circumstance that the latter acts in his ordinary course of business. In the present case, the Supreme Court held that many Italian enterprises - "*formally distinct, but however economically integrated into a unitary structure, instrumental to the achievement of the business purpose in Italy of the non-resident parent*" [87]- could not be regarded as economically independent and therefore assumed the role of permanent establishment. So, also in this case, the Italian Supreme Court recognized the presence of multiple permanent establishments, attributable to a single non-resident entity.

1.8.2. The recent jurisprudence

There are two recent interesting judgments from the Italian Supreme Court on the notion of permanent establishment.

The first judgment regards the *Voith Paper* case[88] and confirms the controversial character of the Italian Supreme Court jurisprudence on permanent establishment matters, where the Court seems indeed to take a 'revolutionary' approach.

The second judgment of the same Court – regarding the *Boston Scientific International* case[89]- seems in line not only with the notion of permanent establishment developed by OECD in respect of commissionaire agreements, but

[86] Italian Supreme Court, judgment n.10925 of July 25, 2002.
[87] Italian Supreme Court, judgment n.20597 of October 7, 2011.

[88] Italian Supreme Court, judgment n. 16106 of July 22, 2011.
[89] Italian Supreme Court, judgment n. 3769 of March 9, 2012.

also with some recent judgments of other relevant OECD countries on the matter[90].

In the *Voith Paper* case, Italian Tax Authorities audited the wholly owned Italian subsidiary of a German entity. The Tax Authorities concluded that the German entity had a permanent establishment in Italy. As regards to the Supreme Court decision, the position is not clear as to the technical basis for finding a permanent establishment, but it was probably by virtue of the presence in Italy of a dependent agent which habitually exercised the authority to conclude contracts in the name of the German principal. Since the German entity was the party which was found to have an Italian permanent establishment to which profits were attributed, it should have been liable for the corporate income tax under traditional permanent establishment concepts. Instead, the Italian Tax Authorities assessed the tax liability against the Italian resident subsidiary company and not against the German parent. The Supreme Court upheld this assessment: based on the fact that not-resident companies are subject to Italian corporate income tax if and insofar as they have a permanent establishment in Italy and the not-resident company has to keep separate accounting records for transactions referable to the permanent establishment, the Court affirmed that the Tax Authorities could well provide the tax assessment regarding the existence of the permanent establishment and the ensuing attribution of profits to it, regardless of the Italian subsidiary company. In the opinion of the Court, such an approach was also confirmed by the VAT

[90] Reference should be made, in particular, to France and Norway. As regards France, the recent judgment of the Paris Supreme Administrative Court regarding the *Zimmer* case is relevant (judgment nn. 304715 and 308525 of March 31, 2010). As regards Norway, the decision of the Norwegian Supreme Court of Dec. 2, 2011 regarding the *Dell* case (judgment of the Norwegian Supreme Court, Dec. 2, 2011, Case HR-2011-2245-A) has to be taken into account. Even if with some differences in the line of reasoning, in both cases the judges dismissed the national tax authorities' position regarding the existence of a PE in the relevant country by virtue of a commissionaire agreement concluded by a resident company with a foreign principal. For a comment on the *Zimmer* case, see J. Wittendorff, *Agency Permanent Establishments and the Zimmer Case*, 5 International Transfer Pricing Journal, 358–364 (2010); for a comment on the *Dell* case, see R. Zielke, *Commissionaire Structure as an Agency Permanent Establishment (PE): Low Risk for Foreign Principals Constituting a PE in Norway – Dell Products v. Government of Norway, Decision of the Norwegian Supreme Court of 2 December 2011*, 8(9) Intertax 494–496 (2012). It is worthwhile highlighting that the configuration of a PE in the area of commissionaire agreements remains highly controversial and devoted to the specific circumstances of the single case: in this respect, in its judgment of Jan. 12, 2012 regarding the *Roche* case the Spanish Supreme Court has taken the view that the Spanish subsidiary of the Roche group constituted a PE of its Swiss resident principal, emphasizing that all the activities carried out by the Spanish company were directed, organized and managed by the Swiss company.

scenario, where the permanent establishment autonomously charges VAT on relevant transactions and may also file claims for the reimbursement of input VAT with the competent Tax Authorities.[91]. This conclusion is undoubtedly surprising and as far as is known it is the first time that the Italian Supreme Court has taken such view. In any case, this position does not seem to be coherent both with the general principles of the domestic income tax system and the well-established principles affirmed at the international level. For the particular relationship between permanent establishment, not-resident parent company and the taxable person see paragraph 2 in the chapter 2.

The judgment referred to the *Boston Scientific International BV* case[92] are in line of continuity with the Philip Morris judgments. The Boston Scientific S.p.a. is an Italian company which is controlled for the 99% by the BSI BV and for the remaining 1% by the Boston Scientific Corporation. The latter is identifiable as the parent company and carries on an activity aimed at "*designing, manufacturing and marketing of medical devices*", the distribution of which in Europe is entrusted to companies in the group, based in various European countries. On the basis of a commissionaire agreement concluded with the Dutch parent, the Italian subsidiary was active in the sale of medical products manufactured by other entities of the group. Coherently with the structure of the commissionaire agreements, the Italian subsidiary was paid through a commission fee, whose amount was determined pursuant to the clauses of the agreement. Based on the lack of independence of the subsidiary both from an economical and juridical standpoint, the Tax Authorities concluded that the subsidiary itself constituted a permanent establishment of the Dutch entity. Both in the first and in the second instance, judgments rejected the position of Tax Authorities and, based on the functions performed and the risks born by the Italian subsidiary, declared the tax assessment served with the latter void. The Supreme Court upheld the second instance judgment, confirming that the position of the Tax Authorities could not be accepted. An element on which the second instance judgment – with an

[91] A. Persiani, *Some Remarks on the Notion of Permanent Establishment in the Recent Italian Supreme Court Jurisprudence, Intertax*, 2012.

[92] Italian Supreme Court, judgments n. 3769, 3770, 3771, 3772 and 3773 of March 9, 2012.

analysis confirmed by the Supreme Court – bases its conclusion is that the Italian subsidiary does not constitute a permanent establishment of the Dutch principal because it acted in its own name and not in the name of the Dutch parent. Rejecting the argument of the Tax Authorities – who supported that the conclusion of the second instance judgment was incorrectly based upon the formal criterion of lack of representative powers – the Supreme Court clarified that the conclusion of the second instance judgment was correctly based on a careful analysis of substantial elements, having the judges ascertained that the contracts concluded by the Italian subsidiary did not have a binding effect on the Dutch parent company. This position is coherent with the OECD approach: even if ,according to certain interpretations of Article 5, paragraphs 5 and 6 OECD Model, the mere lack of representative power could as such be sufficient to determine the exclusion of the commissionaire from the area of the dependent agent and, as a consequence, from the notion of dependent agent permanent establishment, as said OECD Commentary takes a different position, disregarding the formal aspects related to the conclusion of the contract in name of the enterprise[93], and attributing relevance to the actual conduct of the agent carrying on his activity[94].

So, in relation to the concept of permanent establishment, the Italian Supreme Court jurisprudence remains controversial and, to certain extent, a bit confusing.

[93] In this respect, it is worthwhile highlighting that commissionaire agreements regulated by Italian law normally state that the agent has not the authority to conclude contracts in the name of the principal. Such a feature directly derives from the exposed Italian civil law discipline of the commissionaire agreements, where it does not entail the conclusion of the sale contract in the name of the principal, but only on behalf of him.

[94] A. Persiani, *Some Remarks on the Notion of Permanent Establishment in the Recent Italian Supreme Court Jurisprudence, Intertax*, 2012.

CHAPTER 2

2. The tax residence under Italian law

In Italian tax system, the concept of residence is essential to determine the extent to which an individual, a company or a legal entity is subject to the taxing power of the State.

There are two types of income tax, the personal income tax and the corporate income tax. With regard to the first one, the distinction between residents and not-residents in the territory of the State is particularly relevant, as residents are taxed on all their income (under the "worldwide income taxation" principle), not-residents only for income products in Italy. The citizenship is irrelevant. There is, therefore, for the residents, a personal attachment, for non-residents, a real attachment.

The tax meaning of residence differs from the one contained in the Civil Code[95]. For the purposes of income tax of individuals, "*people are considered residents if, for most of the tax period, they are enrolled in the register of the resident population or have their domicile or residence in the territory of the State, in accordance with the Civil Code"*[96]. So, the fiscal residence arises from one of the following three facts (if they last more than six months): (i) from the mere identity registration; (ii) from the domicile, that is the center of business and interests; (iii) from the usual abode.

To obstruct the problem of the "*fake*" transfers of residence in *"tax havens"*, Italian citizens, removed from the registers of the resident population and migrated in States or territories with a *"privileged tax regime"*, are considered resident in Italy. So, there is a relative legal presumption of permanence of fiscal residence in Italy, when an Italian citizen moves in a *"tax haven"*. The taxpayer has the burden to prove that, after the termination of enrollment in the registers of

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[95] Article 43, paragraph 2 of Code Civil: "*The residence is the place where the person has his usual abode"*.

[96] Article 2 of Italian Income Tax Act.

the resident population, he did not maintain in Italy neither his habitual abode, nor the center of his own affairs and interests[97].

With reference to corporate income tax, according to Article 73 of Italian income tax act, paragraph 1 of the Italian Tax Income Act, it applies to:

"*a) the joint stock companies and limited companies by shares, the limited liability companies, the cooperative companies and mutual insurance companies, as well as European companies in Regulation EC No. 2157/2001 and European cooperative companies in Regulation EC No. 1435/2003, resident in the territory of the State;*

b) the public and private entities other than companies, and trusts, resident in the territory of the State, which have as their exclusive or main purpose the exercise of commercial activity;

c) the public and private entities other than companies, and trusts, resident in the territory of the State, which not have as their exclusive or main purpose the exercise of commercial activity;

d) companies and the entities of all kinds, including trusts, with or without legal personality, not resident in the territory of the State."

To the status of tax residents follows that the test about the category of income, the criterion of temporal allocation and the rules of determining income category becomes irrelevant (pursuant to the so called "inclusiveness principle")[98]. This means that the companies or business entities require a preliminary check on the status of tax residence. In case of positive response, the process will stop, focusing only on the rules of the residents subjects and having regard to the worldwide income; in case of negative response, instead, rules on localization, classification and determination of income produced in the State by non-resident will be applied[99].

The notion of residence is regulated by the paragraph 3 of the said Article 73. According to such paragraph, "*for the purposes of income tax, the companies and the entities are considered resident, if, in most of tax period, they have the*

[97] F. Tesauro, *Istituzioni di diritto tributario – parte speciale*, Milano, 2014, pag.19-20.
[98] Articles 6 and 81 of Italian Income Tax Code.
[99] G.Melis, *Le interrelazioni tra le nozioni di residenza fiscale e stabile organizzazione: problemi ancora aperti e possibili soluzioni*, in *Diritto e Pratica Tributaria*, 2014.

registered office or the administration office or the principal business purpose in the territory of the State". Thus, the connection between taxpayer and territory, that determines the global taxable status for tax purposes, is constituted by the registered office, the administration office or the principal business purpose. Hence, it is not relevant the circumstance that the company is incorporated abroad, if one of the above-mentioned elements is located in the territory of the State.

These criteria are alternative: it is sufficient that even only one of them is fulfilled for subject to be considered resident for tax purpose in the State.

The registered office coincides with the head office, indicated in the incorporation deed or in the articles of association. Therefore, the registered office is identified on the basis of a "*formal*" legal element. Such acts are available (publicly) in the Italian register of businesses. Otherwise, both the existence of the office of the administration and the location of the principal business purpose, must be evaluated on the basis of substantial elements and may require complex investigations on the real relationship between the company (as well as the entity) with Italian territory.

The notion of "administration office" is intended by the doctrine[100] as the place in which the administrative management is actually exercised, where the key decisions are taken and the strategies are determined, apart from both the formal assignment of the managing power to certain subjects and the place where the meetings of the Board of Directors occur.

Finally, the principal corporate purpose must be understood as the main economic activity carried on to achieve the business aim. First of all, it is necessary to identify the main purpose, on the basis of the Article 5, paragraph 3, subparagraph d) of Italian Income Tax Act. According to this provision, "*the principal corporate purpose is determined on the basis of the incorporation deed, if it exists in the form of a public act, and, in absence of it, on the basis of the activity effectively exercised"*. After the identification of the main purpose, it must be proceed to its localization in the Italian territory.

[100] G.Melis, *Il trasferimento della residenza nell'imposizione sui redditi*, 2008, Roma.

2.1. Relationship with other States' residence criteria (Article 4 OECD Model)

The condition that the registered office or the administration office or the principal business purpose must be in the territory of the State for most of the tax period is not coherent with provisions of other States, which expect that the acquisition or loss of residence occurs instantaneously with the transfer in (or with the exit out of) the territory of the State, *i.e.* the so-called split year.

This asymmetry between the domestic criteria for determining residence and the criteria provided for by other countries can lead, in the case of transfer from Italy abroad, or vice versa, in situations of dual residence or no-residence. The subject who moves abroad from Italy by the first half of the tax period is not considered a resident, from the beginning of the tax period up to the time of the transfer, in any of the two systems: in fact in the destination State it acquires the residence from the day of transfer, while in Italy it has lost the same since the first day of the tax period. When the transfer takes place in the second part of the tax period, a case of double residence occurs since, from the date of such transfer until the end of the tax period, the subject resides in Italy, as a result of paragraph 3 of Article 73, and both in the State in which it transfers. The hypotheses of double residence can be resolved by the so-called tie breaker rules of paragraphs 2 and 3 of Article 4 of the OECD model.

First of all, paragraph 1 of Article 4 provides for a definition of the expression "*resident of a Contracting State*" for the purposes of the Convention. It establishes that *"the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature"*. The definition aims at covering the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax).

The paragraph 2 relates to the case where, under the provisions of paragraph 1, an individual is a resident of both the Contracting States. To solve this conflict, special rules must be established which give to one State a preference to tax over the other State. As far as possible, the preference criterion must be of such a nature that there can be no question but that the person concerned will satisfy it in one State only, and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State[101].

The subparagraph a) gives preference to the State in which the individual has a permanent home available to him. The permanence for the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc.). If the individual has a permanent home in both Contracting States, paragraph 2 gives preference to the State with which the personal and economic relations of the individual are closer, this being understood as the centre of vital interests. In the cases where the residence cannot be determined by reference to this rule, paragraph 2 provides as subsidiary criteria, first, habitual abode, and then nationality. If the individual is a national of both States or of neither of them, the question shall be solved by mutual agreement between the States according to the procedure laid down in Article 25 of the convention[102].

According to paragraph 3, "*where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both the Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated*". Such paragraph concerns companies and other bodies of persons, irrespective of whether they are or not legal persons. It may be rare in practice for a company to be subject to tax as a resident in more than one State, but it is of course possible if, for instance, one State gives importance to the registration and the other State to the place of effective management. It would not be an adequate solution to give importance to a purely formal criterion like registration. Therefore paragraph 3 gives importance to the place where the company is actually managed[103]. The commentary to Article 4 of the OECD model defines the "place of effective management" as the place where key

[101] Paragraph 10 of the commentary of the article 4 of the OECD Model.

[102] Paragraph 14 of the commentary of the article 4 of the OECD Model.

[103] Paragraph 21-22 of the commentary of the article 4 of the OECD Model.

management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance taken. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time[104].

However, it is not possible to establish a precise rule, because the cases of dual residence of persons who are not individuals are relatively rare and should be dealt with on a case-by-case basis. Anyway, it is important to mention that Italy expressed an observation on the above-mentioned interpretation of the Commentary, affirming that the place where the main and substantial activity of the entity is carried on is also to be taken into account when determining the place of effective management of a person other than an individual.

2.1.1. The case of the relocation of revenues abroad

Article 35 of the Decree Law 4 July 2006,n. 223 introduced in Article 73 the paragraphs 5-bis and 5-ter.

The paragraph 5-bis establishes that, "*unless proven otherwise, it is deemed to exist in the territory of the State the administration office of the companies and entities that hold controlling interests, pursuant to Article 2359, first paragraph, of the Civil Code*[105]*, in the subject referred to in a) and b) of paragraph 1 of Article 73, if, alternatively, these companies and entities:*

a) are controlled, even indirectly, pursuant to Article 2359, first paragraph, of the Civil Code, by residents in the territory of the State;

b) *are administered by a Board of Directors, or other equivalent body of management, composed mainly of directors resident in the territory of the State*".

The purpose of this rule is to obstruct the phenomenon of so-called "esterovestizione", meaning the setting up of a company in the countries with a more favourable tax regime compared to the Italian one, with the aim of imputing

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[104] Paragraph 24 of the commentary of the article 4 of the OECD Model.

[105] Article 2359 of Civil Code: *"Subsidiaries are defined as: 1) companies in which another company holds the majority of votes in the ordinary; 2) companies in which another company possesses enough votes to exercise a dominant influence in ordinary shareholders' meetings; 3) companies that are under the dominant influence of another company by virtue of special contractual restrictions with it."*

the income in the foreign country which would otherwise be taxed in Italy. These subjects have two significant and continuous connection elements with the territory of the State, as they hold controlling interests in companies and entities resident in the territory of the State that, in turn, are controlled or administered by residents.

The Italian Tax Revenue Agency made clear that the paragraph 5-bis establishes, in the presence of the above-mentioned conditions, the reverse of the burden of proof on the taxpayer[106]. In particular, the taxpayer must demonstrate that its place of effective management is not in Italy, but it is located abroad. According to the tax office, it must be shown that, despite the conditions of applicability of the rule, there are factual elements, situations or acts that confirm a concrete rootedness of the effective management in the foreign State. Moreover, the tax office specified that the verification of the effective administration office of a company concerns complex factual profiles on the real relationship of a company with a specific territory, and they cannot be evaluated trough the so-called ordinary or interpretive "interpello" (*i.e.*, a request for interpretation of relevant tax rules issued to the Tax Revenue Agency by taxpayers).

Conversely, when the presumption of Article 73, paragraph 5-bis, does not apply, the financial administration must prove that the company is effectively resident in Italy. As to the effects of paragraph 5-bis, the company is considered "*for all legal purposes*" resident in the territory of the State and therefore is subject to all the instrumental and substantial obligations provided for by law for the resident companies and entities.

The paragraph 5-ter establishes that: "*for the purpose of verification of the subsistence of the control referred to in paragraph 5-bis, the existent situation at the closing date or period for managing of the foreign controlled entity in relevant*".

2.2. The foreign tax credit

The Italian system adopts, as unilateral method against the double taxation, the so-called *"foreign tax credit"*. The allocation of the tax credit for taxes paid abroad to

[106] Tax Revenue Agency circular n. 28/E of August the 4th, 2006.

taxpayers resident in Italy, which produce income in other countries, aims to achieve the "*inner tax neutrality*", from the point of view of the State assets' exporter. It aspires, that is, to ensure that the taxation of income produced abroad is equal to the taxation of income produced within the State of residence of the taxpayer[107]. This is based on the principle that even foreign incomes contribute to form the tax base subject to personal income tax of Italian residents[108]. Therefore, since the taxpayer may have suffered in the foreign country the taxation on income yonder produced, despite having to pay tax on the same income also in Italy, the tax credit allows the deductibility from the Italian tax of the tax levy fulfilled abroad. This discipline is applicable to all taxable persons in the State, including the Italian permanent establishments of non-residents[109].

The tax credit for foreign income is regulated by Article 165 of Italian Tax Income Act.

According the paragraph 1, *"if the foreign income contributes to the formation of the overall income, the taxes paid definitively on that income are allowed as a deduction from the due net tax, up to the competition of the share of the tax corresponding to the relationship between foreign income and the total income, after the losses admitted decreasing from prior tax periods"*. Unlike the previous legislation, Article 165 recognizes the total deduction of the credit also in the hypothesis in which the State, where the foreign income was produced, does not concede to its residents neither the credit nor the exemption for income arising in Italy. However, the taxes definitively paid abroad on such income are admitted in deduction, up to the competition of the part of the (Italian) tax corresponding to the relationship between foreign income and the total income, after the losses admitted decreasing from prior tax periods. Once calculated the result of the relationship, for the purpose of the deduction of credit, within the limits of the net tax[110], it will be assumed the lesser amount between the tax paid abroad and the share of the Italian tax attributable to the foreign income.

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[107] F. Tesauro, *Istituzioni di diritto tributario – parte speciale*, Milano, 2014, pag.169.

[108] Article 3, paragraph 1, and, for resident companies and commercial entities Article 81 of the Italian Income Tax Act.

[109] It is the opinion of Mayr, *La disciplina del credito d'imposta per i redditi esteri*, in *Boll. Trib.*, n.10/2005, p.744.

[110] The gross tax less credits referred to in Article 78 of Italian Income Tax Act.

According to the interpretation of the tax administration, the excess of the tax paid abroad, where is higher than that share of the Italian tax, "*cannot be deducted from the business income of the national subject and because of what is precluded by precise provisions legislative and because this excess is in any case a non-deductible cost for the company under national law, and because it would ultimately borne by the Treasury and not by the taxpayer*"[111].

The paragraph 1 of Article 165 deems relevant only the taxes paid "*definitively*" abroad on the income yonder produced. It must be considered as "definitively paid" the taxes become unrepeatable and therefore, for example, the taxes paid in advance or on a provisional basis, and those for which there is the possibility of full or partial refund not must be considered[112].

Moreover, the Tax Office believes that the deductible foreign tax must be comparable in nature with Italian tax and provides elements to establish the comparability[113]. The prerequisite for the calculation of the tax credit is, however, that the foreign tax has been legitimately perceived by the foreign State. In this perspective, the Tax Office, examining a case in which the foreign State, contrary to what can be deduced from the bilateral agreement in place with Italy, had taken an internal withdrawal, despite the absence of the power to tax, concludes as it cannot be applied the mechanism of recovery of the foreign tax by the tax credit, but must be made only by a written application for reimbursement in respect of the foreign State[114].

For the purpose of the identification of the foreign income, the paragraph 2 of Article 165 establishes that the identification is based on the reciprocal criteria provided for by Article 23 for the income product in Italy by the not-resident. Thus, depending on the specific income categories, the relevance place is: (i) the place where the good is located; (ii) the place of the exercise of an activity; (iii) the place of residence of the person who produces the income. In essence, the rule establishes a so-called "*mirror*" principle. The income considered as foreign income are all the income which, if received by a not-resident, would be taxable

[111] Circolare n.12/1548 of 31 July 1982.
[112] Circolare Min. Fin. 8/2/1980 n.3.
[113] Risoluzione dell'Agenzia delle Entrate 7 Marzo 2008, n.83/E.
[114] Risoluzione dell'Agenzia delle Entrate 3 Luglio 2008, n.277/E.

in Italy. However, it was noted[115] that the legislative solution does not solve all the problems of comparison. For example, some difficulties arise for ordinary revenues of a company (from the transfer of goods or performance of services) produced in the absence of a permanent establishment abroad, on which foreign taxes, however, have been applied. In that case, foreign taxes would not be worthy of consideration, because the subparagraph *e)* of Article 23 states that *" the business income are considered produced in the territory of the State when they derived from activities carried on in the territory of the State through permanent establishments",* except that the Tax Authority does not continue to follow the interpretation given in the resolution. 9/2540 of 21 April 1983 in which it approved the eligibility of the tax credit also for foreign taxes paid on business income produced abroad without permanent establishment (so-called "isolated income").

The paragraph 3 of Article 165 confirms the application of the so-called "*for country limitation*" principle, according to which if the total income consists of also income earned in various foreign countries, the deduction is calculated separately for each of them[116]. Then, the tax credit is calculated separately for each State and not on the total amount of income earned abroad (so-called "*overall limitation*"). The rule, dictated by the need for an orderly accounting of the credits to the countries of origin and of individual production period, establishes a ban on compensation between total income results of the various countries, which translates into an advantage for the resident enterprise, if it suffers losses in any of the States in which it conducts its business. In fact, in these hypotheses, the losses, even though they are deductible from taxable income produced in Italy, do not adversely influence the tax credit regarding to the taxes paid in other States. The separate calculation "*for country limitation*" of the tax credit is, however, less advantageous to the subject that, for example, simultaneously conducts its business in two foreign countries, including one with a lower and the other with a higher tax burden compared to that of the its State of

[115] Fort e Mayr, in *Guida Normativa* de *Il Sole 24 Ore*, n.11 del 2003.
[116] Except as provided in paragraph 6 of Article 165 and in paragraphs 3 and 6 of Article 136, according to which foreign companies belonging to the worldwide "consolidato" are considered entities in their own right, even if they were resident in the same country, unless in that country they were not authorized to a consolidated tax on a integral basis.

residence. In fact, the system adopted in paragraph 3 of Article 165 does not allow to compensate the excess of the not-deductible tax credit with the negative difference between the tax paid in the foreign country, with the lowest tax burden, and the tax worthy of consideration in Italy for such income. The application of the "*for country limitation*" criterion involves the construction of many reports for those foreign States in which it is produced foreign income: the tax credit is given, therefore, by the sum of the credits, attributable to each foreign State but within the limits of the net Italian tax. In the case where the sum of credits attributable to each foreign State is higher than the net Italian tax, it will be necessary to determine which foreign tax is absorbed and which excess of foreign tax is taken back.

For the business income produced abroad through a permanent establishment or by companies participating in the worldwide taxation of group, the paragraph 5 of Article 165 allows, as an exception to the provisions in paragraph 4[117], the exercise of the deduction in the tax return of the competence tax period, even if the definitive payment occurs within the period of presentation of the tax return for the following first tax year. In this case, the exercise of the option is subject to the indication, in the tax returns, of the deducted foreign tax for which the definitive payment has not yet happened. If the condition of deductibility does not occur, it is necessary to make a supplementary tax return, which reduces the credit deducted[118].

Before the introduction of Article 165, the excess of the foreign tax compared to the share of the Italian tax, on the foreign income, was definitively lost. Today, the paragraph 6 gives an opportunity of recovery, if in the preceding or following years a situation of excess of the Italian tax than the foreign one, relatively to foreign income, occurred. Article 165 applies only to income that converges in a business income, so classified in accordance with the domestic law. The persons

[117] According to paragraph 4, the right to deduct the tax credit is born with the tax return for the tax period in which the foreign income must be attributed for competence, identified according to the Italian rules of taxation of its income -and not so in the tax return for the tax period in which the foreign taxes are paid definitively - provided that the payment of the foreign tax definitively occurs within the date of submission of the tax return that includes the foreign income.

[118] According to paragraph 7: "*if the payable tax in Italy for the tax period in which the foreign income contributed to the taxable income has already been paid, shall proceed with a new liquidation, taking into account also any possible major foreign income, and the deduction is made from the payable tax for the tax period to which the tax return relates to*".

other than entrepreneurs are, therefore, excluded from the discipline of the carry-forward. In particular, the excess of the foreign tax configures a tax credit, that can be utilized, during the year, for a maximum amount corresponding to the share of Italian tax attributable to the foreign income, which occurred in previous years, until the eighth. In different cases in which in previous years this excess did not occur, the unused excess of foreign tax will be carried forward in following tax periods (up to eighth) and will be used for the deduction of excess of the Italian tax that may occur, compared to the same business income produced abroad. The last sentence of paragraph 6 of Article 165 establishes that the carry forward and backward of the excesses applies also to business income produced abroad by the individual companies in the national and worldwide taxation of groups.

The paragraph 8 of Article 165 provides that the deduction is not entitled in case of omitted submission of the tax return or omitted indication of the foreign income in the submitted tax return. It is a sanction inferable also by Article 1, paragraph 2, of Presidential Decree no. 600 of 1973, according to which the income for which the lacking indication of active and passive elements necessary for the determination of the taxable income shall be deemed not declared for the purposes of verification and sanctions. However, Italian law provides for the possibility to issue a supplementary return, which acts as an adjustment if it is validly submitted at the time, to acquire the credit due to the terms of paragraphs 4, 5 and 7 of Article 165 originally undeclared.

2.3. Specific rules in case of foreign subsidiaries and groups

2.3.1. Controlled Foreign Company resident in "tax havens" (CFC-legislation)

The regime of the "*Controlled Foreign Company*" applies to the companies, and more in general, to the resident taxpayers which hold controlling interests in companies or entities, that have their head office in states or territories with privileged taxation. As a rule, the income arising from participation in companies resident abroad are subject to tax when they are distributed; according to the CFC-legislation, instead, the income of the controlled foreign subsidiaries are ascribed to the entity resident in Italy, regardless of the distribution, in accordance with the principle of transparency.

The CFC-legislation has an anti-avoidance function and, therefore, it is mandatory. As a result of transparency regime, the income generated by CFC are taxed in Italy immediately, when they are produced: it is so opposed the "*tax deferral*", that is the decision to not distribute the income from controlled foreign companies, to avoid or defer taxation in Italy.

In particular, the CFC-legislation applies to every person resident in Italy who has, "*directly or indirectly, including through trust companies or other intermediaries, the control of an enterprise, a company or other entity, resident or located in any state or territory other than those referred to in the decree of Minister of Economy and Finance issued pursuant to Article 168-bis"*[119]. The notion of control is provided for by Article 2359 of the Civil Code[120].

The taxpayer may avoid the application of the CFC-legislation if he carries out successfully the procedure of the "ordinary" ruling, provided for by Article 11 of the "Statute of the rights of the taxpayer"[121]. The misapplication is provided in two cases. The first occurs in cases where the foreign subject "*carries on an effective industrial or commercial activity, as its main activity, in the market of the State or territory of settlement*". The second case occurs when the resident entity does not enjoy the regime of "tax haven", because "the foreign subject participated" receives gains generated by a permanent establishment or by a subsidiary, whose incomes are taxed in a regime of normal taxation.

The taxation, according to transparency, applies also in the case where the controlled subjects are not established in "tax havens"[122], if there are the following conditions:

a) the controlled foreign entities are subject to an effective taxation less than more than half of that which would be subject if they were resident in Italy;

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[119] D. Stevanato, *Controlled Foreing Companies:concetto di controllo e imputazione del reddito*, in *Riv. Dir. Trib.*, 2000

[120] Article 2359 of Civil Code: *"Subsidiaries are defined as: 1) companies in which another company holds the majority of votes in the ordinary; 2) companies in which another company possesses enough votes to exercise a dominant influence in ordinary shareholders' meetings; 3) companies that are under the dominant influence of another company by virtue of special contractual restrictions with it."*

[121] Law 212, 27 July 2000.

[122] Paragraph 8-bis of Article 167 of Italian Income Tax Act.

b) controlled foreign entities achieve "passive income" or proceeds arising from the performance of "intercompany" services.

The CFC-legislation does not apply if the resident proves that the settlement abroad is not an "*artificial construction*", intended to achieve an undue tax advantage. With this extension, the CFC-legislation appears directed to oppose not only the *tax deferral*, but more generally the dislocation of the profits of the parent in "*artificial*" foreign structures, with the head office in States with a low taxation.

2.3.2. The taxation of international groups

The worldwide groups' taxation entitles the assignment of the taxable income of foreign subsidiaries to the Italian parent company, in proportion to the shareholding. In particular, such system determines the proportional assignment to the parent of the income (or loss) of all non-resident subsidiaries ("*all in, all out*"), for not less than five years. This taxation system has, at the same time, advantages and disadvantages.

The positive side is the countervail ability of the tax losses of non-resident subsidiaries with the income of the residents subsidiaries. The parent who does not adopt the regime can deduct the losses of the permanent establishments[123], but not the losses of foreign subsidiaries. The principal practical function of the worldwide is, therefore, the countervail ability of the cross-border losses. On the other hand, however, it makes immediately taxable in Italy, by the assignment to the parent, the profits of non-resident subsidiaries.

The parent must be a company or a business entity resident in Italy. Neither the partnership, nor the not-resident companies can adopt such a regime. Moreover, the parent can opt for it: a) if it is a company listed on regulated markets; b) if it is controlled by the State, or other public entities, or by resident individuals, who do not have the control of other companies. The requirement of the control exists when the parent owns: a) the majority of the voting rights exercisable at the ordinary shareholders' meeting; b) the right to participate in gains by more than

[123] Article 84 of Italian Income Tax Act.

fifty percent. There are no requirements for the subsidiaries, which can therefore be companies of any kind.

The option is effective if, in addition to the assumptions already mentioned, there are the following additional conditions:

a) the option relates to all non-resident subsidiaries (all in, all out);

b) there is identity of the business year of each subsidiary with that of the parent;

c) the balance sheets of the all companies of the group are subject to audit;

d) the consent of the subsidiaries to the revision of their balances sheet and the commitment to provide to the parent the cooperation necessary for the determination of taxable and to fulfill, within a period not exceeding 60 days of the notification, the requests of financial Administration;

e) the positive opinion of the Revenue on the existence of the requirements for the valid exercise of the option is obtained at the end of a ruling procedure.

The result of income of the foreign companies, calculated according to the laws of the State of residence must be recalculated applying the provisions in force in Italy about the corporate income tax, as is provided for CFC. Then following consolidation adjustments must be made:

a) the adoption of a uniform treatment of the components of income resulting from the audited balances sheet of the subsidiaries;

b) the recognition of the values resulting from the balances sheet of the period prior to that of adoption of the regime, provided that there has not been a change in accounting principles;

c) the exclusion of the gains and exchange losses resulting from intercompany loans of longer than 18 months;

d) the conversion of taxable expressed in foreign currency;

e) application of the arm's length principle to the goods and services exchanged between resident and not-residents in order, to preserve the correct international allocation of income;

f) the exclusion of the funds for risks and charges that do not fall into the categories provided by the Italian Income Tax Act.

On the tax base resulting from consolidation adjustments, the parent determines the corresponding gross tax, from which credits and deductions attributable to the parent company are deductible, as well as the credit for taxes paid abroad by the consolidated companies[124].

2.4. Italian case law

With regard to the case law, until not long ago, the processing in matter of tax residence of the company was very small, having been examined only one case of tax residence of entities other than individuals. It was, in particular, a anonymous company Panamanian, registered holder of transport ships, who had given formal power of attorney, like "general agent", to an individual resident in Naples, which had, however, been followed by the general interests of society[125].

The tax authority, believing that person as "owner" of the foreign company and the place of management localized in the State, had therefore affirmed the residence in Italy of the foreign entity. The thesis was accepted by the tax courts, who identified the holder of the power of attorney as the "*true owner of legal relations and economic interests formally assigned to the company*", as equipped with, for effect of the wide proxy, all the powers necessary for the exercise of the ships (with the exception of the power of alienate), having put in place relevant management acts in the name and on behalf of the foreign company, in the absence of an accountability and a control about his work and being compatible for that kind of activity with a management "at a distance"[126].

In recent times, however, the tax administration and the jurisprudence are working to hinder the problem of the fictitious foreign residences of the companies.

With judgment no. 7080 of 2012[127], the Third Criminal Chamber of the Supreme Court of Cassation decided with reference to the criteria to considerer the tax residence of a legal person and the consequent taxation on worldwide basis. In particular, the Supreme Court analyzed a case of relocation abroad of revenues

[124] A. Contorino, *Il riporto delle eccedenze d'imposta estera nella disciplina del foreign tax credit*, in *Dir. Prat. Trib*., 2007

[125] *Comm. trib. centr.*, 10 ottobre 1996, n. 4992, in *Riv. dir. trib*., 1998

[126] G. Melis, *La residenza fiscale delle societa' nell'ires: giurisprudenza e normativa convenzionale*, in *Corriere Tributario*, 45/2008, p.3648.

[127] Cassazione, Sez. III pen., Sent. 23 febbraio 2012 (24 gennaio 2012), n. 7080.

earned by a Portuguese company participated by some Italian subjects who exercised a coordination activity with a strong interference in social decisions.

The judgment is particularly interesting because the Court does not pronounce on the application of the presumptions provided for in art. 73, paragraph 5-bis of Income Tax Act, analyzed above, but on Article. 73, paragraph 3, which identifies the general rules for defining the tax residence of a company.

The conclusions of the Supreme Court in relation to this case are based on several fundamental considerations about the criteria qualifying the residence of a company. The B.T. S.A. has its registered office in Portugal in the Free Trade Zone of Madeira, and does business in towing offshore sector and assistance to oil platforms in the Atlantic Ocean, through ships and tugs flying the Portuguese flag. The B.T. S.A. is controlled by another Madeira company. Both companies are owned by two brothers living in Italy, B.F. and B.G. who also hold a controlling interest in the Italian company "A. of B. F. & Co" with registered offices in Brindisi. As of 2009, the B.T. S.A. gave the Italian company A. of B. F. & Co all (or however the most important) powers of management and administration of its business, and in particular the organization of the ships belonging to the company, the commercial, technical, personnel and financial management. The Court of Brindisi objected to the brothers BF and BG, to be the top managers and directors of the company BT S.A., artificially resident in Portugal only in order to avoid taxation in Italy, and consequently the failure to submit tax returns in 2008 and 2009.

For the purpose in question, the Supreme Court considered essential to identify, with reference to the foreign company: - the place from where the volitional impulse of the administrative body of the same comes; - the place where the more relevant contracts are concluded or where the most important decisions for life of the company are taken; - the place of residence of the administrators.

Based on the consideration of the domestic provision of Article 73 of the Italian Tax Act and the reservation expressed by Italy on Article 4 of the OECD Model Convention, the Court reiterated interesting points of interpretation in conducting the analysis designed to determine where the effective place of management is located, and concluded that it should be located in Italy. The claimant, in fact, proposed that the tax residence of the BT S.A. was in Madeira, by virtue of the fact that the ships are owned under a Portuguese flag. The Court did not agree with these considerations, reiterating that, as already long recognized in jurisprudence, the place where activity of a company is carried on is not represented by the place where the business goods are situated, but by "*that in which administrative and directional activities are effectively carried on, that is where its legal representative and its directors reside and where the general meetings shall be convened "*[128]. It follows, according to the Supreme Court, that the main criterion for the definition of the fiscal residence of a company is the seat of the administration, as provided also by Article 4, paragraph 3, Convention Italy - Portugal, in line with the OECD model. In fact, paragraph 3 Article 4 states that, "*a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated*". And the place of effective management of a company, in the opinion of the Court, is realized "*in its administrative management, in the planning of all necessary actions to ensure that the social purpose is achieved, in the economic and financial organization of the same*".

The assessment of the tax residence in Italy of a not-resident subject could have an impact much wider than the simple declaration of a permanent establishment in Italy of a foreign entity. In fact, if to the B.T. S.A. was contested the existence of a permanent establishment in Italy, it should present in Italy tax return with reference only income produced in Italy, with the result that undeclared income would be significantly lower and in any case different from the case in which, instead, the company was resident in Italy, because there would be taxable according to the world wide principle, and therefore on the income produced anywhere in the world. The judgment focuses on the existence of shareholding relationships and substantial interference in social decisions by categorizing them as elements of a factual administration by the shareholders resident in Italy. From this, the Supreme Court has inferred, as ultimate consequence, the tax residence in Italy of the foreign company[129].

[128] Cass., 13 ottobre 1972, n. 3028.
[129] Pennesi M. ; Benigni C., *Esterovestizione: la sede dell'amministrazione determina la residenza fiscale*, in *Corriere Tributario*, 24 / 2012, p. 1878

Dealing with the question of the tax residence of a foreign company operating in the Italian market in the field of '”*e-commerce*”, the Supreme Court has made clear that it cannot be considered localized in Italy the main purpose of a company, operating on the web, for the only formal element of the ownership of the Italian concession and by the fact that the referential market is the national one. The case, decided by the judgment, originates from the claim of an order of the Court of Varese concerning the preventive seizure of the bank account of a company operating in e-commerce, with reference to the crimes referred to the art. 11 of Legislative Decree. N. 74/2000 (subtraction fraudulent payment of tax) and art. 5 of the Decree. N. 74/2000 (omitted tax refund). The company, although formally foreign by virtue of the registered office established in Malta, had actually considered fiscally resident in Italy, being located here its operative and administrative seat, its main purpose; therefore, for this it was obliged to the presentation of tax return in our country.

The Supreme Court reversed the decision of the Court of Review, granting the appeal of the company, as in this case it did not believe subsisting on Italian territory the main purpose of the business. In particular, in its judgment, it should be noted the misapplication of Article 73 of the Income Tax Code, being that the main purpose of the company must be identified in the management of the game platform, activity not carried on in Italy, but entirely abroad and by foreign entities. The judgment in question deems that it cannot share the conclusions reached by the Court of Review, precisely because the formal aspect of the 'nationality' grant or reference market does not conciliate with the definition of the main purpose, deduced from the wording of the rule and its judicial interpretation. Indeed, the purpose coincides with the main activity actually carried on that, in the present case, is embodied in the own management platform game on line, while the grant is only a prerequisite for the exercise of that activity. Moreover, the judgment in question affirms the no relevance of a concession to operate on the web in a particular State, for the purpose of subsequent rootedness in that State of the tax residence of the concessionaire company.

The Court of Cassation, on this point, observes how the Italian tax rules should be interpreted and applied, according to the case law of the Court of Justice, in order to not obstacle the freedoms sanctioned in the Treaties of the Union and, in particular, the freedom of establishment. The Court of Justice has, in fact, made clear that the fact that a company was created in a Member State to benefit of a more favorable legislation, does not constitute abuse of the freedom of establishment and that the national measure restricting freedom of establishment may be justified only if it is specifically related to wholly artificial arrangements, devoid of economic reality[130].

[130] B. Santacroce; D. Pezzella, *Il mercato di riferimento non è rilevante ai fini della residenza fiscale di una «web company»*, *Rivista di Giurisprudenza Tributaria*, 4 / 2014, p. 281.

CHAPTER 3

3. European Law

Under the European system, the concepts of tax residence and permanent establishment are treated in relation to the fundamental freedoms (in particular freedom of Movement and freedom of Establishment) and to ensure the non-discrimination principle.

The Court of Justice has expressly recognized that, in matter of direct taxes, the position, with respect to the duties of contribution, of the residents cannot ordinarily be comparable with not-residents' one, for the fact that, on the one hand, residents are taxed in relation to income everywhere products in the world, while not-residents only to income from sources located in the home territory, and secondly, because not-residents usually produce within the borders of a Member State only part - quantitatively minority - of their total income. Thus, the Court formulated the principle that "i*n the tax law the residence of the taxpayer can be a factor that might justify national rules involving different treatment for residents and non-residents taxpayers. Different treatment of resident and non-residents cannot therefore be classified, in itself, which discrimination within the meaning of the Treaty*"[131].

However – the Court specifies yet[132] - a different discipline between these two categories of taxpayers must be considered an unfair discrimination when there is no objective and appreciable differences between the situation of ones and the others.

According to the jurisprudence of the Court started with the *Schumacker* judgment, there is a case where the position of not-residents is substantially comparable to that of residents and it is therefore not acceptable that a Member State treats the two categories of persons in a dissimilar way. The case occurs when a not-resident does not receive his significant income in the State of residence and instead takes the essential part of his taxable income from an

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[131]Judgment of 14 December 2006 in Case C170 / 05 *Denkavit* in database *Eurlex*, paragraphs 23 and 24.

[132] In the judgments of 14 December 2006 in Case C170 / 05, paragraph 25; April 29 1999 in Case C311 / 97, *Royal Bank of Scotland*, in the database *Eurlex*, point 27.

activity performed in another Member State. To eliminate discrimination, the State of occurrence of all or almost all the income must grant to the holder, even though he has not a personal bond with the tax system, the same treatment granted to residents, and, therefore, the same tax benefits. The Treaties provide that the Community promotes the creation of an internal market characterized by the elimination, among member States, of obstacles to the free movement of goods, persons, services and capital.

To ensure the full realization of these four fundamental freedoms, Article 12 of the EC Treaty prohibits *"any discrimination made based on the nationality"*. The Treaty bans any unequal rules as if they are founded directly on nationality as on other criteria of personal connection with the state system, which constitute a disguised form of discrimination performed in consideration of the nationality of the person. Among these parameters there is the residence, because *"not-residents more often are not citizens of the State where they conduct their activities"*[133].

With regard to corporate bodies, Article 54 of the TFEU provides that any collective entity constituted according to the rules of a Member State or having its registered office, its administrative office or the principal purpose in a Member State should be treated in the same way as individuals who are nationality of the State. So, for the corporate bodies, the possession of the registered office, the administrative office or the primary purpose in a Member State has the same effects of the possession of nationality for individuals.

The rules of the Treaty concerning individuals and which are centered on nationality are applicable to the collective entities that meet the territorial bonds described in Article 54 of TFEU. It follows, on the one hand, that for individuals the discriminations based, directly or indirectly, on nationality are prohibited and, on the other hand, for collective entities the differences in treatment that are based on the possession of the legal and administrative office or the purpose of the main activity are prohibited. Therefore, an entity cannot be subject in a Member State to a less favorable tax treatment for the sole reason that does not incorporate any criteria territorial contact, mentioned in Article 54, with that Member State[134].

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[133] So we read in the judgment of 14 February 1995 in Case C279 / 93, *Schumacker*.
[134] A.M. Gaffuri, *La residenza fiscale nel diritto comunitario, Dottrina d'Italia,* 2008.

It is not uncommon that the States submit the foreign companies and their fixed place of business to different rules than those provided for resident companies. In one of the fist cases that concerned direct taxation the ECJ had to deal with the French *avoir fiscal*[135]. The French national provision did not grant the benefit of shareholders' tax credits to a permanent establishment in France of a company established in another Member State whereas such benefits were granted to French companies. The Court came to the conclusion that the permanent establishment and a French company are in comparable situation as the French tax law does not distinguish, for the purpose of determining the income liable to corporate tax, between resident companies and permanent establishments of non-resident companies situated in France. Both are liable to tax on profits generated in France and, consequently, the national law put both on the same footing for the purposes of taxing their profits. The different treatment of the two comparable situations, therefore, constituted discrimination. In this case the Court compared the taxation of the permanent establishment whit that of domestic corporations and explicitly mentioned that a national provision which applies a different treatment to a company seeking to establish itself in that state solely by reason of the fact that it is a non-resident company would deprive the freedom of establishment of all meaning.

The ECJ reached the same result in a triangular case concerning cross-border dividends attributable to a permanent establishment (judgment *Saint Gobain* represents a leading case)[136]. In particular, in this case a French company set up a permanent establishment in Germany through which it held shares in other foreign companies and through which it received dividends on such shares. Under German tax law, the permanent establishment was not granted the same tax credit benefits as those granted to German companies. The ECJ again held that the situations are comparable because both the German company and the French company with its profits attributable to the German permanent establishment are taxable in Germany. Consequently, the two comparable situations have to be treated equally. In these cases the Court again took into consideration the aim and

[135] ECJ 28 January 1986, 270/83, *Commission v France ("Avoir Fiscal").*
[136] ECJ 21 September 1999, C-307/97, *Saint-Gobain*.

purpose of the respective domestic provision to determine whether the factual situation is comparable to the hypothetical one.

From these cases the conclusion can be drawn that permanent establishments have to be treated in the same manner as domestic companies[137].

3.1. Permanent establishment and residence in the Parent-Subsidiary Directive

The Parent-Subsidiary Directive[138], on the common system of taxation applicable in the case of parent companies and subsidiaries of Member States deals with the elimination of economic double taxation arising within a group of companies from cross-border distribution of profits. The first preamble of the Directive affirms the need to create within the EU *"conditions analogous to those of an internal market"* and to *"ensure the establishment and effective functioning of the common market"*. The third preamble recognizes the fact that – from a tax viewpoint – the grouping of companies from different Member States is often put at disadvantage as compared to the grouping of companies resident in the same Member State. The Directive provides – under certain conditions – an exemption from the withholding tax in the state of the subsidiary, as well as the obligation for the state of the parent company to eliminate economic double taxation. In 2003 the Directive was substantially revised by the amending Directive 2003/123/EC[139], which has broadened inter alia the scope of the Directive by extending it to permanent establishments.

Article 2 of the Directive provides for a definition of the terms "*company of Member State"*. The terms include any company that meets the following cumulative requirements:

a) it takes one of the forms listed in the annex of the Directive;

b) it resides for domestic tax purposes in a Member State; furthermore, under any double taxation convention concluded with non-EU Member States, such a company may not regarded as resident in any of those states;

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[137] V. Englmair, *The relevance of the fundamental freedoms for direct taxation,* in *Introduction to European tax law: direct taxation*, 2003.

[138] Hereinafter "the Directive".

[139] Hereinafter "the amending Directive".

c) it is subject to one of the corporate taxes listed in Article 2, without the possibility of an option or of being exempt.

Article 2 of the Directive lists the types of corporate tax. Such Article also includes a residual clause, which refers *"to any other tax which may be substituted for any of the above taxes"*. The condition under *b)* above requires the company to be resident in a Member State both under domestic and tax treaty law. Such a requirement prevents the application of the Directive even if a company is resident for domestic law purposes in a Member State but is considered to be a resident of a non-EU Member State under the tie-breaker rule contained in the double taxation convention concluded with such non-EU Member State[140]. It is not compulsory for a company to meet the three requirements in the same Member State[141]. The Directive also applies to companies that are constituted under the law of a certain Member State and are subject to corporate tax in a different Member State.

The amending Directive include a definition of the term "*permanent establishment"*, which was needed in the light of the broader scope of the Directive. The term "*permanent establishment*" is defined in Article 2, paragraph 2, as "*a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on*". The definition of Article 2, paragraph 2, does refer to what is known as the material permanent establishment, defined in Article 5, paragraph 1, of the OECD Model. Moreover, such a definition requires the profits of the permanent establishment to be subject to tax in the Member State where such permanent establishment is located both under domestic and treaty law. The Directive does not envisage other types of permanent establishment provided for in Article 5 of OECD Model, such as the agency permanent establishment or the construction permanent establishment dealt with in Article 5, paragraph 5 and paragraph 3, respectively, of the OECD Model.

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140 Article 4, paragraph 3 of OECD Model provides for a tie-breaker rule that applies when a company is considered resident under domestic law of both Contracting States. In such case, the provision states that the company must be regarded as resident only in the state in which its place of effective management is located.

141 Terra/Wattel, *European Tax Law*, 2008.

As regard, in particular, to the application of the Directive to permanent establishments, Article 1, third and fourth dash, deals with:

- distributions of profits received by permanent establishments located in a state other than that of the subsidiary (third dash) and
- distribution of profits by subsidiary companies to permanent establishments located in another Member State and belonging to parent companies resident in a Member State, whether or not resident in the same Member State of the distributing subsidiary (fourth dash).

The third dash indeed requires the Member State of the permanent establishment – receiving the distribution of profits – to treat it like a parent company, thus either exempting or granting a tax credit according to Article 4[142] of the Directive[143]. In

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[142] Article 4 of the Directive "*1. Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the Member State of the parent company and the Member State of its permanent establishment shall, except when the subsidiary is liquidated, either:*

(a) refrain from taxing such profits; or

(b) tax such profits while authorizing the parent company and the permanent establishment to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary, subject to the condition that at each tier a company and its lower-tier subsidiary fall within the definitions laid down in Article 2 and meet the requirements provided for in Article 3, up to the limit of the amount of the corresponding tax due.

2. Nothing in this Directive shall prevent the Member State of the parent company from considering a subsidiary to be fiscally transparent on the basis of that Member State's assessment of the legal characteristics of that subsidiary arising from the law under which it is constituted and therefore from taxing the parent company on its share of the profits of its subsidiary as and when those profits arise. In this case the Member State of the parent company shall refrain from taxing the distributed profits of the subsidiary.
When assessing the parent company's share of the profits of its subsidiary as they arise the Member State of the parent company shall either exempt those profits or authorize the parent company to deduct from the amount of tax due that fraction of the corporation tax related to the parent company's share of profits and paid by its subsidiary and any lower-tier subsidiary, subject to the condition that at each tier a company and its lower-tier subsidiary fall within the definitions laid down in Article 2 and meet the requirements provided for in Article 3, up to the limit of the amount of the corresponding tax due.
3. Each Member State shall retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company.
Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5 % of the profits distributed by the subsidiary.
4. Paragraphs 1 and 2 shall apply until the date of effective entry into force of a common system of company taxation.
5. The Council, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, shall, at the appropriate time, adopt the rules to apply as from the date of effective entry into force of a common system of company taxation.

particular, the third dash deals with a triangular situation, i.e. a situation involving three Member States, namely the Member State of the parent company, the Member State of the subsidiary and the Member State of the permanent establishment. In this case, the Member State of the subsidiary is obliged to exempt from withholding tax the profits distributed by a company resident therein under Article 1, second dash[144] and Article 5[145] of the Directive and the Member State of the parent company is obliged to eliminate economic double taxation under Article 1, first dash[146] and Article 5 of the Directive and finally also the Member State of the permanent establishment is obliged to eliminate economic double taxation according to the applicable method whenever the profit are received by resident parent companies. Such a result stems from the combined reading of Article 1, first dash and Article 4 of the Directive. The fourth dash deals with a bilateral situation, in which the parent and the subsidiary are resident in the same Member State whereas the permanent establishment is resident in another Member State. It was uncertain whether prior to the 2003 amendments this situation was covered by the Directive[147].

The main argument against the application of the Directive was the absence of a cross-border distribution of profits, as the parent company resides in the same state as the subsidiary. However, one should take into account that the profits are also taxed in the permanent establishment therein. The application of the Directive in such a situation is therefore in line with its general aim, i.e. the elimination of economic double taxation. In particular, the permanent establishment state would be required to eliminate economic double taxation, as a result of Article 1, fourth dash and Article 4, whereas the state of subsidiary will be required to exempt the distribution, according to Article 1, fourth dash and Article 5 of the Directive. Two more cases not covered by the 2003 amendments, although still involving the

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[143] Should the permanent establishment belongs to a non-EU parent, the Directive would no longer applies."

[144] Article 1 of the Directive: " *each Member State shall apply this Directive: (b) the distribution of the profits by companies of the Member State to companies of other Member States of which they are subsidiaries."*

[145] Article 5 of the Directive: "*Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax"*.

[146] Article 1 of the Directive: " *each Member State shall apply this Directive(a) to distribution of profits received companies of that Member State which come from their subsidiaries of other Member States"*.

[147] Maisto, *EC Tax Review*, 2004.

presence of a permanent establishment, need to be analyzed. First, one could wonder whether the Directive applies in the case the permanent establishment is located in the same Member State as the subsidiary while the parent company is resident in another Member State. In such scenario, the distribution of profits would still be taxable in both the Member State of the subsidiary – which is also the state where the permanent establishment is located – and the Member State of the parent company.

As for the application of the Directive, different positions have been argued in the tax literature. According to some scholars, this scenario would fall outside the scope of the Directive, i.e. neither the state of the subsidiary would be obliged to exempt the profits nor would the state of the parent company be required to eliminate economic double taxation[148]. According to others, the Directive would only bind the state of the parent company to eliminate economic double taxation according to Article 4[149]. Some others argue that the Directive would bind the state of the parent company and would prevent the state of the subsidiary from levying a withholding tax on dividends. However, the latter state would not be prevented from taxing the dividends when received by the permanent establishment, according to domestic and tax treaty rules[150]. Finally, others argue that such scenario should be dealt with under domestic law.

Moreover, it is important to wonder whether the presence of a permanent establishment in a not-EU Member State is covered by the application of the Directive. Certainly, the definition of permanent establishment contained in Article 2 makes reference exclusively to permanent establishments "*situated in a Member State*". Even though there are no specific provisions in this respect, the Directive should apply since the profits are still being distributed by a subsidiary resident in a Member State and are still received by a company of a parent company resident in another Member State. The fact that the profits are attributable to a permanent establishment located in a not-EU Member State should therefore be immaterial[151].

[148] Maisto, *EC Tax Review*, 2004.
[149] Garcia Prats, *ET*, 1995.
[150] Terra/Wattel, *European Tax Law*, 2008.
[151] M. Tenore, *The Parent-Subsidiary Directive*, in *Introduction to European Tax Law: Direct Taxation*, 2013.

3.2. Permanent establishment and residence in the Merger Directive

The Merger Directive[152] adopted in 1990 covered mergers, divisions, transfers of assets and exchange of shares concerning companies of different Member States. Its aim is to avoid the imposition of an income or capital gains tax in connection to these operations. The Directive requires companies involved in the operation covered to qualify as "a company from a Member State". To be characterized as "company from a Member State", the respective company has to meet three requirements: firstly, the company has to take one of the legal forms listed in the annex to the Directive; secondly, the company has to be resident for tax purposes within the European Union; thirdly, the company has to be subject to a certain kind of tax listed in the annex to the Directive. As regard, in particular, the second requirement, it is that the company must be considered to be resident for tax purposes in one Member State on the basis of the domestic tax law of the state. Additionally, the company may not, according to a tax treaty concluded with a third state (not-Member State) be resident for tax purposes outside the EU. Therefore, the second requirement deals with residence for tax purposes in two different respects.

The company has to be resident under domestic tax law in one Member State and it must not be resident for tax treaty purposes in a third state based on the tax treaties concluded by the respective Member State. Companies resident for tax treaty purposes outside the European Union do not have access to the benefits of the Directive. This is especially relevant for dual resident companies that are resident under domestic tax law in one Member State but also resident under the domestic tax law in a third state. If there is a tax treaty similar to the OECD Model with the tie-breaker rule of the place of effective management, this company is not covered by the personal scope of the Directive if the place of effective management is that third state. However, dual resident companies having both of their place of effective management and their registered seat within the European Union are covered by the Directive's personal scope. Even if a dual

[152] Hereinafter "the Directive".

resident company has its place of effective management in a third state this company may still benefit from the Directive if there is no tax treaty in force between the respective Member State and the third state in which the place of effective management is located.

The essence of the Directive is the deferral of capital gains tax. This is basically achieved by a roll-over of basis, i.e. carrying over the value for tax purposes of the assets, liabilities and shares involved. In other words, the Directive requires the Member State to refrain from taxing any capital gains trigged by the cross-border merger, division, transfer of assets, exchange of shares or transfer of registered office of an SE or an SCE. However, the benefit of the Directive is not a tax exemption but a tax deferral.

A reference to the permanent establishment in the Directive is present in Article 4, with regard to the deferral of capital gains tax and carry-over of tax values. In particular, Article 4, paragraph 2, subparagraph b) provides for the "*remaining permanent establishment requirement*". Prima facie, it makes the tax deferral and the carry-over of values conditional upon the transferred assets and liabilities remaining effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company. Furthermore, it is required that these assets and liabilities play a part in generating the profits and losses taken into account for tax purposes. The rationale of this remaining permanent establishment requirement its obviously the safeguarding of taxing rights and thereby the financial interest of the Member State of the transferring company, since under international tax treaty law, a state may only tax profits derived by non-resident if that profit is sourced within its territory. In the case of profits stemming from a business operation, this requirement is as a rule fulfilled if the business is carried on though a permanent establishment in that state. If the assets and liabilities transferred in a cross-border reorganization do not form part of a permanent establishment in the state of the transferring company, then that state as a rule loses its tax claim on the capital gains and fiscal reserves represented by those assets because at a later stage they belong to a non-resident taxpayer and their disposal cannot be taxed in the original source state.

Article 4, paragraph 2, subparagraph b) is therefore regarded as “claim saver”, ensuring that the future realization of the deferred capital gains will be part of the tax base allocated to the state of the transferring company[153]; thus, to the state under whose tax jurisdiction they were generated. However, in order to achieve this goal, it is not always necessary that the transferred assets remain effectively connected with a permanent establishment, such as in the case of immovable property. In this context the permanent establishment requirement is clearly excessive. The permanent establishment concept also fails when the state in which the permanent establishment is situated does not have the right to tax the permanent establishment because of specific provision in a tax treaty.

For the case of transfer of a foreign permanent establishment, Article 10, paragraph 1, sentence 1 in conjunction with sentence 3 of the Directive addresses the transfer of a permanent establishment in a triangular situation, in other words the transfer of a branch of activity in the form of a permanent establishment situated in one Member State by a company resident in another Member State to a company resident in a third Member State. Tax neutrality in the Member State that hosts the permanent establishment is achieved by Article 10, paragraph 1, sentence 3, which requires that the state of the permanent establishment and the Member State of the receiving company apply the provision of the Directive as if the transferring company was situated in the state of the permanent establishment. Consequently, the State of the permanent establishment may not tax any capital gains in the assets and liabilities of the permanent establishment and must allow the carry-over of tax-free provision and reserves, provided that within the permanent establishment the original book values and depreciation methods are maintained.

Article 10, paragraph 1, sentence 4 clarifies that the rules of Article 1, paragraph 1 providing for tax neutrality also apply to transaction commonly known as incorporation of a branch into a subsidiary, i.e. where the permanent establishment that is to be transferred is situated in the same Member State as that in which the receiving company is resident (transfer of a permanent establishment in a bilateral situation).

[153] Terra/Wattel, *European Tax Law*, 2008.

Even though the Member State of the transferring company may not tax any unrealized capital gains upon the transfer of the foreign permanent establishment, Article 10, paragraph 1, sentence 2 entitles that Member State to recapture any loss deductions granted in the past to the transferring company in respect of losses incurred by its foreign permanent establishment, provided these losses have not been recovered by the time of the transfer. Since after the transfer, the permanent establishment no longer belongs to the transferring company but is part of the receiving company's enterprise that is resident in another Member State this recapture rule is regarded as necessary to safeguard the financial interests of the Member State of the transferring company. The question in this respect is, however, whether an immediate claw-back of the losses concerned is also proportionate within the meaning of primary EU law.

Article 10, paragraph 2 particularly addresses those Member State that apply the credit method for the avoidance of double taxation. By way of derogation from paragraph 1, the Member State of the transferring company is allowed to include the capital gains of the foreign permanent establishment's assets and liabilities in the taxable income of the transferring company. However, it is the obliged to credit a notional amount of tax, i.e. the amount of tax that the Member State in which the permanent establishment is situated would have levied on those gains, had it not been required to grant tax neutrality on the transaction under the rules of the Directive. In this way double taxation should be avoided[154].

3.3. Permanent establishment and residence in the Interest and Royalties Directive

On 1 January 2004 the Interest and Royalty Directive[155] entered in force after long years of preparatory works and many disputes. The Directive is based on the notion that in the single market interest and royalty payments between associated companies of different Member States should not be subject to less favorable tax conditions than those applicable to the same payments carried out between associated companies of the same Member State. Less favorable tax conditions

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[154] M. Hofstatter, D. Hohenwarter-Mayr, *The Merger Directive*, in *Introduction European Tax Law: Direct Taxation*, 2013.
[155] Hereinafter "the Directive".

could consist in a double taxation of such EU cross-border payments since bilateral and multilateral tax treaties do not always ensure the elimination of double taxation. Although in many cases double taxation is avoided through the application of tax treaties, the application of the particular tax treaty and especially source taxation often causes additional administrative burdens, cash-flow problems, interest and other opportunity costs[156]. Thus, according to the Directive, an equal treatment of EU cross-border and domestic interest and royalty payments should be achieved by the Directive whereby less favorable tax conditions, as well as double taxation and double non-taxation could also be avoided. The main principle of the Directive is found in Article which provides for an exemption from source state tax (which is in most cases a domestic withholding tax) for interest and royalty payments made by:

a) a company of a Member State

b) a permanent establishment situated in another Member State of a company of Member State, provided that the beneficial owner of the interest and royalty payments is:

a) an associated company of another Member State or

b) a permanent establishment situated in another Member State of an associated company of a Member State.

Thus, in either case a company of A Member State is required for the applicability of the Directive. Article 3 contains the definition of the term *"company of a Member State"* and makes the definition dependent on the fulfillment of three cumulative requirements. The term means any company:

i) taking one of the forms listed in the Annex hereto; and

ii) which in accordance with the tax laws of a Member State is considered to be resident in that Member State and is not, within the meaning of a Double Taxation Convention on Income concluded with a third state, considered to be resident for tax purposes outside the Community; and

iii) which is subject to one of the taxes listed in Article 3, without being exempt, or to a tax which is identical or substantially similar and which is

[156] Eicker/Aramini, *EC Tax Review*, 2004.

imposed after the date of entry into force of this Directive in addition to, or in place of the taxes listed in Article 3.

With reference to the second requirement, in particular, the provision is especially important for dual resident companies. To solve the problem of dual residence, the Directive refers to the relevant double taxation convention concluded with a third state. Normally double taxation conventions contain a tie-breaker-provision and provide that with respect to dual resident companies the place of effective management is the preferred criterion. If according to the double taxation convention, the company is resident in a Member State, the Directive is applicable; otherwise, the benefits of the Directive are denied.

According to Article 1, the payer or the beneficial owner of interest and royalty payments may also a permanent establishment belonging to a company of a Member State that is situated in a different Member State. Thus, it is important to point out that according to Article 1, paragraph 8 the exemption from source state tax in Article 1, paragraph 1 is not applicable if the payer or payee is a permanent establishment situated in a third state of a company of a Member State and the business of that company is wholly or partly carried on through that permanent establishment. Correspondingly, Article 3 defines a *"permanent establishment"* as a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on. By the extension of the personal scope, the Directive seems to resolve within the EU dual source problems in connection with triangular and quadrangular cases involving permanent establishments. In such cases, a separate bilateral double tax convention generally does not contain real solutions due to its bilateral character.

Nevertheless, it should be mentioned that the Directive resolves triangular and quadrangular situation only if the companies to which the payer or the payee-permanent establishment belongs are associated companies according to Article 3. Outside the scope of association, reference has to be made to the certain double taxation convention concluded between the various Member State.

As regards to interest and royalty payments made by a permanent establishment belonging to a company of a Member State that is situated in a different Member State, Article 1 provides for the same sourcing rule as for companies of a Member

State. Thus, payments made by a permanent establishment belonging to a company of a Member State that is situated in a different Member State are deemed to arise in the first-mentioned Member State where the permanent establishment is situated. That Member State is also treated as the source Member State for the purposes of the Directive. The Directive re-emphasized that aim in Article 1 when pointing out that, if a permanent establishment is treated as the payer of interest and royalty payments self-evidently, no other part of the company, to which the permanent establishment in principle belongs, may be treated as the payer of that interest or royalty payments. However, in Article 1 the Directive contains another more problematical requirement for permanent establishments. This provision provides that a permanent establishment is considered to be the payer of an interest or royalty payment only if that payment is a tax-deductible expense for the permanent establishment in the Member State where the permanent establishment is situated. Otherwise, the source Member State may exclude the permanent establishment from the benefits of the Directive[157].

[157] D. Hristov, *The Interest and Royalty Directive*, in *Introduction to European Tax Law: direct taxation*, 2013.

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Profit allocation to a permanent establishment and transfer pricing

(arm's length principle, formulary apportionment)

Sara Sabbatini

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1. Introduction to permanent establishment

During the last years, thanks to the growth of the international markets, the Italian enteprises managed to develop and to face with foreign companies and foreign tax systems. The globalization strengthened the close connecting link between the worldwide businesses. The developement of international markets and companies allowed the scholars of international taxation to study and try to understand how to split the tax powers (the so-called *ius impositionis*) between the States that realize cross – border economic transactions. Every time an enterprise executes a cross - border operation, and consequently achieves profits abroad, it becomes necessary to find out a criterion of profits localization. A solution arranging the taxing powers of both *residence state* and *host state* was reached thanks to the permanent establishment model, that "enable to measure the crossborder roofs of an enterprise"[1]. In other words, the permanent establishment is the instrument that allows to link up to a non-resident company the profits earned in the territory of another State. Notwithstanding, even if a permanent establishment in the host state legitimates the foreign enterprise imposition, the permanent establishment does not itself make an autonomous taxpayer, but it is considered "*nearly an individual*"[2].

The permanent establishment concept provided by the OECD Model Tax Convention on Income and on Capital was the first starting point that allowed

[1]M. CALCAGNO, La Stabile Organizzazione, in Principi di diritto tributario e europeo e internazionale, Claudio Sacchetto, Torino, 2011

[2] G. Melis, *Le interrelazioni tra le nozioni di residenza fiscale e stabile organizzazione: problemi ancora aperti e possibili soluzioni*, in "I venerdì di diritto e pratica tributaria", Milano, 11-12 Ottobre 2013, p. 303

Italy to define first the basic elements and the embryonic structure of the permanent establishment, and then, after the fiscal reform[3], the new Italian Income Tax Code[4] was updated with Art. 162 which contains the permanent establishment definition.

1.2 Art. 5 of the OECD Model Tax Convention on Income and on Capital: positive and negative lists, fixed place and personal permanent establishment

Article 5 of the OECD Model states: *For the purposes of this Convention, the term "permanent establishment " means a fixed place of business trought which the business of an enterprise is wholly or partly carried on.*

The definition includes a place of management, a branch, an office, a factory a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. According to the Model, a building site or a construction or installation project constitutes a permanent establishment only if it lasts more than twelve month.

This broad definition requires firstly a technical installation, an office, a factory, a building, and secondly states that the istallation has to be "fixed", established with a certain degree of permanence, in the way to qualify a close link between the business performed and the territory of the foreign country[5]. The economic activity should be performed on a durable and lasting way; it is not relevant the reason why the permanent establishment was set, the main point is the regular use

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[3] D.lgs. 12 December 2003, n. 34
[4] D.P.R. 22 December 1986, n. 917
[5] LOVISOLO A., Il concetto di stabile organizzazione nel regime convenzionale contro la doppia imposizione, in Dir. Prat. Trib., 1983, 1

of that structure from a temporal point of view. In accordance with the Commentary, both the *location test* and the *permanence test* must be fullfilled to qualify a permanent establishment. The third requirement deals with the execution of an economic activity (*business activity test*). The fourth and final condition prescribes a nexus of instrumentality between the permanent establishment and the foreign company activity (*business connection test*). Going through the positive and negative test of Art. 5 par. 2 and par. 3, the Model emphazises that preparatory and auxiliary activities are deemed not to be included in the permanent establishment definition. The Commentary itself points out the difficulties in distinguishing between activity, which have an auxiliary or preparatory character, and those that have not[6]. Alongside this positive list, Art. 5 par. 4 provides a negative list, whose activities are not deemed to qualify a permanent establishment, the list includes: the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise, the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery, the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise, the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise, the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character, the maintenance of a fixed place of

[6] Commentaries on the Articles of the Model Tax Convention, par. 24

business solely for any combination of activities mentioned when the combination results of a preparatory or auxiliary character.

Article 5 par. 5-6 of the Model, offers the definition of the personal permanent establishment, concerning the situation where a person (agent) acts on behalf of a foreign company and habitually concludes contracts in the name of that company. *“Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom par. 6 applies – is acting on behalf of an enterprise and has, and habitually excercises, in a Contracting State an authority to conclude contracts in the name of an enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any actrivities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in par. 4 which, if exercited through a fixed place of business, would not make this fixed place of business a permanent establishment under the provision of that paragraph”.*

The personal permanent establishment is so necessarily qualified by a person (natural or legal) acting in the name and on behalf of the non-resident company, having the power to conclude contracts concerning the core business of the enterprise in the host state, on a durable way[7]. The activity carried out by the the agent should not be simply of preparatory or auxiliary character, or exclusively of goods purchase. To summarize, the essential elements that distinguish the personal permanent establishment are the subjective element, according to which the agent should be a person different from an agent of an independent status and acting in the limits of his ordinary activity, and the objective element: the power

[7] VALENTE P., La stabile organizzazione occulta nella giurisprudenza italiana, in Fisc. e Comm. Int., 2012, 5, pag. 30 – 35

to act and negotiate on behalf of the enterprise. The agent has to trade and negotiate regularly and systematically, therefore, any sporadic assignment does not qualify a permanent establishment. An authoritative doctrine held that the subordination take place when the agent assume the obbligation to carry out the management acts included in the program of the company, according to the instructions and the modalities issued.[8] Analyzing the two patterns of permant establishment, in accordance with the hypothesis of the Commentary, it is easy to notice the residual nature of the personal permanent establishment compared to the fixed place. As for the classification of a permanent establishment as personal or as a fixed place, paragraph 35 of the Commentary provides for the enforcement of an "alternative test"[9]. The Commentary points out the importance of starting analyzing the features of the p.e. firstly taking into account par. 1-4, and secondarily par. 5 of Art. 5, in order to determine the permanent establishment as personal only in case of lack of the fixed place's peculiar elements.

1.3 Permanent establishment in the Italian Legislation

1.3.1 The Italian tax system, the principle of territoriality and the Reform of the 70s

In the early Seventies, an important legislative reform renovated the Italian tax system. Before the reform, taxation was based on the principle of territoriality. The Italian tax system was characterized by two proportional property taxes about

[8] F. NANETTI, La funzione della stabile organizzazione, la dipendenza, la subsidiary e l' attribuzione di utili: riflessioni giurdiche, in Dir. Prat. Trib. Int., 2009, 2, pag. 658;
[9] Commentaries on the Model Tax Convention, par. 35

land ownership, and two other complementary personal taxes in order to ensure the progressive nature of taxation[10].

The reform managed to change the system's basis. The relationship single individual – territory, replaced the relationship income – territory, in order to allow every kind of income, no matter form where, to take part in the global amount of income of the taxpayer. This system permits the Italian Tax Authority to tax non-residents on income arisen in Italy. Because of the fact that tax liability refers to the individual himself and no more to the territory from where income arise, it become necessary to refer to the worldwide income, wherever the production takes place[11]. This new concept, totally in accordance with Art. 53 of the Italian Constitution, authorises to distinguish from residents, whose income is taxed irrespective of the place of production (*worldwide taxation*) and non – residents, taxed in accordance with a strict criterion of territoriality.

Following the common international practice, the Italian tax legislator applied the territorial taxation principle, according to which people have to pay national taxes exclusively on income realized in Italy.

The source taxation is in that way due as a reward for the services and all conditions made avaiable by the State, that allow foreigners to create income and benefit from it[12]. In this manner is the kind of connection with the territory that influences the criteria of taxation. If a person has his tax residence in that territory, he has to reward his State of residence with payments for all his worldwide income.

[10] F. TESAURO, Istituzioni di diritto tributario, parte speciale, Milano, 2014, pag. 8-9

[11] G. Melis, *Le interrelazioni tra le nozioni di residenza fiscale e stabile organizzazione: problemi ancora aperti e possibili soluzioni,* in "I venerdì di diritto e pratica tributaria", Milano, 11-12 Ottobre 2013

[12] R. BAGGIO, Il Principio di territorialità e i limiti alla potestà tributaria, Milano 2009

On the other hand, as for a person without tax residence in the territory of the State, taxation will only take place with reference to income earned in that place[13].

1.3.2 The evolution of the permanent establishment concept

Despite of the preminency of the concept of permanent establishment in our tax system, our legislation did not provide for an Italian definition until the innovations of the Italian Income Tax Code in 2003. Nevertheless, Italy has always complied with the OECD Model definition of permanent establishment.

The Supreme Court in the 1946 affirmed in a judgment about foreign branches of Italian companies, that the hypothesis of a branch itself qualify the existance of an organization abroad of the Italian company, having the power of acting on behalf of this, and to allow third parties to relate with the branch instead of the parent[14].

Before the reform, in the absence of a clear formulation of permanent establishment, the doctrine, jurisprudence and practice tryed to define in some way the first features of the notion, even in in different way.

1.3.3 Art. 162 of the Italian Income Tax Code: most important points and differences with the OECD Model

In 2003, the so-called Tremonti reform (Legislative Decree, 12 December 2003, n. 344) introduced a definition of permanent establishment in our Italian Income Tax Code. Nowadays Art. 162 offers a definition of permanent establishment, that in big part reflect the definition of the OECD Model, but at the same time with

[13] R. BAGGIO, Il Principio di territorialità e i limiti alla potestà tributaria, Milano 2009, pag. 270
[14] Cass. Sent. 14 January 1946, n. 19

different caracteristics and peculiarity, due to the legislator aim to take account of Italian experience. The first four paragraphs substantially reproduce the OECD model definition, as well as the last paragraph. Paragraph 4 of art. 162, in accordance with the negative list of the Model, presents the activities that are not able to qualify a permanent etablishment.

Differently the Italian legislation seems to say more in par. 5, claiming that the availability of electronic laboratories and related auxiliary facilities, that make possibile to collect and broadcast data and information useful to the sale of goods and services, does not it self make up a permanent establishment. Under the Italian rule, differently from the Commentary to the Articles of the Model Tax Convention, the property of a server in Italy is not enough to qualify a permanent establishment. In addition, the building sites issue deserves attention: even if most of the Italian agreements signed before considered the building sites as permanent establishment including them in the positive list, the legislator decided to adopt to the OECD Model definition, but opting for a minimun three month time period instead of the twelve months minimum of the Model. Paragraph 8 deals with the area of nautical trade, about the agents and brokers dealing abitually with the admninistration of the ships of the company, and denies to these people the opportunity to qualify a permanent establishment.

The Italian Supreme Court (Suprema Corte di Cassazione)[15] holds that a fixed place of a non resident enterprise should fulfill several requirements: *a)* the instrumentality of the fixed place for the non resident enterprise's activity performed in Italy, *b)* the stability, in order to allow a lasting use of the fixed

[15] Philip Morris case: Cass. Sent. 20 December 2001, n. 3367 and n. 3368; Cass. Sent. 20 December 2011, n. 7682; Cass. Sent. 20 December n. 10925

place, *c)* the activity performed by the permanent establishment can be of secondary importance to the activity of the enterprise and its purpose shouldn't be necessarily economical, *d)* the structure and the size of the fixed place itself are not relevant [16].

To sum up we can list the requirement needed for the existence of a permanent establishment: a fixed place of business, characterized by both tecnical and personal equipement, the stability, in order to to carry out sistematically a durable activity, the connection of the permanent establishment activity with the parent company one and its ability to produce income by itself.

Then, going forward with the Italian features of personal permanent establishment, par. 6 of Art. 162 t.u.i.r., in accordance with par. 6 of the Model, excludes a permanent establishment presence when the agent benefits of an independent status, providing that a person, no matter if resident or not, and different from an indipendent intermediary, is considered to be a permanent establishment of a foreign enterprise if he habitually concludes contracts in the name of the enterprise, that according to the Commentary are deemed to be related to the proper activity of the enterprise[17]. Art. 162 expressly leave out from the typical activities carried out by the agent contracts, concluded for the sole aim of the purchase of goods[18].

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[16] P.VALENTE, La stabile organizzazione occulta nella giurisprudenza italiana, 2012, 5, pag. 30-35

[17] Par. 33 Commentary on the Articles of the OECD Model Tax Convention

[18] A. LOVISOLO, La "forza di attrazione" e la determinazione del reddito della stabile organizzazione, cit., pagg. 75-76.

The Italian Supreme Court ruled that is not necessary the concurrent presence of both the fixed place of business and the personal P.E. in order to qualify a taxable presence in the host state, the two figures are alternatives disjointed indeed [19].

1.3.4 Italian case law

In the Philip Morris case, the Court elaborated the new idea of "group permanent establishment", not included in the Model. The Court held that an Italian company could be qualified as the permanent establishment of different foreign companies when they are all members of the same group and when they are trading according to a business plan jointly planned[20]. The Court also adopted the *"anti-single entity clause"*, arguing that the mere membership of a company in a group is not enough to qualify the presence of a permanent establishment. According to Art. 5 par. 7 of the OECD Model, the parent company control over its subsidiares does not automatically turn them into permanent establishments[21].

The Court had to face with the difficult issue of the identification of a permanent establishment in the Philip Morris Case, solving the point with the presumption on existence of the p.e. in Italy. The Philip Morris group used a company, Intertaba s.p.a. to pursue its activities in Italy. Despite that, the activity carried out by Intertaba s.p.a. was part of the activities included in the positive list of the Art. 5 of the OECD Model and of art. 162 t.u.i.r., the company was not legally and duly

[19] Cass. Sez. Trib. Sent. 9 April 2010, n. 8488
[20] Cass. sent. 3368/2002, Cass. sent. 7682/2002
[21] A. BALLANCIN, *La nozione di stabile organizzazione di gruppo in una recente pronuncia della Suprema Corte di Cassazione,* in Dir. Prat. Trib. Int.

established as a P.E. The reason of the infringment was obviously about profit. The Italian Tax Authority accused the Philip Morris group companies because they didn't record (through the italian permanent establishment) the payments made by the Autonomous Administration of State Monopolies for the distribution of tabacco and Philip Morris cigarettes according to certain supply contracts. The group's aim by hiding the permanent establishment was avoiding the full Italian taxation of royalties and of the profits of the Italian sales. The most important point of the case at first was the qualification of Interba s.p.a. as a permaent establishment. The Court underlined the importance to analyze the activities actually performed by the company, paying special attention to all activities not falling in the ordinary business. The Intertaba s.p.a. business plan and all the other activities carried out by the Italian company were totally dedicated to the Philip Morris group. More specifically, Intertaba s.p.a. dealt with cigarettes filters and a with the control over the contracts execution by the Autonomous Administration of State Monopolies. According to the Court opinion, such a supervisory activity on the contracts execution does not qualify a simple auxiliary activity, but on the contrary is very important and essential related to customers services and able to produce revenue.

The Court held that according to the Commentary, the so called after sale organization, the activity of offering assistance to customers, it's not an auxiliary activity, but essential.

1.3.5 Internal payments between head office and permanent establishment

The Italian power to tax must match with international conventions and, first of all with the EU Directive of the 3 June 2003, n. 2003/49/CE, the so-called Interest and a Royalty Directive, transposed in Italy thanks to the d.lgs. n.143, 30 May 2005.

As for Italian provisions, the t.u.i.r. in Art. 23, par. 2, Lett. c) states that the remuneration for the use of intellectual property rights, industrial patents and trade marks, as well as processes, formulas and informations related to experiences gained in the industrial, commercial or scientific field, are considered produced in Italy, if payed by the State or by permanent establishment of a non – resident company situated in territory of the State, secondly, according to art. 25 par. 4 , the royalty payments to non – resident are withheld for the 30 % of their amount.

Even if interest and royalty payments are subject to a withholding tax of 30 %, Italian national provisions have to deal with the Interest and Royalty Directive, based on the notion that in the single market interest and royalty payments between associated companies of different Member States should not be subject to less -favourable conditions that those applicable to the same payments carried out between associated companies of the same member state[22]. The directive generally provides for an exemption from source state tax for interest and royalty payments made by a company of a Member State, or by a permanent establishment situated in another Member State of a company of a Member State, provided that the beneficial owner of the interest or royalty payments is an associated company of a Member State or a permanent establishment situated in

[22] M. LANG, P. PISTONE, J. SCHUCH, C. STARINGER, Introduction to European Tax Law: Direct Taxation, Wien, 2013, p. 176

another Member State of an associated company of Member State[23]. The transposition of the Directive led to the introduction of Art. 26 quater in the Presidential Decree 27 September 1973 n° 600, and provided for an exemption from withholding tax for every kind of interest and royalty payment made by an italian company or by a permanent establishment of an european company located in Italy. As for the payments made by the permanent establishment, art. 26 quater states that the interest and royalty payments in order to benefit of the exemption from taxation at source, should necessarily be inherent to the permanent establishment activity, independently from the parent company one.

1.3.6 The force of attraction of the permanent establishment: the functionally separate entity approach and the relevant business activity approach

The presence of a non - resident company in a contracting state (host state) through a permanent establishment, allows the State itself to tax directly the profits earned thanks to the permanent establishment activity. The tax claim reason is the strict connection between the host State territory and the non – resident revenues. The permanent establishment is able to create its own income, thanks to an algebric sum of positive and negative components of its own and separate activity[24]. The force of attraction is the power of the p.e. to attract in it the income produced in the territory where it is located.

[23] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States
[24] A. M. GAFFURI, La determinazione del reddito della stabile organizzazione, in Rass. Trib., 2002, 1, p. 86

The OECD Model Tax Convention provides for the **force of attraction principle** in Art. 7, according to which: *"all the profits attributable to the permanent establishment, in accordance with the provisions of paragraph 2 may be taxed in that other State"*. Thanks to the article, the profits attributed to the permanent establishment are to be taxed in the contracting State were the PE is situated. Analyzing the disposition is simple to notice that the OECD doesn't apply the force of attraction principle totally. The OECD model expresses its preference for the ***" functionally separate entity approach"***, according to which interest, dividend, royalty and capital gain payments are taxable in the host state only if attributable and actually connected to the permanent establishment. As stated by art. 7 par.2, the profits of the permanent establishment are those that it would have earned if it had been a distinct and separate subject from the foreign parent, performing the same or similar activities in full independence. Under this method the incomes should be calculated considering the fixed establishment as a separate entity, distinct from the parent company, secondy it' s necessary to identify the activities that the permanent establishment actually carries out, from which depends risk allocation, the ownership of assets, obligations and rights arising from contracts with third parties[25]. In other words this method qualifies first the permanent establishment functions within the company activity, and consequently attributes the profits gained to the permanent establishment, in relation to its functions.

The other method, the **relevant business activity appoach**, imposes a limit to profits that can be attributed to a permanent establishment. This method provides

[25] A. GAGGERO, Determinazione del reddito di una stabile organizzazione, conforme da una recente pronuncia della CTP di Milano, in Dir. Prat. Trib. Int.

that the profits of the permanent establishment are those related to the specific production or trade activities carried out, and in respect of which the permanent establishment plays an active role. To be specific the mere presence of a p.e. does not attribute all activities performed in that jurisdiction to it, and the force of attraction principle does not apply. The PE is considered to form part of a sigle enterprise. The profits of this single enterprise can only be earned from transaction with third parties and with associated enterprise and not between the PE and the enterprise[26].

The commitee of Fiscal Affairs in 2008 published the *Report on the attribution of profits to permanent establishment* in order to uniform the application of art. 7 among the States. The report cointains primarily guidelines for the application of art. 7 par. 2, according to the *"Authorised OECD Approach"* or *"AOA"*. The OECD aim about this method is to consider the profits attributable to the permanent establishment as the profits that would have been earned by an independent company engaged in the same activity and in equal conditions. In particular the AOA provides for two different stages *(two – steps process)*: the method starts with the *functional and factual analysis* and evaluates to the p.e. as a free standing company, autonomous from the parent company. In that way is possible to identify the specific activities carried out by the permanent establishment and related risks, the assets needed and free capital. Secondy, as for the second step, it is required to pay attention to the remuneration of the operation concluded thanks to the application of the transfer pricing guidelines. Business transactions between associated enterprises are regulated by art. 9 of the Model.

[26] C. HJI PANAJI, Recent developements regarding the OECD Model Convention and EC Law, European Taxation, IBFD

1.3.7 The Italian approach

The first thing to do in order to assess companies and commercial entities income tax is the “residence test”. In the positive case the company is charged for a corporate income tax on its worldwide income (IRES)[27], in the opposite case it’ s necessary to locate and define income received by the non – resident company in Italy. The most important issue about the localization and calculation of non – resident companies revenue, is the presence of a permanent establishment in the our territory. Art. 152, par. 1 (Presidential Decree 22 December 1986, n. 917) states about income determination of non – resident companies and commercial entities having a permanent establishment in Italy, providing for a dedicated income statement for the calculation of the permanent establishment revenue. Differently, in the opposite case, par. 2 affirms that in case of lack of a permanent establishment, the revenue of the non - resident company should be calculated under the regulation of the specific income categories. The force of attraction is that way the power exerted by the permanent establishment on income that would have been subjected to an autonomous treatment, the so – called “isolated treatment of income”.

It is used to distinguish more precisely between a “full force of attraction” and a “limited force of attraction”. The first operates when the mere presence of a permanent establishment in the territory of the State is able to catch the totality of income earned, the revenue is in that way taxed according to the same tax regime

[27] IRES: Italian Corporate Income Tax, Art. 73 Presidential Decree 22 December 1986, n. 917

of resident enterprises. The reason of such a regulation is due to the strong connection link created, that allows the host state to tax the permanent establishment as a resident enterprise, because of its “economic allegiance” to the Italian territory[28]. The “limited force of attraction” operates when the attraction power concerns only part of the p.e. income, so as to distinguish between profits arising directly from the core business acrivity of the enterprise, for that reason linked to the permanent establishment, and profits arising differently from other several activities, separately considered. Consequently, all income arisen in the Italian territory may benefit of an isolated treatment only twice: when the force of attraction is limited and not full, and secondly when a non – resident company does not have a permanent establishment located in Italy. With regard to the features of the permanent establishment force of attraction on income, it is possible to distinguish between “income ontologically belonging to the enterprise” (i.e. income usually achieved by the non – resident company through the p.e. business)[29] and “passive income”, that according to Art. 151 par. 2 and Art. 153 par. 2 t.u.i.r. are capital gains and losses related to assets used or otherwise related to business activities in the territory of the State, although not gained through permanent establishments.

This provision has given rise to several opinions: according to one point of view, the capital gains and losses are related to assets of activities performed in Italy without permanent establishment, by a non – resident company involved in the meanwhile in other business activities in our country performed through a

[28] GARBARINO C., Forza di attrazione della stabile organizzazione e trattamento isolato dei redditi, in Rass. Trib. 1990, 6, parte prima, pag.427

[29] Income arising from sporadic business activities, different from the company main industry, are rarely considered as business income and then subjected to the force of attraction of the permanent establishment.

permanent establishment. Some others argue that the capital gains and losses, even if related to non - resident companies' assets not belonging to the p.e., are somehow connected with it. Onother point of view includes capital gains and assets in the business income regardless of a permanent establishment presence. The second theory seems to be the most correct in order to protect the Italian revenue[30].

We can affirm that the force of attraction doesn't operate generally because of the mere presence of a permanent establishment, but just in the cases listed in Art. 151 and Art. 153. Our Income Tax Code[31] prescribes for a full force of attraction solely regarding the capital gains and losses list in Art. 151 par. 2 t.u.i.r., that include profits earned in the business income regardless of the permanent establishment presence.

A doctrinary debate focuses on the p.e. purpose. The issue discussed is if the permanent establishment has the solely task to locate income or if it's able to qualify that income as business income[32]. The Italian Income Tax Authority opinion on that functions was negative, according to the Revenue Agency Resolution n. 41/E[33].

In that case, while the company involved claimed that taxation was unfair because of the inexistence of a permanent establishment in Italy, our Tax Authority argued that business income could never escape from taxation, even if the activity is performed without permanent establishment. The Italian position on

[30] MELIS G., La tassazione delle società e degli enti non residenti: soggettività, residenza, localizzazione e determinazione del reddito, November 2007

[31] Presidential Decree n. 917, 22 December 1986

[32] MELIS G., "La tassazione delle società e degli enti non residenti: soggettività, residenza, localizzazione e determinazione del reddito", November 2007

[33] Revenue Agency Resolution, n. 41/E, 9 March 2007

that point was such to refuse to grant a localization and qualification power to the permanent establishment.

Another point discussed was the territorial scope. The difference between resident and non-resident persons is that the first one are assessed on their worldwide income, whereas non-residents according to the specific activities carried out in Italy.

Going specifically into the regulation of income, Italy has always denied the idea to consider the profits earned by the permanent establishment as separate and autonomous assets, consequently set apart and calculated on its own. The practice prevailed in our country was to disaggregate the income earned abroad by the p.e. from the parent company's income, in order to make them secondly flow to the parent company account. According to the Italian general appoach, the permanent establishment profits are not considered as an independent amount, but nothing more than positive and negative accounting items of the parent company's balance. This point of view undervalues the p.e. patrimonial autonomy, in contrast with the Italian Income Tax Code. Art. 3 (Presidential Decree n° 917/ 1986) provides for a total income taxation of non – residents, so including income earned in the residence state as well as income earned abroad thanks to a permanent establishment. As well, art. 23, par. 1, lett. e) prescribes that according to non – residents taxation, business income collected in our country through a permanent establishment are deemed to be produced in Italy. As for income determination, art. 152 t.u.i.r. provides that the p.e. income has to be calculated through a dedicated profits and losses account. Moreover, art. 14, par. 5, Presidential Decree of 29 September 1973, n° 600, orders that the permanent establishment has to arrange for a separate accounting for the management of its own business. In spite of the law, the Italian Tax Authority usual procedure is to calculate the permanent establishment income by a subdivision of the parent company total income. In other words there are two methods to consider the p.e. income. According to the first, the permanent establishment is an independent entity, distinct from the parent company and its income is to be calculeted separately. On the contrary, the second method includes the permanent establishment in the parent company activity, and attributes to the first one part of the incomes of the second one, after computing the global income[34]. In accordance with the OECD approach, the results achieved thanks to the first method are probably able to represent in the most correct way the activity actually performed by the permanent establishment.. Nevertheless, becouse of the fact that the OECD adheres to the functionally separate entity approach, the application of this method has become practice in Italy, in order to follow international conventions. Moreover the legislator expresses is will to separate the two income sources in art. 14 par. 5 of the Presidential Decree n° 600/ 1973 that focuses on the importance of the separate accounting of parent company and permanent establishment.

1.4 Taxation in the context of digital economy

The worldwide spread of Internet actually represents a Copernican Revolution. The innovation is about the overcoming of territorial limits, distance, and the

[34] A. M. GAFFURI, La determinazione del reddito della stabile organizzazione, in Rass. Trib., 2002

possibility to instantly interact with people and enterprises, and, above all, without any influence on costs. Nowadays the electronic commerce is incredibly growing, becouse of its simplicity and cheapness. In this new scenery arose the issue of redefine and modernize some basic models such as residence and permanent establishment, in order to protect tax revenue. Thanks to the internet, a user, equipped with his personal computer, is free to connect with users of all around the world, to exchange information and data, provide or receive services, and make commercial transactions. The main problem of the elettronic commerce is the localization of income arising from web transactions, and the taxation of that income, becouse of the fact that every user is a tax resident of a particular different country. According to the OECD Model, only the permanent establishment is likely to attract and locate incomes in the country in which it is set, thanks to the fixed place of business identification.

The e – commerce differently, is not made up by barriers or material transaction, there is not a material place of business in a host state in relation to which income are liable to tax. The notion of permanent establishment needs a redefinition in order to maintain its importance. For that reason, the OECD Commitee on Fiscal Affairs in 2000 issued a document: *"Clarification on the application of permanent establishment definition in e- commerce: changes to the Commentary on the Model Tax Convention on Art. 5"*.

1.4.1 Innovations of the Commentary on the Model Tax Convention on Art. 5 and the Italian point of view

The document issued by the Commitee added ten additional paragraphs to paragraph 42 of the Commentary. The Commitee of fiscal affairs held that the web site, which is a combination of software and electronic data, does not itself constitute tangible property[35]. The web site is notoriously immaterial, not able to qualify the fixed place of business that characterize the permanenent establishment. On the other hand, according to the Commentary, the server and all the other equipments needed for the web site functioning, fall within the definition of permanent establishment if there is a technical and physical link with the country and they are all property of the enterprise. Above all, the definition of permanent establishment is fullfilled if the server and similar equipment are extremely necessary and irreplaceable to carry out the activity, and so they do not have a merely auxiliary or preparatory character. As for the internet service provider, the Model seems to exclude to qualify it as a permanent establishment becouse usually the ISP doesn't act or conclude contracts on behalf of the enterprise.[36]

The Italian legislation, differently from the OECD Model, in art. 162 par. 6 t.u.i.t., states only about servers. The article seems to clarify the legislator intention to fully consider a server as a permanent establishment every time the activity performed through it is not only of auxiliary or preparatory character, but necessary and essential for the production cycle. In 2007 (Resolution 28 May 2007, n° 119/E)[37] the Italian tax office had to face with art. 162, par. 4,5 t.u.i.r. The case was about an e – commerce activity performed in Italy by a non –

[35] Commentary on the Articles of the Model Tax Convention, par. 42.2

[36] M. MARTIS, Brevi considerazioni sulla nozione di stabile organizzazione ai fini tributari nel contesto del commercio elettronico, in Studi Economico Giuridici, Torino, 20041

[37] Revenue Agency Resolution, 28 May 2007, n. 119/E

resident company throught a server set in our contry. The Italian Tax Authority held that the activity of the non - resident French company in that case was taxable in Italy. The company was using its own server, settled for a long and indefined period in Italy: for that reason the company was considered to provide services through a permanent establishment. Conversely, according to the Italian approach, a web site is not liable to form a p.e. becouse of its lack of material consistency[38].

1.4.2 The significant people function in the digital economy

The new authorized OECD approach provides that the profits to be attributed to permanent establishment are profits that the PE would have earned at arm's lenght if it were a separate and distinct enterprise engaged in the same activities and at the same or similar conditions. The interpetation on Art. 7 of the OECD Model is characterised by two steps. Firstly the functional and factual analysis, trying to define the characteristics and functions of the separate and distinct enterprise, taking into account the assets used and the risks borne by the permanent establishment. Risks and assets should be allocated according to the significant people function (i.e. how much each of that significant people function contribute to the assumption of risk or to ownership of financial assets). The significant people function relevant to the assumption of risks are those which require active decision – making with regard to the acceptance and management of those risks[39].

[38] R.TOMASSINI, "Stabili organizzazioni e commercio elettronico", in Corr. Trib., 2013, 19
[39] OOSTERHOFF D., The true importance of significant people functions, in International Transfer Pricing Journal, March/ April 2008, 15, pag. 68-75

The theory is that within the financial sector of an enterprise, there is a strict correlation between assets management and risk management and it' s likely that the same individual or individuals are responsible for making the key decisions related to these assets and risks. The risks initially assumed by a permanent establishment is considered to be transferred to another part of an enterprise only if this different part is managing the risk. As for the assets, the AOA approach distinguishes between tangible and intangible assets. According to the first one, the criterion is to consider the use of these assets to determine the ownership. On the other side according tho the AOA approach, the economic ownership of intangible assets should reflect the significant people function that is the power to make decision in accordance with the taking on and management of risk. Once the functional and factual analysis has attributed the assets and risks of the enterprise to the p.e., it's necessary to estimate how much of the enterprise's capital needs to be attributed to the permanent establishment to cover these assets and risk assumed. As for the second step, it is required to determine the permanent establishment profits on the basis of a comparability analysis. By applying the transfer pricing methods the p.e. should obtain an arm's lenght return for its functions and activities, taking into accout assets and risks assumed, as if it was an independent enterprise. On 24 March 2014, the OECD published a discussion draft on Action Point 1 of the BEPS project, regarding the tax challenges of the Digital Economy. Paragraph 212, pag. 65 proposes an option in order to allow countries to tax foreign enterprises that are used to do business over the internet: a new nexus based on **Significant Digital Presence**. The proposal would determine that an enterprise engaged in certain fully dematerialised digital activities would have a permanent establishment if it mantained a significant digital presence in the economy of another country[40], several elements are considered to be taken into account. For example there could be a significant digital presence if the core business of the enterprise is completely or in a considerable way related to digital goods or services, or to the maintenance of servers and websites or other IT tools and the collection, processing, and commercialisation of location – relevant data. Some other potential elements to test the fully dematerialised digital activities are, as for contracts, electronic contracts concluded by internet or by telephone, and, as for payments, transaction made through credit card or other electronic payments using on – line forms or platforms linked or integrated to the relevant websites. Another positive test could be the case in which the biggest part of the profits are attributable to the provision of the digital goods or services. (…)

Another hypothetical remedy, according to par. 211, could be the modification of the exemptions for the activities of preparatory or auxiliary character, in order to stop considering these activities out of the concept of permanent establishment. This could be a solution in order to defeat the de-fragmentation tactics that the enterprises organize, by separating in several entities, in order to escape from taxation. The report provides for the new concept of "**virtual permanent establishment**" by considering three alternatives: the "virtual fixed place of business ", that would create a p.e. in the case in which an enterprise has a website on a server of another foreign enterprise and carries on business through that website, the " virtual agency PE", in order to include in the pe of the dependent agent cases in which contracts are concluded on behalf of an enterprise with

[40] Par. 212, pag 65, Public Discussion Draft on BEPS Action 1

person simply located in other countries thanks to technological means and not thanks to a real person, and then the “on-site business presence PE”, which would look at the economic presence of an enterprise in a jurisdiction in the case in which the foreign enterprise provides on – site services or other business interface at the customer’s location. Another potential option discussed was the creation of a **Withholding Tax on Digital Transaction**, that are payments made by residents for the digital goods and services provided by a foreign e – commerce provider.

1.4.3 The value of Data

Every time a consumer decides to fulfill his needs using the e-commerce, the same consumer becomes a source of data. Every time we use the internet looking for a service or some goods, our activity is captured in the form of data. Every on line users is, in this moment, producing information about his needs, his tastes, attitudes, and way of life. This data are produced by online purchases, Google searches, web site visited, status posted on social networks, on line video sharing sites. These data are gathered from various sources and are nothing more that ordinary activities, but however they produce the value of the digital economy.

Companies are day by day increasing their ability to understand and forecast our choices and needs thanks to big digital platforms that collect information we provide. Exactly from this point Jaron Lanier, one of the most importan theoretician of digital innovation, expresses his idea to consider Google, Amazon etc. as “Siren Services” by alluding to the sirens of Ulysses, because of their power to attract value. Lanier affirmed that “without human presence this bits are meaningless" and that "the digital hive grows against individuals"[41], for all those reason he focuses above all to the users' right to be rewarded for the value they create, by suggesting a bilateral transaction through which the user receives payments in relation with the data he creates, "a world in which people will begin to collect royalties for the ten of thousands of information provided during their active life on the Internet"[42]. The Public Discussion Draft on BEPS Action 1, paragraph 184, p. 58, explains that one of the biggest tax challenge is the **attribution of value to data**, in order to levy tax on systems, softwares and people that do business thanks to the use and the analysis of this information. In a situation in which data are collected in a specific country using the technology of another country, it's necessary to find out a criterion to split profits between the first country and the second one, by assigning an objective value to these data thanks to the analysis of the related functions, assets and risk.

1.4.4 The OECD Action Plan on Base Erosion and Profit Shifting and the Italian delegation law for the reform of the tax system (L. 11 March 2014, n. 23)

With the developement of the digital economy many issues are to be taken into account. On September 16, 2014, the Organisation for Economic Cooperation and Development ("OECD") released a report on Action 1 of the OECD/G20 Base Erosion and Profit Shifting Project (also known as the "BEPS" project) titled "Addressing the Tax Challenges of the Digital Economy". The rise of the digital economy has had an impact especially on our typical business structures and the

[41] LANIER J., Tu non sei un gadget, Milano, 2010
[42] LANIER J., La dignità ai tempi di internet, Milano, 2014

general need of a physical presence. For that reason companies dealing with digital services and products do not any longer need a fixed tangible place of business in all countries in wich the are operating. The OECD in the report underlined the State's backwardness about the new issues of the digital economy and the necessity to redefine the idea of permanent establishment among all jurisdictions. The Italian Supreme Court has recently stated that "the permanent establishment is a fixed structure, personally and materially equipped, with or without legal personality, appointed by the parent company to handle business, without reference to activities of a merely auxiliary or preparatory character, like consultancy or know - how supply ".[43]

The Italian legislator, in order to conform the Italian tax system to the OECD BEPS Action Plan, delegated the Government to reform our tax system especially with regard to cross-border relations with the delegation law (L. 11 March 2014, n. 23). The act deals with the distortion of tax bases because of the misuse of the transfer pricing regulation and with the artificial outsourcing of the enterprises[44]. According to the transfer pricing issue, the enabling act states about the necessity to improve the control methods with reference to base erosion, by infringing the transfer pricing rules. The Italian legislator complied with the OECD Action Plan, that deals with transfer pricing in action 1 (digital economy), 4 (interest deduction), 8 (intangibles), 9 (risk and capital), 10 (other high risk transaction), and 12 (transfer pricing documentation). The delegation law tackles also the digital economy in Art. 9 par.1, stating about the introduction of a transnational activities taxation system, no more based on the territorial connecting criterion but

[43] Cass., sent. 29 May 2012, n. 20678

[44] ROLLE G., Legge delega per la revisione del sistema fiscale e influenza dei lavori OCSE/G20, in FIsc. e Comm. Int., 2014, 12

on the new idea of “significant digital presence”. Since much of the delegation law refers to the BEPS Action, the italian tax legislator seems willing to adapt our tax system to it.

1.4.5 Current developements in Italy: The “Web Tax”

The Italian legislator concern about this new contest in which the big multinational companies are free to trade electronically and advertise freely on the internet was tax avoidance and tax evasion. The biggest multinationals are able to operate abroad without a local fixed place of business or with some other simple structures bodies that according to the OECD Model are not enough to qualify a permanent establishment. The Italian lagislator reacted by presenting the “WebTax”, introducing an amendment to law n. 147/ 2013[45]. The major companies involved in the e – commerce usually have their headquarters located in low tax countries, and because of the fact that they carry out only auxiliary activities in Italy, they manage to escape taxation. “The Web Tax (also known as “Google Tax”) is not a proper tax, but a set of provision whose main purpose is to restore tax fairness in the e – commerce market, in order to make these big companies liable to tax within the Italian territory”[46]. Under current tax rules in fact, internet giants such as Google, Amazon, Facebook, pay little or no tax on their international digital sales, as they have no physical location in the country in question[47]. As for the VAT issue, the Web Tax innovation is about the

[45] Law n. 147 of the 27 December 2013 (Stability Law 2014)
[46] TOMASSINI A., IASELLI G., “WEB-TAX” in cerca d’ autore, in Corr. Trib. 2014, 4, pag. 297
[47] Report “Taxing the digital economy: Mejor changes in 2014?”, 22 January 2014, www.freshfields.com

introduction of Art. 17 - bis of the Presidential Decree n. 633/ 1972[48] about on – line advertising purchase taking place in the "business to business transactions". Art. 17 – bis provides that clients be required to purchase on – line advertising only from companies having an Italian VAT Number issued by the Italian Tax Authority, the same for on – line advertising space and for sponsored links on web pages (search advertising). The aim of the regulation is to require companies to arrange for an Italian VAT number both in case in which the non – resident company operates in Italy through a permanent establishment, and in case where multinationals trade within the Italian territory without a p.e., in which it's necessary the appointment of a tax representative[49] or the direct identification in front of the Italian Tax Office[50]. Anyway Art. 17 – bis, probably because of its formulation, raises many doubts. First of all the Web Tax proposal is silent about any sanctions in case of on – line purchase from non – resident companies not provided with a VAT Number, and, beyond this, Art. 17 – bis is not entitled to derogate from Art. 17, dealing with the reverse charge regime. For that reason the reverse charge can apply every time a non resident company, trading in Italy without a permanent establishment, sells goods or services to an Italian VAT – taxable person, even if equipped with VAT Number. The web tax text was again and again reduced because of lots of amendments, nowadays the remaing parts are par. 177 and par. 178 of Art. 1 (Law n.147/2013). With regard to income tax, par. 177 deals with the transfer pricing issue (Art. 110 par. 7 t.u.i.r.) of multinational enterprises operating in the on – line advertising field. It states that companies should use specific profit level indicators, different from those based on costs

[48] Presidential Decree n. 633, 26 October 1972
[49] Art. 17 Presidential Decree 633, 36 October 1972
[50] Art. 35 – ter Presidential Decree 633, 36 October 1972

incurred within the activity such as the Cost Plus Method. While OECD Guidelines approach provides for a case-by-case analysis of the best method suitable for the circumstances of the case, the Web – Tax proposal excludes anyhow this transaction method. Anyway, enterprises with international activity can opt for the international standard ruling procedure provided by Art. 8 of Decree Law n. 269 of 2003, in order to agree in advance with the Italian tax administration about: *i)* the correct transfer pricing methodology applicable to the transactions carried out, *ii)* the tax treatement provided for interest, dividends, royalties or other income paied or paid or received from non resident persons in cases listed in art. 110 par. 7 t.u.i.r., *iii)* the application of the provisions of the law, including tax treaties, to specific cases related with the attribution of profits or losses to permanent establishment in Italy of non – resident enterprises as well as to permanent establishment abroad of resident enterprises. The procedure result is an agreement between the taxpayer and the Tax Authority on cross – border transaction valid for five tax years[51].

Art.1 par. 178 provides that on – line-advertising payments can be realized exclusively by bank transfer or by other mean that allows the Italian tax office to identify the payments made clearly. The transaction has to make clear the the peyee identification data and VAT Number.

1.4.7 The position of the Italian Association of Italian enterprises on the digital economy

[51] Italian Revenue Agency, International Standard Ruling Report, 21 April 2010

During the audition held by the Finance Commission of Italian Parliament on the 11 December 2014, Elio Catania, president of the Italian “Confidustria Digitale”[52] introduced his speech by presenting the OECD Action Plan on Base Erotion and Profit Shifting pointing out the new digital economy issues.

Elio Catania focused on the radical change of the economic system and held that “The digitalization transformed the *value chains* to create new one, with added value, through the improvement of the relationship between the consumer benefits and related costs. The value chains reorganization take place globally, with inevitable impacts on markets and legal systems”. Catania highlighted the importance of implementing the new instruments proposed by the OECD such as the creation of a **nexus** between the digital enterprises and the States entitled to tax, the innovation of the permanent establishment concept, by replacing the definition with the “significan presence “concept, and the introduction of the **bit tax,** a tax based on the web sites use. With regard to the bit tax, Catania clearly expressed the discrepancy on the point of the Association of Italian enterprise. The President realized the risk that such a tax can obstruct and limit enterprises appoaching the digital economy, by increasing the tax burden.

1.4.7 The “Internet Bill of Rights”

Internet is the Twenty-First Century Revolution. The whole world started to change drastically when internet affected our lives and redefined our personal

[52] CONFINDUSTRIA DIGITALE is a Federation representing Italian industries, whose goal is to promote the digital economy development in Italy. The activity of Confindustria Digitale concerns studies, researches, bills and outreach programs held at the Parliament, Government and other Italian istitutions, in order to increase awareness about the digital economy issue.

relations. The extraordinary success of the internet was the elimination of any kind of material or geographical barrier in order to make every individual capable of using technology to accomplish anything. This global resource, affordable by the almost the majority of people nowadays, layed the foundation of a new Era: the daily presence of thousands of people on the internet network, providing continuously personal information and data, has made it necessary to look for an instrument to protect people rights, in order to guarantee a safe and free society. The Italian Chamber of Deputies published the Internet Bill of Rights on the 13 October 2014, the document is a declaration of the rights of liberty, equality, dignity and diversity of people, "a necessary condition for the democratic functioning of Institutions, in order to prevent public authorities to prevail, and to allow people to live in a monitored and controlled society"[53]. The Internet Right Declaration is the outcome of the work of the study commission established in July 2014 by the President of the Chamber of Deputies, Laura Boldrini, and led by Professor Stefano Rodotà.

The peculiarity of that work is not only the worldwide promotion of that innovative kind of "Constitution", but also the possibility for Italians to take part in the edition of the internet fundamental rights, providing suggestions, comments, critiques or additional proposals which will be collected and examined by the study commission. The major points of the document are: the recognition of human fundamental rights on the Internet, the right of access to the internet for everyone, network neutrality, data protection, the right of every individual to ask for the modification, cancellation or integration of personal data, the inviolability

[53] PREAMBLE - Internet Bill of Rights, text drawn by the study commission on the right and duties of internet established at the Chamber of Deputies in July 2014

of personal computer system without judicial authorization, the regulation of the automatic processing of personal data, people rights to identity, anonymity, the right to oblivion or right to be forgotten, the regulation of people rights on digital platforms, network security, the right to education in order to acquire the ability to use internet consciously, and finally the creation of a “supranational internet law”, in order to provide for an equal rights regulation, both nationally and globally.

The final draft of The Internet Bill of Right, after the public consultation, could be the first starting point of a common regulatory freamwork that could be adopted by most European States.

Chapter 2 – Transfer Pricing (arm’s lenght principle, formulary apportionment)

2.1 Italian national provisions dealing with transfer pricing

Art. 110, par. 7, Presidential Decree 917 of 1986 states that the Italian Tax Authorities have the power to assess the price of goods and services sold between controlled or related legal entities having regard to the arm’s length principle. One of the companies involved must be resident outside of Italy. The Italian Tax

Authority can excercise such power only if Italy suffers from a loss of revenue, or however, even in the lack of a loss of revenue, when a double taxation convention provides for it because of a mutual agreement procedure. The law wants to prevent Italian resident enterprises and non – resident companies, members of the same group, to put in place economic elusory transactions aimed at manipulating the sale price in order to obtain a tax advantage. The transfer prices manipulation is one of the most common techniques of international tax avoidance addressed to transfer profits abroad. The profit that hails from that mechanism is achieved by transferring to a low – taxation country profits that would have been subject to tax in a higher tax jurisdiction. The Italian Supreme Court (*Corte di Cassazione*), in her latest judgement about transfer pricing[54], affirmed that the tranfer pricing regulations should be applied every time transactions are considered irregoular and settled up for tax avoidance reasons in order to obtain a tax advantage. The Court also held that the Italian Tax Authority, by determing the arm's lenght price, has to take account of the contractual conditions arranged between the associated enterprises that may affect the prices somehow.

Art. 110, par. 7, t.u.i.r. applies in case of supply of goods and services occurring between a foreign company and an Italian company, when one of them directly or indirectly controls the other, or in the case in which they are both directly or indirectly controlled by a third Italian or foreign company. This phenomenon takes place when the sale price is not in line with the arm's lenght value of goods and services.

[54] Cass. 23 December 2014, n. 27296

2.2 The arm's lenght principle, Art. 9 of OECD Model and Art. 9 of the Italian Income Tax Code

The authoritative international definition of the *arm's - lenght principle* used in the transfer pricing is set out in the Article 9 (1) of the OECD Mod1el and interpreted thanks to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Admnistration, issued on 22 July 2010. According to chapter 1 of the Trasfer Pricing Guidelines, when independent enterprises enter into transactions with each other, the conditions of their commercial and financial relation are ordinarily determined by the market forces. Differently, as for transactions that take place between two associated enterpises, the price is not determined in this way, as a consequence every difference from the arm's lenght priciple may distort tax liabilities of the associated enterprises and the tax revenues of the countries. Art. 9 (1) OECD Model seeks to adjust profits according to the conditions which would have obtained between independent enterprises in comparable transactions and in comparable circumstances (*comparable uncontrolled transaction*), in order to adapt the transfer price to the arm's length price. The Italian approach clearly reflects the OECD arm's lenght principle and the methods offered by the Model to determine the arm's lenght price. The Italian tax legislation reference to the arm's length principle is contained in the notion of "normal value" (*valore normale*), defined according to Art. 9, par. 3 t.u.i.r. as "the average price or fee charged for the same or similar goods and services, under free competition conditions and at the same marketing stage, at the time and place in which these goods were purchased and services provided or, otherwise, in the nearest time and place". "In order to determine the normal value, reference is made, as far as it is possible, to the price lists or tariffs of the supplier of goods or services and, where such information is lacking, to the market-lists of the Chamber of Commerce[55] as well as to professional tariffs, taking into account distributor discounts". Art. 9, par. 4 states that the normal value is determined, as for shares, bonds and other securities listed in a domestic or foreign stock exchange, on the basis of the average price recorded in the last month. Secondly, the normal value of the other shares, participations of companies not limited by shares, and of securities or shares representing participations in the capital of entities other than companies, must be calculated in proportion to the company or entity net worth or, for newly established companies or entities, to the total amount of the contribution of capital. As for bonds and securities other than those listed before, the normal value is defined by analogy with securities with similar features listed in a domestic or foreign stock exchange and, where such information is lacking, on the basis other elements which can be objectively determined".

The determination of the arm's lenght value has to take into consideration first of all the kind of transaction in question, secondly it's necessary to compare it with a equal or similar one, in order to analyze the features. The arm's lenght value has to be determined also according to market conditions, business strategies and the economic activity of the enterprise, looking at the risks assumed and assets used.

2.3 The Traditional Transaction Method

[55] The Chamber of Commerce is a form of network between local businesses who elect a board of directors or executive council to set the common policy of the chamber.

The traditional transaction methods to calculate the arm's lenght price are: the comparable uncontrolled price method "CUP", the resale price method "Resale Minus" and the Cost Plus Method "Cost Plus". The alternative methods are the Transactional Net Margin Method "TNMM" and the Transactional Profit Split Method "TPSM ". The Italian Revenue Agency in the Ministerial Circular n° 58/E dated 15 December 2010[56] spelled out clearly about the transfer pricing documentation and about the choice of the best transfer pricing methods. According to the Agency, the Italian taxpayer is suffering the burden to show the reasons behind the choice of the method considered the best for the particular case and all the informations related. Furhermore the clarification of the grounds of the method's selection is much more relevant in the case in which the taxpayer decides to apply one of the alternative method, which according to the particular circumstances of the transaction is as suitable and applicable as one of the traditional method. In that case, it is necessary to give adequate reasons for the choice. On the other hand, in compliance with the Ministerial Circular, the taxpayer is not required to show his reasons every time he decides to choose the transactional methods because of their adequacy to the case, differently from the traditional ones. The clear and synthetic explanation made by the Revenue Agency is able to overcome the traditional practice of the Italian Tax Authority and to update and conform the Italian regulation to the OECD Transfer Pricing

[56] Ministerial Circular n° 58/E, 15 December 2010, "Oneri documentali in materia di prezzi di trasferimento di cui alla disciplina prevista dall' art. 1, comma 2-ter del decreto legislativo 18 Dicembre 1997, n° 471"

Guidelines of the 22 July 2010.[57] Previously, the Italian Tax Authorities, according to the Ministerial Circular n. 32/1980[58] was very strict and provided for two different categories of methods: the first one about the traditional methods, and the second one about the "TNMM" and the "TPSM". This clear distinction is in order to qualify the second category of methods as an alternative class, subsidiary to the the main methods. In accordance with paragraph 4 of the circular, only if the traditional methods do not meet the specific case, because of the lack of comparable transactions, it is suitable to examine the other methods, so considered "last resort methods". The same hierarchical criterion about the choice of the best method was confirmed in the Ministerial Circular n. 42 issued on December 12, 1981. Par. 3 explains that the taxpayer should apply preferentially the Comparable Uncontrolled Price method in order to calculate the arm's lenght price. On the 22 July 2010, the OECD issued the new version of the "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration. Thanks to these new guidelines, the OECD tried to overcome the traditional concept of subsidiarity of the alternative methods (Transactional Profit Split Method, Transactional Net Margin Method), considered "last resort methods" by the OECD Guidelines of 1995. The new version provides for a new standard, no longer based on a hierarchical criterion, but on "the most appropriate method to the circumstances of the case". The alternative methods are in that way no longer considered subsidiary or alternative to the traditional ones and the new Guidelines seem to get over the strict formulation of the Ministerial Circulars (n. 32/1980, n. 42/1981). In this way, taxpayer is allowed to make his choice in order to find the

[57] SALVATORE M., VALENTE P., "Principi e criticità nella selezione del metodo per determinare il transfer pricing ", in Corr. Trib. n. 3, 2011

[58] Circolare del Ministero delle Finanze n. 32, 22 Settembre 1980

most appropriate method, by supplying all the informations and reasons required into documentation.

2.4 Functional analysis

The arm's lenght priciple supposes the comparison of the conditions of transaction between associated enterprises with the conditions of the transactions of independent enterprises. Clearly, in order to judge the compliance of the transfer price with the arm's lenght price it is necessary that the transactions considered are comparable, both in terms of product or service, and in terms of market conditions. The comparison can be internal, between a company that is member of the group and an independent enterprise, or external, by referring to transactions between independent enterprises. The Italian provisions, particularly the Ministerial Circular n. 32/ 1980[59], shows a preference for the internal comparison method, differently from the OECD Transfer Pricing Guidelines. The identification and selection of comparable transaction, in the comparability analysis, cannot overlook the analysis of the function performed, risks assumed and assets used by the parties in question.

The comparison will be considered reliable in the case in which the functions, the risks, and assets related to third parties are similar to those of the transaction in question.

Secondly, as for the choice of the method to determine the arm's lenght price for intra-group transaction, it is important to identify activities and process that make

[59] Ministerial Circular n. 32, of the 22 September 1980

up the **value chain,** to pick out the global value created by the enterprise[60]. The activities that generate value can be divided into primary and secondary activities. Once analyzed the value chain, it's possible to determine the allocation of functions, risks and assets, in order to pick out the best method, and, in order to define if the transactions between controlled or uncontrolled enterprises are comparable it's important to analyze the economically relevant activities, the assets used, and responsabilities and risks assumed.

As for the choice of the best method, the Italian approach is substantially similar to the approach of OECD Transfer Pricing Guidelines, as it doesn't provide for a specific hierarchy of methods, but simply suggest the selection of the solution more in line with the transactions and able to estimate the price in accordance with the arm's length standard. The best method's choice is not governed by strict rules, but is made according to the features of the case.

2.5 Criminal aspects of transfer pricing. Documentation and exemption from penalties. Burden of Proof and nature of the regulation

One of the most important issue to examine is the potential criminal liability of taxpayers in the transfer pricing area. Art. 3 of Legislative Decree n. 74 of 10 March 2000 relates to violations of the obligation to truthfully disclose income. The offence relates to fraudulent transactions, intended to obstruct the assessment, such as, for example, the simulation of legal transactions, the fictitious

[60] VALENTE P., Transfer Pricing, l'analisi di funzioni, assets, e rischi, in il Fisco, 2012, 25

interposition of persons or the utilization of hidden warehouse, in order to falsify accounts.

The provision states more specifically that the simple erroneous transfer pricing calculation, due to inaccuracy or omissions in the accounting procedures, is not criminally relevant.

Art. 4 of the same Legislative Decree deals with violations regarding discrepancies in tax return, providing for a penalty (subject to a minimum quantitative threshold) any time the taxpayer reports less income in the annual tax return or conversely claims fictitious losses. The Criminal Court duty is to ascertain whether the threshold has been exceeded and if the conduct presents the specific intent of tax evasion. Art. 7 of Legislative Decree n. 74/2000 identifies two cases where sanctions are not to be imposed, both representing circumstances characterized by no intention to evade tax. The first case deals with violation of transfer pricing methods. Art. 7 (1) states that the routine application of improper criteria is not punishable if the choice of the methods is the result of a defective accounting structure, which causes irregularities over several years. The second relief pertains to incorrect estimated valuation, excluding the crime if the evaluation criteria adopted are disclosed in the financial statement. The legislator provided for another "safeguard measure" under Art. 7 (2), stating that under no circumstances valuations are punishable if no more than 10% lower than correct valuations, even if their criteria are not expressed in the financial statement[61].

Consequently to the "Code of Conduct on transfer pricing documentation for associated enterprises in the EU", issued by the European Council, Italy updated

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[61] CARACCIOLI I., VALENTE P., "Rischi penal – tributary potenzialmente configurabili nel transfer pricing", in Corr. Trib., 2011, 32, pagg. 2616 - 2621

national legislation according to the OECD guidelines. Art. 26, Law Decree n°78/ 2010 introduced paragraph 2-ter in Art. 1 Legislative Decree n° 471/ 1997, providing for an exemption from the penalties usually charged in case of transfer price assessment by the Tax Authority. Circular n.58/E issued by the Italian Revenue Agency[62] established that the taxpayer is safe from penalties when, in case of inspections, access, audits and other investigation activities, is able to show to the auditors an appropriate documentation, prepared in accordance with the Regulation of the Director of the Italian Revenue Agency issued on the 29 September 2010, and able to prove the compliace with the arm's lenght price.

Italy does not have its own rules on transfer pricing documentation, for that reason our regulation expressly refers to the OECD Guidelines and to the European Code of Conduct on transfer pricing documentation and provides for the Masterfile and the "Documentazione Nazionale", the equivalent of the Country File. The taxpayer should also inform the Revenue Agency in advance about the documentation, in order to qualify for the benefit[63]; the purpose of that documentation in fact, as specified in the Circular, is to promote tax compliance of the taxpayer[64]. Despite the burden of proving the validity of transfer prices lies with the tax authorities, the latter can request the taxpayer to make available all details in order to prove the transfer price compliance with arm's length. Anyway,

[62] Circular n. 58/ E issued by the Italian Revenue Agency on 15 December 2010

[63] The provincial Tax Commission of Milan, in sent. n. 99 of the 29 March 2012 denied the exemption from penalties provided by Art. 26 Legislative Decree n. 78/ 2010 to the company-involved, becouse of failure to meet deadline to sent the proper documentation.

[64] FERRANTI G., Finalità ed effetti degli oneri documentali per il transfer pricing, in Corr. Trib., 2011, 3l

the collection of the information needed should not be extremely hard among all foreign branches[65].

One of the most controversial topic on the point is the nature of the transfer pricing provisions and the burden of proof. The Italian Court of Cassation opinion seems to deviate from the OECD Guidelines that at Par. 1.2 affirm: *"A tax adjustment under the arm's length principle would not affect the underlying contractual obligations for non-tax purposes between the associated enterprises, and may be appropriate even where there is no intent to minimize or avoid tax. The consideration of transfer pricing should not be confused with the consideration of problems of tax fraud or tax avoidance, even though transfer prices policies may be used for such purposes".*

Conversely, our Court of Cassation in the "Ford" case[66] held that the transfer pricing regulation has an anti-avoidance nature that generally allows the Italian Tax Authority to deny tax advantages in case of intercompany transactions performed for the solely aim of tax saving. The burden of the proof is on the Tax Authority, which firstly should make sure that the Italian tax burden is higher than that of the other countries involved and is responsible for demonstrating the transfer price manipulation made to shift profits to low-tax countries. In other words, while the taxpayer has the power to disclose his transfer pricing policy for an exemption from penalties, the Italian Tax Authority that has to prove any profit shifting to law-tax countries[67].

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65 FUXA D., Il transfer pricing e l'inesistenza degli obblighi di documentazione in Italia, in Corr. Trib. 2010, 15, pagg. 1220 - 1229

66 Cass. Sent. 16 May 2007, n. 11226

67 AVOLIO D., SANTACROCE B., "Oneri documentali e prova nel transfer pricing", in Corr. Trib., 2012, 37, pagg. 2866-2871

2.6 The extension of the transfer pricing regulation to IRAP

Recently (Law 27 December 2013, n° 147) has widened the field of application of the trasfer pricing regulation, no longer limited to corporate income tax. The Italian legislator extended Art. 110 par. 7 t.u.i.r. to IRAP[68]. The IRAP tax base is calculated by considering the value and the costs of the production as a result from the balance sheet and, according to the previous regulation (l. n. 244/ 2007), art. 110, par. 7 was irrelevant. In spite of the lack of legislation, the Italian Tax Authority was used to apply the transfer pricing regulation by ensuring the penalties exemption provided for by art. 26, l. n° 78/ 2010. This period of legal uncertainty ended in 2013 when the new regulation entered into force providing the extention of art. 110 par. 7 t.u.i.r. to tax periods subsequent to 31 December 2007. Art. 1 par. 281 of Law n. 147/2013 states exactly that the transfer pricing regulation should apply on the calculation of the net value of production on which the IRAP is charged, even for tax periods following the 31 December 2007 [69]. The regulation is clearly retroactive and this has given rise to a huge debate on its nature and legitimacy. Paragraph 281 seems to be worded as an interpretative norm, whose typical purpose is to clarify the meaning of previous laws, already in force. In this way, the retroactive effect of the norm contrasts with the Taxpayers' Statute[70], which states that "the use of interpretative norms in taxation matters is permitted only in exceptional cases and with an ordinary law (Art. 1, par. 2), and apart from that, tax provisions are not retroactive" (Art. 3, par.1). Some others

[68]IRAP: Italian regional production tax, charged on enterprises and professionals.
[69] Art. 1, par. 50 of Law 244/ 2007 stated about the non-appicability of transfer pricing provisions (art. 110, par. 7, Presidential Decree 22 December 1986, n. 917) to IRAP
[70] The taxpayers' charter introduced into the Italian system by Law n. 212 of the 27 July 2000

argued that the norm is not interpretative but innovative, and thereby capable of producing effect only for the future[71]. Anyway, Law. n. 147/2013 legitimates the Italian Tax Office practice to extend to IRAP the transfer pricing regulation, but excluding the applicability of penalties to taxpayers for tax periods from 2008 to 2012.

2.7 Transfer pricing practices between Italian companies

The OECD Report "Multi-country analysis of existing transfer pricing simplification measures" issued by the Centre for Tax Policy and administration on 10 June 2010, focused on the lack of specific national transfer pricing rules on transactions between Italian companies, differently from most of the European states. The first original draft of our Income Tax Code actually included some domestic transfer pricing provisions, but the final text excluded them at the end. More precisely, Art. 110 par.7 t.u.i.r. deals exclusively with intercompany transactions performed between an Italian enterprise and a foreign company, when one of them directly or indirectly controls the other, or in the case in which a third Italian or foreign company directly or indirectly controls them both.

The Italian Tax Office addressed the issue in the Ministerial Resolution n. 9/198 of 10 March 1982, stating, "The normal value principle can not be limited only to the cases required by the law, but must be extended to several different circumstances".

[71] AVOLIO D., SANTACROCE B., "Transfer pricing esteso all' IRAP. La previsione retroattiva rischia di far esplodere il contenzioso tributario", in Il Sole 24 Ore, 16 January 2014, pag. 22

The Tax Authority stressed this gap of our legislation in the Ministerial Circular n. 53/E of 26 February 1999, and argued about the necessity of a new regulation for any kind of intercompany transaction carried out for the solely purpose of profit shifting to companies benefiting from a lower tax or no tax. This exemption may occur in the case of enterprises located in some areas, especially in the South, or in the case where unitilized tax losses of a previous period are automatically carried forward[72].

Italian case law always affirmed the anti avoidance nature of the domestic transfer pricing regulation[73] and the Tax Authority duty to make reference to the arm's length principle in order to assess the prices charged by companies.

Our Court of Cassation in the sentence n. 17955 of 24 July 2013 extended the arm's length value to domestic intercompany transactions, in order to deny the transfer of income from a resident company, subject to an ordinary tax regime, to another resident company member of the same corporate group, seated in a territory of Southern Italy and entitled to receive relevant tax benefits[74].

2.8 The Italian position about the Common Consolidated Corporate Tax base; The CCCTB model and the Formulary Apportionment

[72] FERRANTI G., "Il transfer pricing interno secondo la Corte di Cassazione tra elusion e inerenza", in Corr, Trib., 2013, 33, pagg. 2605-2610
[73] Cass. Sent. 24 July 2002, n. 10802, Cass. Sent. 11 April 2008, n. 9497
[74] BORIA P., "Il transfer pricing interno come possibile operazione elusive e l'abuso del diritto", in Riv. Dir. Trib., 2013, 9, pag. 427

The Association of Italian Enterprises, known as *Confindustria*, recently issued a report on the digital economy[75]. As for corporate taxation, the report focused on the importance of the BEPS Action Plan to fight tax evasion by a renewal of transfer pricing provisions. The Group considered the profit allocation to intangibles and the profit allocation to business risks especially important in the contest of the digital economy: nowadays intangibles such us IP, patents, copyrights, brands and trademarks are a big part of the business. The transfer pricing regulation has to consider the IP to allocate profits, in order to prevent the country loss of revenue. The Group suggested a definition of the new concept of digital taxable presence and the review of the permanent establishment concept and of taxation of multinational enterprises. One of the main concern of the report was the transfer pricing arm's lenght rules appropriateness in front of the new digitalized world, for that reason the group took into consideration the Council work on a common corporation tax base, in order "*to tackle corporation tax in a fair and transparent way*". The CCCTB provides a common consolidated corporate tax base with allocation of taxable profits among jurisdiction according to factors such as capital, labour and sales. This Model is able to overcome the peculiarities of the 27 tax systems and the different transfer pricing regulations, this could lead to the creation of a common market. The CCCTB consists of the creation of a consolidated tax base of a group of companies; secondly, the consolidated profit is apportioned back to the enterprises according to a prederminated formula, the formula apportionment. The group, headed by an EU parent company, would include all its EU subsidiaries, according to the "all in" or

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[75] Report of the Commission Expert Group on taxation of the digital economy, 28 May 2014

“all out” principle, so the consolidation is mandatory for all companies having opted for the CCCTB. A parent company is able to consolidate the subsidiary if it directly or indirectly controls it, having over 50% of its voting rights or if the parent company has the ownership of more than 75% of the company’s capital or more than 75% of the rights giving entitlement to profit, provided that the thresholds is met for the total tax period and for a minimum uninterrupted period of nine months. One of the main features of the common consolidated corporate tax base is the loss carry forward relief, including cross – border losses, without any time limit.

Another important innovation of the common consolidated tax base is the “one stop shop” principle, according to which the entire group has to face with only one Tax Authority, that of the main taxpayer, normally the parent company. This would lead to a necessary comparison and coordination among all the tax authorities and a redefinition of the assessment procedures and the payment of taxes.

The CCCTB revolutionary change it that it sets aside the arm’s lenght method used for the income allocation and introduced the Formulary Apportionment Method. The formula consists in three equally weighted factors: labour, capital and sales and should be so clear and precise to share the consolidated profits among all the companies of the group. The OECD specified the importance to consider separately the global formulary apportionmnt and the transactional profit split method, inasmuch the second is not made by a preconceived formula that suits in every circumstances, but requests a case – by – case analysis investigation and is based on a comparability analysis.

The adoption of the CCCTB would mean a radical change of international corporate taxation and it is necessary to prove that this method would not lead to a loss of tax revenue for the EU countries. Anyway, the Commission proposal, because of long years of work and in – depth analysis, raises the problem of the necessary unanimous approval by the Member States. The Italian Finance Commitee of the Senate of the Republic discussed about the CCCTB arguing that the proposal does not have the characteristics of a specific regulation but is mostly similar to a guideline for its abstractiveness, in this way it's hard to make a comparison with our domestic legislation[76]. The Commitee focused on the anti-abuse clause whose aim is to make irrelevant all the artificial transactions carried out to circumvent taxation. According to the Committee the anti – abuse clause of the proposal is too general and undefined, for that reason the Commitee underlined the importance of more specific definition of some terms like "artificial transaction".

Another point was the coordination of this part of the proposal with all the other Italian anti abuse rules, and in particular with Article 37 – bis of Presidential Decree n. 600, 29 September 1973. Anyway, the Italian Tax Authority seems to cooperate with Parliament in order to analyze the impact of the model on the national revenue.

2.9 Transfer pricing and profit shifting

[76] ASSONIME, Audition of the Italian Finance Committee of the Senate of the Republic on the CCCTB proposal, 1 June 2011

Action 8, 9, 10 of the OECD Beps project deal with transfer pricing rules and identify five elements: 1) profit allocation to intangibles, 2) profit allocation to business risks, 3) characterisation of transaction, 4)base eroding payments and 5) global value chains and profit splits. The action 8 developed rules to prevent BEPS by moving intangibles among group members. The action underlined how the big part of today's business value is incorporated in IP, patents, copyrights, brands, trademarks and so on. The growth of these intangibles has preminency in the context of the digital economy, it means that transfer pricing rules also allow a significant part of the aggregate profits of the digital enterprises to be allocated to the IP itself, in order to tackle all companies that have established structures in which these profits accrue and are not subject to taxation[77]. The practices used by multinationals to erose tax bases have frequently concerned intangibles, the OECD expressed the importance to adopt new rules for the identification and evaluation of these assets, that according to Action 8 will involve: i) the adoption of a clear definition of intangibles, ii) the importance of ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with the creation of value, iii) the necessity to develop new transfer pricing rules, and iv) updating the guidance on cost contribution arrangements. On 30 July 2013 the OECD published a Revised Discussion Draft on transfer pricing aspects of intangibles, in order to provide guidance to define the arm's lenght conditions for transactions dealing with the use or transfer of intangibles. According to the OECD an intangible is something different from a physical or

[77] Report of the Commission Expert Group on Taxation of the Digital Economy, 28/05/2014

financial asset, capable of being owned or controlled for use in commercial activities, and something whose use or transfer would be paid between independent parties in comparable circumstances. The document proposes a list of typical examples of intangibles that includes: patents, know - how and trade secret, trademarks, trade names and brands, rights under contracts and government licence, licences and similar limited rights in intangibles, goodwill and ongoing concern value. Secondly the document expresses some consideration about how properly allocate the "return attribuitable to an intangible", providing some different steps. First of all, it's necessary to identify the legal owner, thanks to legal arrangements and other relevant contracts, secondly it' s necessary to identify the parties performing functions, expecially using assets and assuming risks, then it's important to confirm the consistency between the conduct of the parties and the terms of the relevant legal arrangements regarding intangible ownership trought a detailed functional analysis. The transactions related to the developement, maintenance, protection and exploitation of intangibles should be identified as for the arm's lenght price of them (par. 66). The document, in par. 89, generally provides that the legal owner of an intangible is entitled to all returns attributable to them only if he is able to fullfil some requiremnts. The legal owner should perform and control all of the important functions related to the development, enhancement, maintenance and protection of the intangibles, these functions could consist in planning the R&D contracts, monitor investments budget, and control the execution of the strategic decisions on the developement and the legal protection of intangible assets. The legal owner should control the R&D functions asked to third parties and remunerate these functions at arm's lenght, he should provide for the assets necessary for the R&D activities and control risks associated to these activities.

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Characterization of income (e.g., influence of intellectual property law, commercial law, digital goods and services, bundled contracts, criteria to distinguish, e.g., business income, royalties, other income, capital gains)

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THE “DIGITAL GOOD” IN THE ITALIAN LEGAL SYSTEM

1.1. THE “DIGITAL GOOD” UNDER ITALIAN CIVIL LAW

Under Italian Law, there is not a specific definition of “digital good” and for this reason it is necessary to analyze any general regulatory schemes which could be useful to define it, anyway.

Article 810 of the Civil Code only defines the "goods/assets" as "*things that can be the subject of rights*". All lecturers believe that "goods" and "things" are different from each other under the said Article 810, even if such notions are often confused or used interchangeably.

According to the traditional lecturers[1], goods should be defined as material things that can be source of utility, *i.e.* that can satisfy human needs and can be legally owned. The legal meaning of “good” is linked to the concept of property: goods would be the things that a person is interested in owning, by excluding other persons from their use.

Another orientation[2], however, establishes the legal significance of “thing” as “goods” on legal interest that the law refers to those things. Article 810 would codify the following principle. Only after verifying which are the interests and needs that the set of rule considers worthy of protection, we can recognize that certain "parts of material reality" or "economic utility" have the quality of legal interests.

If the former thesis describes the characteristics of the material goods, the latter seems to be referred to immaterial (intangible) goods, too: with reference to such goods, the interest of the beneficiary is to take an advantage of the economic value of the property by selling or by leasing and transferring their use to third parties. [3]

The fact that intangible good hasn’t physical existence and can’t be perceived using senses is only one of the qualities of intangible goods.

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[1] S. PUGLIATTI, *Beni (teoria generale),* in *Enc. Dir.*, V, Milano, 1959, p. 164 ss.

[2] F. GAZZONI, *Manuale di Diritto Privato*, Napoli, 1994

[3] Truthfully, the fact that art. 810 c.c. can also be interpreted with reference to the intangible assets also follows from the transposition in internal law of the first paragraph of the Directive 112/2006/EC in which "electricity, gas, heat or cold, and the like" are assimilates to material goods.

Firstly, these goods are characterized by an intellectual essence. The key role of creativity (art. 2575 c.c. and article 1 of l. N. 633 of 1941, *i.e.* the Italian copyright act) is underlined by the use of "invention" in relation to all immaterial goods which postulates that these goods have to be characterized by originality and novelty (even if the measure of these requirements are different in the case of patent or copyright protection, as we will see.)

The second element that identifies the intangible goods is the possibility to reproduce them in countless copies, to give people the chance to use them temporary. The use of one, in fact, not involving the deterioration of goods, does not preclude the use of the others. Only if this happens, the work is likely to be used economically and becomes worthy of protection.[4] The intangible asset must not be necessarily used in full and exclusive way by a unique owner, as material things, because the creative idea, manifested through the *corpus mechanicum*, by its nature becomes common[5].

It is important to briefly point out what will be broadly shown below: law gives general protection to material goods, but with reference to immaterial goods law recognizes some rights only in relation to particularly qualified intellectual creations; in other words, in such cases law gives protection by categories.

Once defined the difference between the two categories of goods under the civil code, it is possible to frame the digital good in one of these.

Digitizing means converting a product or information in a "digital physical quantity" (*bit*) that can be made intelligible to the human senses only through suitable instruments.

The characteristic of digital assets is the fact that they are unconsumed and able to be used simultaneously by an indefinite number of people without disablement of earnings per each one[6]; however, their nature of "intangible assets" is not clear.

According to some authors[7], the aforementioned thesis depends on a misunderstanding about the identification of immaterial and intangible assets:

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[4] G. FERRI, *Manuale di diritto commerciale*, Torino, 1980, pag 169

[5] D. MESSINETTI, *Voce Beni immateriali (diritto privato),* in *Enc. Giur. Treccani*

[6] G. FERRI, *Manuale di diritto commerciale, op. cit*. For a more complex position, M.ARE, *Beni immateriali*, in *Enc. Dir.*, V, Milano, 1959, p. 248-249, all immaterial goods are characterised by the need of externalization, trascendence, reproducibility, possible to be used simultaneously.

even though they are not properly tangible, they claim that it is not correct to speak of immateriality as the format digital is a way of externalization of human thought, equally physical.[8]

Such doctrine[9] then responded positively to the question concerning the possibility of considering as "material goods" the concatenation of bytes (*files*) which represents the protected intellectual entity.

This opinion has consequences on taxation. We limit to introduce a topic that will be further analyzed in the following chapter 3.

The above-mentioned authors[10] consider the telematic transmission as an assignment of goods in accordance with the article 2 of the Presidential Decree 633 in 1972. In accordance with that article "are assignations of goods, acts with onerous title that import transfer of ownership or the formation or transfer of real rights on assets of any kind": not essential requirement of corporeity/entity and being able to be the subject of rights, also digital goods may be considered sold. This approach might appear correctly on the internal regulatory plan, however, leads to a solution in contrast to what was expressed in the Directive 2006/112/EC.

The digital good is here considered as subject to the provision of service. Whether that conclusion which emerges from the provision of art. 25 that "the provision of services may be the assignment of intangible property" it cannot be accepted as authoritative doctrine mentioned above, it leaves no doubt the express provisions of the art. 58 which refers to Annex II to the indicative list of services provided electronically which are generally defined as "services provided through the Internet the nature of which renders their supply essentially automated by human intervention and minimum impossible to ensure in the absence of the information technology".

Such classification means that, for example, the sale of a book through traditional channels and the acquisition of the same publication through systems of computing trasmission, are differentially regulated in terms of tax and the

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[7] E. MARELLO, *Le categorie tradizionali del diritto tributario ed il commercio elettronico, Riv. Dir. Trib.*, I, 1999, p.595 ss.
[8] G. DI GIANDOMENICO, *Tipo negoziale e beni immateriali, Ras. Dir. Civ.*, fasc.1-2, 2002.
[9] C.M. BIANCA, Diritto civile, *La proprietà*, Milano, 1999
[10] M. GIORGI, *Gli acquisti attraverso reti informatiche: la dsciplina Iva*, in *Rass. Trib.*, III, 1999

consequent violation of the policy of neutrality between the different forms of trade.

1.2. SOFTWARE DEFINITION AND COPYRIGHT RULES IN COMPARISON TO PATENT REGULATION

Protected, intellectual creations constitute a "*numerous clausus*", *i.e.* an exhausted list. So, the justification of the legal protection must not be found in the general origin of the creation of an intellectual activity, but in the recognition of the suitability of the activity itself to contribute to the cultural and economic progress. Software is a digital good which is considered an intangible asset that is characterized for the intellectual creation. As a consequence, it deserves to be protected by law.

The most common legal interpretation of software allows us to define it as a set of instructions arranged in sequence and expressed in a clear language (in the so-called programming language); the set of instructions is a calculation procedure or algorithm that is loaded in the computer (it is recognized thanks to a binary language, also called machine language, that makes the original program executable through the processor). The program allows the machine to perform specific operations or to control specific performances in order to give the user the requested service.[11]

Software protection was introduced the first time in Italy to fulfil the delegating law n. 489/1992, with the decree 29.12.1992, n. 518, which modified the law 22.4.1941 n. 633 on copyright and extended the protection of literary and artistic works to computer programs (art. 1 of "the copyright act"); Article 2 underlines that the term program "*also includes the preparatory material for the planning*". The discipline is currently completed by Articles 2575-2583 of the Civil Code.

The source code receives protection as it is configured as a creative work. Since it consists in executable instructions that lead to a specific result, it is similar to the content of teaching or technical manuals peacefully included in the category of

[11] MARCHETTI P. –UBERTAZZI L., *Commentario breve alle leggi su proprietà intellettuale e concorrenza*, PADOVA, 2012

"literary works": this definition includes all the creations in which the word is used to communicate information in a personal way[12].

When we qualify computer programs as literary works we have to consider a distinctive characteristic of software: user manuals are devoted to users, while instructions of computer programs are devoted to the machines[13] because the source code must be adapted to be made executable by the processor through the binary language: even this code is protected.

Since the national law has considered the software as a creative work - that is a creative idea rather than industrial inventions - and a creative idea in the technical field, it has clearly opted for the copyright protection rather than the patented one. First of all, this option has given the possibility to protect software based on the only condition of creative work (art. 2575 of the Civil Code): it is sufficient that the work has a minimum of objective originality compared to pre-existing things of the same kind and a modest progress of inventive step.

The Court of Cassation, sect. I, judgment of 12.01.2007, n. 581, has decided that the requirements of creativity and originality exist even if the work is composed of simple ideas and concepts, including the intellectual heritage of people with experience in the same field, provided that they are formulated and organized in a personal and independent way. Conversely, the patent protection requires the most onerous novelty requirements, great inventive and industrial applicability (the so called intrinsic originality) of the invention: it shouldn't be easily understood or deducible from a technical point of view by a skilled person[14] and it should be a real improvement according to the current state of technique.

In addition, the patent is granted from the Italian Office of patents and trademarks as a result of the verification of the aforementioned characters, while the protection based on copyright is granted without any formalities: the creation of the work represents the constitutive part of law (art. 2576 of Civil Code and 61 of the copyright act) and its manifestation is sufficient[15]. However, it is useful to

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[12] See Cass., 93/11953.

[13] A. GRAZIOSI, *Parola detta, parola scritta e parola telematica,questioni in tema di prova e provenienza, in AA. VV., Scrittura e diritto,* Milano 2000, p. 168 "the difference from writing is only that the digital word requCompany Income Tax always the intermediation of a machine".

[14] Code of Industrial Property, art. 48.

[15] D. SBARISCIA, "*Il software come creazione intellettuale*" in *Diritto dell'informatica*, 2014

store the program in the appropriate register, in this case in the Special Public Register held at the Italian Authors and Publishers Association (art. 103 of the Law on copyright); this deposit, which is optional and therefore it does not constitute a "registry" of software, is provided only for published programs and has a declaratory, probative function of the work existence and of its authorship at a certain date, transferring to a third party the burden to prove the contrary (a further detailed regulation providing for the recording mode is established with a presidential decree n. 244/1994).

While the patent protection allows to protect the invention in any form, both literally and equivalent, the protection based on copyright covers only the form of expression used in the specific program, because copyright protects intellectual works limited to the form in which the same are expressed. It must also be noted that the preference of the protection of software the copyright act was a necessary choice because of the prohibition of patentability provided for computer programs ruled by Article 12, r.d. n. 1127/1939; this ban still exists.

The Code of Industrial Property (decree 30/2005) describes, under Art. 45, the object of a patent for inventions and excludes the patentability of computer programs; it admits, however, a patent protection for the results arising from the use of innovative programs. The reason for the exclusion from patentability has been explained through the doctrinarian planning[16] that favours the abstract essence of the program according to its potential utilitarian implications; it should be noted that the legislation was formulated at a time when the Internet was not developed and the application had a software which was closely linked to the machines trade, therefore it seemed difficult to predict an extensive industrial applicability to justify an economic interest in patenting. Any abstract content remains excluded from protection; since they are intellectual assets that can be freely appropriated by anyone, they are not patentable and are not the subject-matter of copyright under the provisions of the art. 2, n.8: the exclusion concerns

[16] See the discussion in P. MARCHETTI.- L.UBERTAZZI, op. cit., and E. GIANNANTONIO, *Manuale di diritto dell'informatica*, Padova, 1997

"*the ideas and principles which underlie any element of a program, including those which underlie its interfaces*".[17]

In general, copyright protection has both a moral and financial position. As far as the first one is concerned, the author has the right to claim the universally valid authorship of the work, to decide its publication and the way to do it; these rights are equally recognized in connection with the creation of software. As far as economic rights are concerned, we should underline the distinction between the so-called open source programs and the closed source ones that is based on the contribution to the user, as well as the object code, including the source code and the resulting changes in the applicable regulations.

It is also important to distinguish the case in which the program is the subject of sale from the one in which it is the subject of the license. As regards the first case, there are no particular problems because all the property rights of the software are transferred to the buyer. As regards the second case, it is necessary to clarify that in our system the term license refers exclusively to the patent. So, with reference to software, it's better to specify "right of user". Actually, according to the prevailing doctrine,[18] the reference contractual scheme is the one concerning the lease that transfers the use of property for a specified time. The subject-matter of the contract is not the software itself but the right to use the copy of the software whose fruition, unlike other works of the intellect, is not passive but interactive. With the right of user only some economic rights are transferred: the license holder can only use the software and the use includes the right to install and load hardware, the visualization and execution of the program for the purpose provided for by the license agreement and he may also perform the operations allowed by general rules. The clause concerning the installation of software is often proposed: the installation of software is limited to a single machine in use. In absence of an express clause providing for "multiple" licenses, it is established that the use of multiple machines is unlawful according to Art. 119 of the copyright act. So, only the rights explicitly mentioned are transferred.

[17] European Court of Justice, case C 393/09 : the protection is justified only when the process of formulating is so far that is possible using program.

[18] D. MESSINETTI, op. cit.; G. PASCUZZI, *Internet (diritto privato*), item of *Digesto civ*., Torino, 2000, p.531

The decree 518/1992 has implemented Directive 91/250, now replaced by Directive 24/2009, on the legal protection of computer programs, by modifying some articles of the law on copyright and inserting new ones; a special section has been also added (section six), which includes Art. 64 *bis*, concerning the exclusive rights granted to the author of software, Art. 64 *third* and Art. 64 *forth* on derogations reserved to the owner: the rules impose a discipline that is in part derogatory compared to the one established for the work of the intellect in general[19]; it protects the peculiarities of the work and the requirements of the software market.

Article 64 b, reproductive of Article 4 of Directive 24/09/EC, introduces a wide range of rules concerning the same category of rights: first of all, the provision allows the author to prevent permanent reproduction of the program "*in any form or by any means*", so even by scanning or downloading it from the Internet. The author is also protected against forms of temporary and indirect reproduction regardless of operations that are likely to affect the economic interest of the owner, even when the reproduction is made by the user within his own computer, provided that the conditions established by art. 64 *third* are not fulfilled. Such rules give to the author the faculties related to the reworking of the original program which are exemplified in order to include "*the translation, adaptation, transformation and any other modification of the program as well as the reproduction of the result, without the prejudice of the rights of those who change the program*" (even this provision is subjected to derogation according to Art. 64 *third*). Finally, Article. 64 b, in conjunction with Articles 17 and 18 b, regulates the copyright of distribution of the program to the public.

Articles 64 third and 64 forth concern the limitations of the software rights: the first one provides that the reproduction and reworking rights of the author or owner of the same program are limited by the requirements related to the use. The user is allowed to make a copy of the program if it is necessary. On the contrary, Article 64 provides for the "reverse engineering",[20] so, without permission, it's possible to take apart the program in order to discover the source code: in this way

[19] P. AUTIERI, *Diritto Industriale, Proprietà intellettuale e concorrenza*, Torino, 2009
[20] Directive 24/09, 15th recital.

it's possible to learn the software principles and create programs which are compatible with the original one.

1.2.1. REGULATION ON THE COPYRIGHT PROTECTION ON ELECTRONIC COMMUNICATIONS NETWORKS AND IMPLEMENTATION PROCEDURES UNDER L.D. 9TH APRIL 2003 N. 70

The law 248/2000 introduced into the copyright act the article 182 *bis* which requires Competition Authority (Autorità Garante della Concorrenza e del Mercato, hereinafter "AGCOM") and Italian authority for authors and publishers (Società Italiana degli Autori ed Editori, hereinafter "SIAE") carry out inspection tasks and supervisions to prevent any infringements of copyright, by exercising their own powers: AGCOM exercises its power over the copyright in the field of electronic and communications networks.

The decree n.70/2003 provides for judicial and administrative power, even in case of emergency, to prevent or to stop internet service provider's unlawful behaviours. The administrative authority of supervision is identified as AGCOM under the art.182 *bis* and under Law 249/97 and it means that the AGCOM has both supervisory powers and sanctioning powers. The article 6 of the Legislative Decree n. 44/2010 added Art. 32 in the legislative decree n. 77/2005 (act on the audiovisual media services and radio) which requires the AGCOM to emanate the necessary regulations to ensure that the limits and prohibitions on media services become effective also on the Internet. According to AGCOM, it would be an expression of a bigger regulatory power.[21]

On the 12th of December 2013, AGCOM adopted the Resolution n. 680/13/CONS, "*Regulation on the protection of copyright on electronic communications networks and implementation procedures under the Legislative Decree 9 April 2003 n. 70*", which came into force on 31 March 2014 as provided for in Article 19 of the same regulation.

The regulation takes into account the observations made during an extensive consultation of stakeholders and during the interlocution with the European Commission, even aimed to contrast computer piracy.

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[21] A. STAZI, *Il regolamento di cui alla delibera n. 680/13/CON dell'AGCOM per la tutela del diritto d'autore in rete*, in *Riv. Dir. Ind.*, II, 2014

Firstly, the definition of “digital good” also contributes to identify the area of applicability of the decree. The digital good is a “*good or its part, of sound character , audiovisual, photographic, gaming, publishing and literature, including application programs and operating systems for computers protected by the law on copyright and spread of electronic communications networks”*.[22]

The model adopted by AGCOM shall promote the education to legality in the use of digital goods and timely and economical legal procedures. Article 4 has therefore instituted a special committee, which all the stakeholders participate to, including public agencies, in order to specify the measures aimed at promoting the development and diffusion of digital goods. The AGCOM pursues these aims making the access to services and their legal use easier.

The act includes measures of enforcement only after a notice, compiling a form. In fact, AGCOM shall proceed only following the holder’s request because of the nature of subjective available right of the protection, with the exception of procedures of self-regulated "notice and action".

The procedures laid down in the Regulation combine efficiency and guarantees. On the one hand, they shall ensure a fast answer to the decision on the law infringement, especially when the breaches are very serious, and effectiveness of repressive measures; on the other hand, they guarantee fundamental freedoms and respect for procedural rights and the “*audiatur et altera pars*” (cross-examination) principle. In the communication – sent to the subject, to the service provider, to the uploader (if known), and to the manager of the page and the website – AGCOM gives two chances to the responsible of the claimed breach; he can spontaneously solve the illegal situation or he can rebuttal arguments.

Then, as a result of the investigation, the process may end with a decision to close the website or with an order to desist from the infringement, addressed to service providers.

According to the European legislation on electronic commerce manifested in Directive 2001/31/EC and to the national transposition of the legislative decree n. 70/2003, AGCOM may order to remove the illegally disseminated digital goods or to make the access to them unavailable. If the AGCOM’s decisions are not

[22] Resolution n. 680/13/CONS, art. 1, letter p)

respected, according to the Article 1, paragraph 31 of law n. 249/1997, the transgressor must pay a penalty.

The measures provided by the regulation are the same of the Decree. N. 70/2003, with the specification that their application will be based on criteria of adequacy and proportionality.

The legislative decree n. 70/2003 states an alternative choice between the procedure before the AGCOM or the judge. If the trial started first, the administrative procedure cannot be promoted or prosecuted. Moreover, all orders adopted by AGCOM can be appealed before the administrative courts.

1.3. THE CLOUD COMPUTING UNDER ITALIAN CIVIL LAW. CONTENT OF CONTRACTS AND RISKS FOR CLIENTS

Before dealing with the cloud service under the current set of rules and, in particular, with the responsibility of the cloud-providers for infringement of copyright, it is necessary to briefly describe the limits for the use of intellectual property and the roles performed by the provider of these services.

The term “cloud computing” indicates a way of supplying computer services. The service offered by a provider to a customer lies in storing/archiving and/or processing data thanks to instrumental resources guaranteed from the access to remote servers managed by the supplier.

It’s possible to identify three kinds of cloud services. The private cloud consists of a computer infrastructure to meet the needs of a single subject; it is located in his premises so that the owner of the data can have the control of services and data, without any risks with regard to privacy and disaster recovery. The public cloud is an infrastructure owned by a third person (the provider) who is specialized in supplying services to private customers, companies and governments through the web. The use of these services implies the transfer of data and of an important part of the control exercised to the provider's systems, which plays an important role in order to protect the entrusted information. This model allows at using technology solutions in a safe way but it brings about the loss of direct control of data. When someone uses both the systems simultaneously, he generates the hybrid cloud model. The public cloud includes "subcategories" concerning the services offered, designated by the acronyms: IaaS (Infrastructure as a Service), so, on the basis of the model "according to consumption", the user can profit from hardware offered by a third person and he can install software; Paas (Platform as a Service) which offers the right to receive an entire technology platform, resulting from the combination of different services and features, such as from the possibility to participate actively (generally speaking, this kind of service is addressed to market participants who use it to develop their own application solutions, such as applications for financial management, accounting or logistics, in order to fulfill domestic needs or to provide services to a third person); and SaaS (software as a service) which gives the right to enjoy a software offered by a third person (such as e-mail service).

The contract is the most appropriate legal instrument to regulate the cloud computing, due to the complexity of the relationships that are created. In practice, complex arrangements will be made and they might not be included in a single model of contract.[23]

The contract scheme that is often considered to regulate relation of cloud computing is the outsourcing contract, under which an entity (outsourcee) entrusts to another (outsourcer) some technical activities that are secondary than the core business of outsourcee. There is not a clear definition of such situations, because they are characterized by a lot of variations. Some authors[24] qualify outsourcing as a mixed contract and say that the regulations of the contract will be determined by the most important element. Truthfully the classification of a contract as a mixed cause contract not necessarily determines the application of the principle of primacy. Could be applied the principle of competition that guarantees protection to specific types of contract.[25]

However the prevailing doctrine [26] frame the contract of outsourcing in the service contract.

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[23] M. C. DE VIVO, *Il contratto ed il cloud computing, in Ras. Dir. Civ.*, IV, 2013
[24] G. BAUSILIO, *Contratti atipici*, Milano, 2014
[25] F. GALGANO, *Trattato di diritto civile*, Padova, 2009
[26] A. MUSELLA, *Il contratto di outsourcing del sistema informativo, Dir. Inform. e informatica*, 1998,p. 859; C. ROSSELLO, *I contratti dell'informatica nella nuova disciplina del software*, Milano, 1997

This contract, regulated by Art. 1655 and following of the Civil Code, is characterized by the element of outsourcing (decentralization), under which a party assumes the obligation to give a service in the interest of the other, assuming the risk management. The contractor assumes, therefore, an obligation of result and if he fails, he has the legal responsibility.

Another contractual scheme that seems appropriate to regulate the relationship of cloud computing is the supply contract because it is characterized by periodic or continuous benefit. A part undertakes to give a specific performance to another one, against payment.

Some authors[27] think that between the service contract and the supply contract there is a relation of "genus to specie" while others[28] argue that the difference is clear reading the article. 1559 c.c.. The supply contract concerns only things while, when the object of the contract is a service, we have a service contract. Another category of contract to be considered is the deposit agreement (art.1766 and following c.c.) in which the user/customer gives his data to the provider and supplier assumes the obligation to keep them safe and return them back as the customer requests them.[29]

The cloud computing contract is also marked by another element: the technological instruments are not sold, they are only used by customers. This is the focus point of contractual license and for this reason the cloud can be considered a remote way of use in license of a software.

In this situation we have to consider, case by case, interests of parties and specific elements of an agreement to bring it in one of these types.

Since the legal classification of the cloud services depends on contractual autonomy of parties, the time of negotiation including the definition of the clauses is very important.

The contract should specifically indicate the general profiles such as the language, the time, the law and the applicable jurisdiction, the price, the terms of service that is the general terms of use of the service and the so-called "Service Level Agreements" (SLA) through which the parties define the terms and conditions that

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[27] R. BOCCHINI- G. GAMBINO, *I contratti di somministrazione e di distribuzione*, Milano, 2011
[28] R. CORRADO, *Contratto di somministrazione, in Noviss. Dig. It.*, XVII, Torino, 1970, p.881 ss.
[29] M.C. DE VIVO, *Il contratto ed il cloud computing*,op. cit.

the service provider shall ensure to the user: in fact, parties, using SLA, clarify levels of quality and quantity of services, the assumptions of the damage, the discipline of responsibility and the level of security guaranteed. Usually, in the contract there is a "policy" that develops into a general section, with the provision of any prohibitions, and a specific section on privacy or rather on the processing of data.

Cloud services are often regulated by standards on which the customer hasn't any negotiating power, and thus the customer is qualified as a weaker contractual party (the fact that these contracts are often predetermined unilaterally is confirmed by clauses that identify the applicable law in the State in which the provider is). Many of the major cloud providers impose terms and conditions, without a guaranteed minimum level of performance: in these cases, the user can't invoke provider's liability for breach of the obligation unless it depends on wilful misconduct or gross negligence, according to the art. 1229 c.c. under which "*shall be established the nullity of any agreement that prior excludes or limits the liability of the debtor in case of wilful misconduct or gross negligence*"[30].

In the cases B2C (when the contracting party is a consumer) in addition to the contractual regulations, the protections provided by the Consumer Code are applicable.[31] We consider in particular, the Art. 49 about information that supplier must give to the client and the discipline of the right to reconsider. The client can terminate the contract without motivation, within 14 days, if he is informed in time about the existence of this right or otherwise, within 12 months and also we consider the protection of Art.143 establishing the irrevocability of rights granted to the consumer on pain of nullity and the discipline of absolutely and relatively abusive clauses.

Conversely, about the asymmetries of information and negotiation power between two businesses, there isn't the same protection and articles.[32]

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[30] The customer should prefer ISPs that include contractual service levels in their agreements: in this way he can analyse the adequacy of performance standards in relation to his professional needs and he can make a balance benefit-risk having specific knowledge of the obligations assumed by the providers.

[31] Recently reformed by Legislative Decree N. 21/2014 which implemented Directive 2011/83. It has also made changes in relation to the regulation of distance contracts, the category in which on-line contracts are peacefully included.

[32] Artt. 1175-1776 c.c. and from art. 1218 to art. 1229

We need to consider that businesses have less protections than consumers, but they aren't radically without protection as far as the conclusion of unbalanced clauses. In fact, in Italy there is the discipline of the abuse of economic dependence: in accordance with art. 9 l. 192/98, law defines as economic dependence on "*the situation in which a company is able to determine, in trade with another company, an excessive imbalance of rights and obligations*". The ban, originally developed about subcontract and then extended to settled case-law in all contracts of commercial cooperation, sanctions with the nullity all conditions negotiated by a business that is in economic dependence position. There is this situation also when a party has not other good option. A similar principle is found in the "*Principles of International commercial contracts*" UNIDROIT.

If the user has enough power to negotiate the terms of the contract, but also in the case in which "suffers" the contract, he has to pay attention to the service level agreement and to the provisions on privacy and data security.

The service level agreements help to define the object of the contract and concern, as mentioned, the technical parameters and measurable objectives. In any case, with regard to the protection of the users of the cloud services, the European Commission with the decision n.2013/C174/04 founded the Expert Group of the Commission on Contracts for cloud computing in order to identify fair and safe clauses.

A second area of risk for the proper performance of the contract is linked to the ability of cloud providers to ensure the confidentiality, security, integrity and availability of data that the user gives to external data centres. It is that broad area that has been qualified by the doctrine[33] as "*the right of information security*".

The security and confidentiality of the data to the cloud provider is a major problem of a user who wants sufficient guarantees concerning the respect of standards of protection. At first, we need to identify what kind of relationship is created between the cloud service provider and user concerning privacy.

Community legislation in the field of personal data has a datum-centric structure so the role played by the various entities is determined on the basis of the

[33] A. MANTELERO, *Processi di outsourcing informatico e cloud computing*, Torino, 2010

relationship that each one has with the information[34]. We can make a distinction between “controller” who is the person or entity which determines the purpose and means clustering of the processing of personal data and “processor” that is the person or entity which processes personal data on behalf of the controller.

About the provider-client relationship, if the user has decision-making power relating to the data processing and the security measures, he is designated as “controller”: he tests to have an effective control on his data and on the security and he can nominate a processor, usually the provider, as set out in the Art. 29 of the legislative decree n. 196 of 2003 (Code about the protection of personal data). In any case, the controller has to check the work of the processor and the correct execution of processor’s obligations and, in case of processor’s breaches, he has legal liability.

Undoubtedly, a small customer has a big difficulty in negotiating adequate conditions of data management, but this difficulty does not involve disclaimer because the customer can choose other cloud service providers that offer more guarantees, anyway. Under Article 13 of legislative decree n. 196 of 2003, the controller must receive a prior report about the methods of treatment and, therefore, about the way in which data are stored and also about the persons who data are communicated to. According to the Article 7 of the same decree, the controller has the right to "*request a copy of their data intelligible, their updating, correction or integration*" and "*in case of infringement of law, he has the right to block, delete or translate in anonymous form this information*". The provider, according to the type of services offered, should ensure protection in order to guarantee confidentiality, integrity and availability of data.

The contract offers to clients a good protection against the risks that could result from a bad network connectivity or in case of abnormal events such as failures or fires, or from the risks associated to privacy associated with the presence at the same moment in the same infrastructure of information of competitors.

The controller, therefore, has to verify the safety and reliability of the provider and the technical and organizational measures in order to minimize the risk of destruction or loss of data, treatment not allowed or not in accordance with pre-

[34] A. RICCI, *L’outsourcing e cloud computing,* in *Diritto dell’informatica*, 2014

established rules[35]. The decree n. 69 of 2012, implementing the European Directive 2009/136/EC on security and privacy in the electronic communications area, has established that providers must notify to the Authority and to the customers any data breaches that their data base may suffer as a result of cyber attacks, or adverse events. The guidelines adopted by the Guarantor determine who has to notify, in which cases the provider is obliged to notify users, the technical and organizational security measures to alert the authorities and the users of a "data breach", the timing and content of the communication.

In the opinion on cloud computing 5/2012, the European privacy guarantors wrote "*giving data to providers, customers have risk losing control of the data and not being able to take appropriate technical and organizational measures to ensure the availability, integrity, confidentiality, transparency, data isolation and the possibility of intervention on the same*". In this risky environment, there is the standard ISO 27018 that introduces a set of policies, procedures and controls through which providers ensure compliance with the European directive on the processing of personal data, reassuring buyers on the opportunity to monitor the full transparency data processing systems in the cloud provider. It should be noted that adherence to ISO 27018 by a provider does not necessarily translates into a transposition of its clauses in contracts.

1.4. PERSONAL RIGHTS ON THE INTERNET. ITALIAN CASE LAW AND EUROPEAN COURT OF JUSTICE DECISIONS

Italian legislation is neither quite advanced in the computer science, even for the receipt of international and European regulations.

In 2010 Prof. Stefano Rodotà has suggested a constitutional amendment to extend the sphere of the fundamental rights recognized by our legal system. That proposal contemplated the idea of including Art. 21-b in the Constitution with the following text: "*everyone has equal rights of access to the Internet, on equal terms, with a technologically appropriate manner that removes any social and economic obstacle*", in order to reaffirm and re-expand the constitutional principles of equality and freedom construction of personality through the

[35] A. MANTELERO, *Responsabilità aquiliana per uso della Rete e responsabilità del provider, in Diritto dell'informatica,* 2014

guarantee of access to Internet for all Italian citizens; this implies that such access becomes essential for the citizens. It is argued that Internet is configured as an important space to promote the individual and collective participation in democratic processes and essential equality. This should be fulfilled not only with regard to broadband, but also promoting the computerization of the public administration and promoting computer literacy in general.

The bill has not been approved by the Chamber of Deputies but it can be considered the starting point of different proceedings that brought, on 13th October 2014, to the publication of the draft of the Declaration of the Internet Rights developed by the homonymous Study Commission promoted by President Boldrini and Professor Rodotà. The declaration is currently the subject of a public preliminary consultation for to the final draft of the text, and represents a contribution to the public debate: it indicates the possible regulatory developments, not only within the national limits but also from a supranational point of view. The declaration is currently made up of 14 items, sanctioning the right of access and the principle of net neutrality and the right to an internet education and information, and clarifies some issues concerning the management of personal data in the network.

With regard to this argument, it is important to underline that the protection of personal data is enshrined in decree of 30.6.2003, n. 196, "*Code on personal data protection*", art. 1: "*Everyone has the right to his personal data protection*”.[36] The constitutional basis is provided for by law, as for other personal rights, in article 2 Cost. designed to be an open clause and a general protection for the free development of the person, as stated by the Supreme Court. The object of the right to data protection is quite extended: "*a personal data is any information concerning a natural person, identified or identifiable, even indirectly*", it is the right of an individual to control the set of information that relates to himself and therefore delineate his “being” in the information society; in short, the legal situation in question, as well as all personal rights (right to privacy, the name, the image, the reputation, etc.), are designed to protect a single legal right: the

[36] The same in enshrined in Art. 8 of the Charter of Fundamental Rights of the European Union and Directive 95/46/EC.

identity.[37] Identity is a synthesis of elements of different nature: events occurred at a specific time may no more correspond to the personality of a subject in a different historical moment; so, contextualization and historicization become essential.

The right to be forgotten is based on the conflict between historical truth and actual reality. This right has been explicitly sanctioned for the first time by the Supreme Court in a decision concerning the publication in a weekly newspaper related to the indictment of a person for acts of mob that had taken place several years before and was announced in the press again.[38] The subject objected that such disclosure concerned past experiences and events historically overtaken by subsequent events silenced by the reporter. In that judgment, the Supreme Court - moving from the principle that "*the relevance of the public to information is not closely related to the published fact but remains present when its public importance becomes topical once again*"- established that every person has the right not to remain indefinitely exposed to further damage caused to his honour and reputation by the repeated publication of news already spread, unless current events occurring again give rise to a new public interest and new dissemination of information. In summary the interest in oblivion, that sticks to discretion, cannot be resolved since it relates to news already escaped from the sphere of the person concerned, but it can be recognized when there is no social utility.

The situation becomes complicated because of the peculiar characteristics. The Supreme Court, in its judgment, noted that "*the Internet is not an archive, but a deposit stock*"[39]. If the first one is characterized by being "*ordered according to the specific criteria, sometimes interrelated with information to facilitate access and to permit consultation, the Internet is a reality in which the information is not*

[37] G. FINOCCHIARO, *La protezione dei dati personali e la tutela dell'identità*, in *Diritto dell'informatica*, 2014
[38] Cass.civ., 9th April 1998, n.3679
[39] Cass.civ. , 5th April 2012, n.5525.

recorded, but only stored and appears isolated, located on the same level, without an assessment of the relative weight and without contextualization".[40]

In this case, it isn't important to protect the right to be forgotten, which represents the right not to be remembered for more facts not subject of public interest, but it is important that the news are not available on-line; these news are not complete and updated so they discredit the person concerned who becomes a media victim. The real subject is, therefore, whether or not there are rights related to information concerning a person and that are present online: they should be constantly updated so that the identity of the person concerned is faithfully represented in its dynamic evolution.[41] The Supreme Court recognizes the existence of this right, and states that "*the news, originally complete and true, becomes out-date, partial and not exact, and therefore they are not substantially true*".[42]

Anyway, the Court stated that "*the obligation to establish a system designed to signal the existence of any development, allowing a quick and easy access to this information*": depends on the owner of the site and not on the search engine. As far as these aspects are concerned, the Italian case law is in contrast with the judgment of the Court of Justice of May 13, 2014, Case C-131/12 in which the Court ruled in the context of the dispute between the companies Google Spain and Google Inc. Agencia Espanola de Protection de Datos (AEPD) and Mr. Costeja Gonzalez. In particular, the applicant complained about the fact that, by typing its name in "Google search", it was possible to obtain links concerning pages of a newspaper (dating from 1998) were people could read about auction sales of properties, connected to a seizure made against him for the enforcement of social security credits; the applicant demanded the removal of the data from the newspaper and "Google search". The AEPD upheld the complaint lodged by the applicant against the above companies and ordered Google Inc. to remove personal details from their indices .The decision was appealed by Google Inc. and

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[40] The applicant, that is a politician, complained that an article published many years before in a website gives the correct information on his arrest, but it does not inform of the subsequent fact that the court case ended with the acquittal. So, he does not deny the veracity of the content of the writing nor the fact that it can still be considered in the public interest, but asks for the displacement of the article in an area of the website which is not indexed by search engines and asks for its integration with the news related to subsequent developments of the story

[41]F. DI CIOMMO- R. PARDOLESI, *Dal diritto all'oblio in internet alla tutela dell'identità dinamica, in Danno e Resp.,* 2012, VII,p. 701

[42] Cass. Civ. 5th April 2012 cit.

Google Spain at the Audiencia Nacional de Espana which stayed the proceedings and referred to the Court of justice to submit a series of questions and to ask in particular: "*should the rights of erasure and block of the data -covered by art. 12 and art 14 of Directive 95/46 about the right to opposition- imply that the person can apply to the search engines to prevent indexing of the information concerning himself and published on web pages by third parties?*" The Court first examined the activities of the operator noting that he explores Internet in an automated way to find data that are extracted, collected, recorded, organized with indexing programs and stored in a server and then made available to users. With regard to this last activity, "*all data on-line are available to any Internet user who makes a search starting from the name, even to those who would not have found the web page on which the data are published*" and that the aggregation and organization of the information published on the Internet are made by the search engines in order to facilitate their users access to information; this means that data concern a multitude of private, life aspects. Without search engine they could not easily be connected and capable.

The Court has defined this information as "personal data" according to the Directive 95/46 and has upheld the request of the person concerned, taking into account the possibility to trace the material and the absence of an overriding public interest; for the first time it has ruled that cancellation requests may be submitted directly to the manager of the search engine, even if the relevant information was originally published on other sites and then indexed by Google. The search engine is considered "*the controller*" according to Art. 2 of Directive 95/46, that has the purpose to fix aims and means of processing and, therefore, imposes the obligation to remove from the list of results the links to pages that contain personal data, even when this information remains on the site of origin.

This position has led, according to someone, to a wrong definition of the search engine responsibility and to a certain consideration for the regulations set out in Directive 2003/31 which limits the liability of providers.[43] Actually, Advocate General, in his conclusions, pointed out that in recital 47 of Directive 95/46 the data controller, related to messages containing personal data transmitted via

[43] S. PERON, *Il diritto all'oblio nell'era dell'informazione on-line,in Resp.civ.e prev.*, IV, 2014

telecommunications, is the one who sends the message and not who offers the transmission service; even Directive 2000/31 on electronic commerce is not expected to have any effects and therefore no liability on the transmission. A similar interpretation relating to the liability of intermediary service providers has recently been adopted by the Supreme Court regarding the criminal case Google / Vividown with the judgment n. 3672 of February 3, 2014. The ruling has been originated from a story concerning some teenagers who loaded a video in which they were protagonists of an episode of bullying: a guy suffering from Down's syndrome was bullied and the activities of an association for the protection of people with this syndrome were defamed. The video, uploaded online, was indexed by the search engine. The parents of the victim, which was joined by the association shown in the video, filed suit against the leaders of the Italian provider, stating the providers contributory negligence in the crime of defamation and the violation of certain provisions of Legislative Decree no. 196/2003, in particular art.167 that "*punishes the processing of personal data in order to make a profit or to cause damage to others and article 13 which concerns the informative obligation*". The story had a troubled development so the defendants were convicted at first instance and acquitted on appeal and in the last instance. When the Court confirmed the ruling on appeal it pointed out that dealing with a video in order to scan it and then to store it does not mean that someone handles its sensitive data. Consequently it refers expressly to Art. 16 of Legislative Decree N. 70/2003, transposing Directive 2000/31, according to which the service provider has no control over the data stored nor he contributes to its choice or to its research; this data is entirely attributable to the user, recipient of the service, who loads it on the available platform. The provider becomes responsible for any illegal information only after he finds out it (Article 16 of decree n. 70/2003) and he does not remove it. In this particular case, Google Italy would act as a mere Internet host provider, that is as a subject that provides only a platform where users can freely load information. In this connection, the Cassation underlines the orientation of the working group established according to art. 29 of Directive 95/46 which highlighted that the owners of the data loaded on hosting sites are individual users and that being the holder of the treatment involves that the subject has chosen to process personal data for its own purposes, with the result that the person called upon to answer for violations of the rules on personal data protection must be the holder of the treatment and not the mere hosting provider.

CHAPTER 2
THE TAXATION OF TRANSACTIONS IN THE E-COMMERCE

2.1. THE DEFINITION OF ROYALTY IN COMPARISON TO BUSINESS INCOME

The “digital revolution” has caused the rethinking of the traditional transactions classifications. Consequently, several problems with reference to the taxation system have arisen.

In the past, for example, a literary work was sold only in printed edition, and even though the material element represented just one part of the transaction value, the tax nature of the transaction was the goods sale. Nowadays, the same literary work, digitized, can be read online, through a web connection, and this internet connection gives the opportunity to have additional services, such as the information selection and the constant update of the contents.

The various transmission methods affect the transactions classification. This requalification must be adapted in order to guarantee the tax neutrality principle, according to which it the uniformity of the tax treatment on transactions that differ only for the operation methods must be preserved.

In the above-mentioned example, the principle is respected as the digital transaction concerns not only the literary work but also various and additional services, therefore it is impossible to talk about “object connection”. Broadly, the observance of the neutrality principle can be attainable through the classification according to the intrinsic nature of the transaction. First, it must be decided if the transaction is a sale of good or a service, and then, the kind of service and its characteristics in order to decide the applicable taxes.

The OECD has the merit to have overviewed in details the tax problems related to the e-commerce. In November 1997, during the Turku conference, it was decided to adapt the tax instrument in use to the new contest of the e-commerce, instead of introducing new forms of taxation. During the next conference of Ottawa, the representatives of the Member States expressed their large approval for the guidelines issued by the OECD and represented by the e-commerce report "*Taxation framework conditions*".

The report has established the general principles of taxation that should be used in e-commerce, the already mentioned principle of neutrality, efficiency, certainty, simplicity, equality and flexibility. It has also reaffirmed the considerations of the European Union included in the COM (98)374 which concerned the implementation of the existent taxation and its adaptation to the e-commerce.

A lot of the digital goods that are the subject of electronic transactions are protected by copyright. For tax purposes, it's important to determine if the income arisen from the sale of products or if they are the payment for the use of the rights that set up the protection.

We analyze the case in which the subject who receives the income has his tax-residence in Italy.

In case of a complete and final transfer to the assignee, of all the rights for the economical use of the intangible asset (and therefore when the assignator has no other rights), the proceeds of the disposal classified as self-employment incomes, or other incomes if the taxpayer is a natural person who does not carry on a business activity and, therefore, is subject on Individuals Income Tax.

Within the meaning of Article 53, second paragraph, letter b),of Income Tax Act, the incomes received by the author for *"the economic exploitation of intellectual works"* are treated as self-employment incomes. Otherwise, the Article 67, paragraph 1 (g), includes in the other incomes, those resulting from the economic exploitation of intangibles by other subjects than the author.

Some authors[44] gave the opportunity to include in the concept of economic exploitation of the intangibles, any ways of using for economic purpose.[45]

The art. 54, eighth paragraph, determines that for what concerns self-employment incomes the taxable amount is based on the gross income, received in the tax period, reduced by the 25%, as a flat-rate deduction for the income related expenses (40% if the receiver is under 35). Whereas, in case of other incomes the

[44] L. DE MURI, *Gli aspetti legali e contrattuali del commercio telematico*, in *Guida al fisco*, ottobre 2014

[45] Although, according to the art. 23, second paragraph (c) the word "exploitation" has the only meaning of granting in use.

taxable amount will be the result of the deduction of the 25% from the gross income received in the tax period, just in case the incomes are the result of the acquisition upon payment of the rights.

When the intangibles are sold by an entity carries on a business activity, as single businessmen or as a company, the “economic” use becomes “commercial” use and the incomes are automatically included in the business incomes according to article 81 for companies and other taxpayers subject to Company Income Tax.

In this case, the taxable base will be equal to the gross income earned in the tax period (on accrual basis).

If the subject who receives the payment is not resident in the country, it will be subject to the regulations of the art. 7 of the OECD model convention - “*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 that permanent establishment*” – . The second paragraph specifies that “*the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise”*. The provision is taken in the art. 23, first paragraph, (e) of the Income Tax Act[46], as well as by the articles 151, second paragraph, and 152 , second paragraph, with a specific reference to Company Income Tax subjects.

The art. 12, paragraph 16, of the OECD Commentary clearly qualifies the transfer of the full ownership of a good is to be intended as source of income according to the articles 7 and 13 of the OECD model.

Generally, business transactions produce business income, but if they have specific characteristics, which may include them in other income categories, these

[46] Presidential decree n. 917/86

hypothesis will be removed from the generic qualification of business profits, therefore in the scope of the art. 7 OECD.

This is the specific situation when the intangible asset is transferred with "something less" than the property of intangibles and therefore less than the totality of the related rights.

When only some of the rights are transferred to the licensee, whilst the licensor keeps the ownership of the goods, the transaction remuneration must be qualified as royalty.

2.1.1. THE DEFINITION OF KNOW HOW AND THE KNOW HOW CONTRACT

In order to understand the qualification used in the civil law, and, consequently, the fiscal regulation of the royalties, we have to mention the "know how" and the criteria that allow to decide whether a commercial operation can be considered to be a know how license or a provision of services.

With reference to the Italian Tax Authority circular n. 42 of 1981, the paragraph 11 of the OECD Commentary, defines the "know how" as "*undisclosed information of industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived*". The notion of "know how" is also further clarified in the Regulation n. 556/1989/CEE, that identifies its most important elements, that are: the secrecy; the concreteness (it includes notions useful to the licensee when the contract is pledged) and the fact that it is identifiable (it is sufficiently intelligible).

In the know how contract, one party undertakes the obligation to transfer its knowledge (not publicly known) to the other, so that such knowledge can be used by the counterpart on its own (par. 11 of the commentary to the art. 12). The granter is not directly in charge of the application of the know how transferred, and he's not guaranteeing that the utilization of the know how will be providing to the counterpart the expected result.

For this reason, it is possible to compare this contract with the “provision of consulting services”, that occurs when one of the parts commits himself to use his abilities to carry out a task for the counterpart[47].

The civil law regulation states that the object of the consulting contract is the solution to particular problems, fulfilled through the utilization of specialized notions owned by the provider; on the other hand the know how contract is based on a secret knowledge transfer, without any obligation for the provider. This formulation has been transposed by the treasury with the resolution n.128/E of September 24th, 2003, when it was ascertained that the “provision of services” contract can be included in the procurement contract, in which the service provider guarantees the result or, in general, puts his efforts in executing the service with the normal diligence. The know how contract assumes that the task has been already concluded and that it is owned by the one who gives the license.

The fiscal consequence of this is that in the first case (due to the role of the provider) the amount paid will constitute “business, or employment or different income”, and in the second case it will be considered as royalty.[48]

2.1.2. THE TECHNICAL DEFINITION OF SOFTWARE, THE CONTENT OF THE COPYRIGHT AND THE TAX TREATMENT

The royalties are, therefore, the remuneration for the exploitation of rights that is the very essence of the copyright on literary work to which, as explained in Chapter 1, the software and generally, all the digital goods are assimilated.

The definition of software provided in technical field is broader than the legal one. The software is technically described as “*a whole or a part of the programs, procedures and rules that are necessary for the operation of a data processing system, including in it all documentation about it*”.

However, we must specify that, in the resolution n. 169 of 1997 of Italian Tax Authorities, the fees paid for the purchase of software does not constitute royalties if the purchase is aimed at private or commercial use and is independent of any form of reproduction and distribution of the software itself. Therefore, incomes are qualified as business income.

[47] L. ZAGATO, *Il contratto comunitario di licenza di know how*, Padova, 1996

[48] R. MORO VISCONTI, *La valutazione economica del know how*, in *Il dir. Ind.*, III, 2012

Art. 64 *bis* of the copyright act, mentioned in Chapter 1, reproduces literally Art. 4 of EU directive n. 24/09. It includes a wide range of powers for the author, such as the right of reproduction of the work, the right of communication to the public and the right of distribution. This takes back to what explained before, with further specification of the difference between the right of communication, defined as "*making available to the public of works in a way that everybody can have access to the work from a place and at a time individually chosen by them*" and the right of distribution: the latter is consumed at the first use.

After having explained the contents of the transaction, it is important to analyse the conventional rules, which play a fundamental role for the definition and the limitation of the implementing area of royalties in a conventional environment.

Paragraph 8.2 of the commentary OECD provides that "*where a payment is in consideration for the transfer of the full ownership of an element of property referred to in the definition, the payment is not consideration for the use of, or the right to use that property and cannot therefore represents a royalty*".

As noted in paragraphs 15 and 16, the software can provoke some problems with reference to the income classification if the transfer of rights for economic exploitation is given in a partial alienation of the right (for example, because it is limited for certain period of time or in a specific geographic area).

The commentary established that it concerns business incomes instead of royalties because the copyright property, in part or in total, can be transferred and the fees cannot be linked to the use. Italy has however reserved its position, considering that the partial transfer of rights in word that falls under Art. 12 is subject to the royalties' regulation ("*the transfer of the ownership of an element referred to in the definition of royalties fall within the scope of this article where less than the full ownership is transferred*").

Italy was also doubtful concerning paragraph 10.1, on the subject of exclusive distribution, and on paragraph 14.1, concerning the software distribution, respectively *sub* paragraph 27.1 and 31.2[49].

Paragraph 10.1 of the Commentary classifies as business income the payment received to obtain exclusive rights for the distribution of products and services in

[49] M.GABELLI, *Note in merito alla distribuzione del softwere e all'obbligo di effettuare ritenute su royalties,* in *Fisc. Inter.*, V, 2008

a specific area. In this situation, payment is not the charge for use but for the right of distribution, exclusively granted. Paragraph 27.1 aims to take into account the cases in which the right of exclusive sale determines other rights included in the definition of royalties.

According to paragraph 14.4, the software distribution does not generate royalties if the contract includes the right of distribution of software copies supplied by the Software house. The distributor has only the necessary rights for the software distribution and no others, which the protection of copyright is guaranteed. Therefore, unlike the license agreement, the distribution implies that the copyright owner will use and take economical advantage of the intangible asset, instead the distributor is only trade intermediary given that he cannot reproduce or modify the program. In such transactions, distributors are paying only for the acquisition of software copies and not to exploit any right in the software copyrights. The price paid to the software house represents the business profit.[50]

Paragraph 31.2, specifies that Italy – *sic et simpliciter* - doesn’t accept this to be in any event applicable, but to be judged on a case-by case basis, according to the rights granted in the contract.

The complex evaluation of the object of the distribution agreement and the resulting tax qualification of the payment appears when considering the approach adopted by the Tax Revenue Agency in the resolution n. 128/E of April 3, 2008 and the criticism of the doctrine.

The case involves a French software house that concludes with a person resident in Italy a contract for the non-exclusive distribution of the software products in the State. The Italian distributor licenses on products and resells them to its clients - licensees of the software house with a contract between the latter, the distributor and the customer. The Italian distributor cannot make any modification or customization of software, it has not the right to copy computer programs and then to generate copies of the software to be placed on the market, it can only distribute subsequent updates of the program developed by the software house. In addition, the supply of the software house to the distributor is made on terms that

[50] M. GABELLI, op. cit.

match those of the contract signed by the customer: the configurations of licenses sold are symmetrical to those purchased.

The Tax Revenue Agency has qualified the compensation paid by the distributor as royalty, with reference to section 13.1 of the art. 12 commentary, according to which, in the absence of specific license marketing software, the distribution would result in a violation of copyright. Because of this, the Inland Revenue has provided that "*the contract is subject to, among other things, the partial transfer of copyright in the form of limited distribution of the computer program to the public*" and thus the amount for making available for use of the right takes the form of royalty.

From such resolution, ultimately emerges the qualification of the distribution contract in terms of transfer of a right partial. For this qualification the contract is considered a grant of right of use that product royalties.

Several lecturers[51] have contradicted the conclusion of the Agency and have said that, in this case, the copyright owner is the software company that leverages economically copyright as part of its business, achieving business income by distributor who acts as a mere intermediary. The distribution right, under the definition of art. 17 of Law 633/1941, has as its object "*the marketing or to put in circulation, or otherwise to be available to the public, by any means and in any form, of the original work or copies of it*", as mentioned, is consumed by the first sale of the protected product. We can not speak, therefore, of a partial assignment of rights or granting the use of the same; substantially the transaction takes place between the software company and the user, being the distributor a mere intermediary who merely receives a commission on the sale of goods that incorporate the intangible protected asset.

The Directive n. 96/9/EC introduced for databases the copyright protection, as the Directive n. 250/9/EEC had done for the software. Because we speak about the same type of protection, the conclusions that have been reached about the software are also extensible to databases.

However we have point out that the user of a database can perform the acts provided by art. 5 of the Directive (including reproduction) when they are

[51]M. GABELLI, *Note in merito alla distribuzione del softwere e all'obbligo di effettuazione delle ritenute su royalties,* op. cit., p. 409

"necessary for access to the content of the database and for the normal use of it." It is possible to conclude that the qualification of fees is different if the user pays for copying for consultation and the use of works in the database or if the fees are paid by the operator of the database to the authors.

While the first are classified as positive components of the business income of the beneficiary, the latter are among the royalties because the author licenses for use one of his rights, in this case "the right of communication to the public".

2.1.3. MIXED CONTRACTS. THE CIVIL AND THE TAX QUALIFICATION

It is also important to mention some examples which cannot be defined as a singular kind of contract.

These “mixed contracts” include different performances, such as the sale of a computer with a software installed on, such as the sale of a software with technical assistance services. The contract scheme considers the joint supply of different performances in nature and characteristics, bound by ties of functional interdependence. So, it is important to understand if the supply contract must be considered as a single contract or as a plurality of separate (but related) contracts.

The Court of Cassation in the judgement n. 2661, 22.3.1999, has identified the contract for the supply of complete IT system within the atypical and complex contracts, because composed of two different causes: the typical of the buying, selling, and that of procurement. The first one is the supply of the system, the second the technical assistance necessary for the purpose and to guarantee the proper functioning.

The definition of the contract as “atypical contract with mixed cause” needs to find its legal regulatory framework. The Court of Bari represented this problem in a decision according to which “*the case of a contract for the supply of hardware and software can be applicable on the negotiating pattern of the sale only for the part concerning the hardware supply, as this pattern cannot be applicable for the software*”.

It is necessary to make a distinction between the contracts for the transfer of rights for the program use and the contracts for the transfer of the rights for the program economical exploitation. The first contract type, named license agreement, concerned the transfer of the rights for use, not- exclusively, as the licensor gives the use of the program to a plurality of subjects, without transferring the property of the program. The second type is a sale which doesn't give the opportunity for a repeated use of the good by different users to whom the property has been transferred.

As to the rules applicable to mixed contracts, case law and doctrine[52] in some cases opt for the prevalence rule, in the others for the application of the legislation on each embedded contract. The judgement of the Court of Bari[53] decided for the separation criteria, according to which the economic classification of the remuneration must be distinguished in accordance to whether the right is transferred or given in use. It does comply with what explained in paragraph 17 of the commentary, art. 12, under which, for a correct taxation, it is necessary to make a difference regarding the grant in the part concerning the transfer of the goods or service and in that concerning to the use of the software.

It is also important to put in evidence that some lecturers[54] built up the nature of the contract for the supply of IT system in terms of negotiating connection according to which, while the mixed contract is in a single complex cause, on the other situation there are several independent causes connected. In this case, the separation criteria will find its application.

Another example of mixed contract, not explicitly regulated in the commentary, but common in practice, is the contract for the software creation work-for-hire. This contract is included in the category of the contracts of work disciplined by the art. 2222 c.c. when the charge is submitted to a person that develops "*with predominantly proper job and without tie of subordination*". When, instead, the charge is assumed by a commercial entrepreneur, as procurement contracts or supply contracts.[55]

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[52] M RICOLFI, *I contratti dell'informatica Profili civilistici, tributari e di bilancio*, in *AA.VV.*, a cura di G. Alpa- Z. Zenovich, Milano, 1998

[53] Trib. Bari, 4.6.1994

[54] M. BADIALI, *Il regime impositivo delle royalties nel diritto tributario internazionale*, in *Manuale di fiscalità internazionale*, 2008

[55] V.M. DE SANCTIS, *La protezione delle opere d'ingegno*, Milano, 2004

Generally, when the purpose of the contract is not to attribute to the buyer the faculty to economically exploit the rights to the software, but only that to allow him to use the good, the correspondent must refer to Art. 7 of OECD model.
Nevertheless, it will be necessary to refer to the specific content of every contract of such kind to identify the possible transfers of rights of distribution or reproduction. In these cases the payment will be a royalty.

2.2. THE TAXATION OF ROYALTIES

The definition of royalty is not explicitly mentioned by the Italian legislature; for its definition we must make reference to art. 12 of the OECD model, paragraph 2: "*The term "royalties" as used in this article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience*".
With reference to the distinction between "use" and "rights to use", it has been assumed[56] that such a difference can be related to the will to implement the disposition on royalties not only on the incomes arising from obligation of contractual nature (the right of use) but also by those arising by illicit use. As a consequence, its source stands in a no-contractual obligations (as in case of a judgement which orders to pay damages, including loss of profit caused by the non-authorized user), as confirmed by the paragraph 8 of the commentary to art. 12.
Under Italian tax rules, the only reference to the notion of royalty is contained in Income Tax Act, Art. 23, clause 2, letter c), where there is a precise mention of "*the income by use of copyright, industrial patent and trademarks and by process, formula and information about the understood experience in the industrial, commercial or scientific field*".
Only recently, Article 1, clause 1 letter b) of the legislative decree n. 143/05, through which the directive 2003/49/CE has been transposed, introduced in the

[56] M. PIAZZA, *Guida alla fiscalità internazionale,* Milano, 2004

internal law a clear definition of “royalty”, aligning it to the one commonly used in the European field.

However, starting from the 1992 OECD model, the royalty for the concession of commercial, industrial or scientific tools have been excluded from the application field of article 12, in order to be included in the “business income” definition and, in this sense, are under the specific regulation provided by the articles 5 and 7 of the OECD model while Italy has reserved to continue to observe the previous law and to consider them as royalties.

As for the tax treatment of the royalties, the art. 12 of the Model OECD provides for the taxation exclusively in the State of residence of the beneficiary. Contrarily, the greatest part of the conventions against the double impositions stipulated from Italy provide for the application of the national legislation and, therefore, the competing taxation in the State of the source.[57]

If the beneficiary is a resident in the territory of the State, the Income Tax Act provides that the royalties are included in three different incomes categories (income of enterprise, of self-employment or different incomes) according to the quality of the beneficiary. The quality of beneficiary is not relevant if he is not a resident in Italy.

If there is a convention between Italy and the contracting State, in which a subject resides with permanent establishment in Italy, the principle of the strength of attraction is applied "with limits". The royalty will be taxable only in Italy, as income of enterprise, if the right from which the income arise is indeed connected to such permanent establishment.[58]Nevertheless, in some cases, as in the conventions stipulated with Switzerland and Ireland, the principle of the absolute reserve of the permanent establishment is in force, for which the existence of a permanent establishment is enough to bring back the royalties, with the consequent taxation in the State of the source, without the further condition of the pertinence of the generating rights of the royalties in demand to the permanent establishment.

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[57] L. CARPENTIERI- R. LUPI- D. STEVANATO, *Il diritto tributario nei rapporti internazionale,* Milano, 2003

[58]C. GARBARINO, *voce Royalties, Dig. comm.*, IV, Torino, 2000, 818 ss.

As for a no-resident person without a permanent establishment, the art. 25 paragraph 4 of the Presidential Decree of September 29th 1973, n.600 provides for the 30% withholding tax of the taxable amount corresponding to the remuneration. The income is submitted to taxation in Italy for the only reason of being paid by the State, by resident subjects in the territory of the State or from permanent establishments in the same territory of subjects not residents, as expressly anticipated from the art.23 paragraphs 2 of Income Tax Act. Such rule of location of the income is founded, in reality, on a link of low consistence. The reference to the residence of those providing the income does not necessarily imply the existence in Italy of the source of the income in a proper sense, but "*rather, the location in Italy of the subject who handles the payment*"[59].

In every case, when more favourable tax rates are provided for by a conventions against the double impositions, such rates are applied.

According to Art. 169 of Income Tax Act, the conventional norms cannot produce tax facts not covered by the national law of the competing States; in the unlikely hypothesis that the conventional disposition is more serious than the domestic one, this last will be applied.

2.2.1. THE EU DIRECTIVE ON INTEREST AND ROYALTY PAYMENT

The adoption of the regime of ordinary taxation of the royalties paid to the not residents it is also subordinate to the lack of applicability of the most favourable conditions from the directive n. 2003/49/CEE that has found application in our legal system, following the emanation of the d.lgs. 30th May 2005 n. 143, through the introduction of the art. 26 *quater* in the Presidential Decree n. 600/73.

The directive has disciplined in an homogeneous way the applicable tax regime to the payment of the royalties (and interests) among the companies of the same group that are established in different States of the UE.

To avoid any phenomenon of double imposition in the EU framework on the "out-bound royalties", the EU has provided for the exempt from taxation of the royalties (and interests) in the State of the source if they are paid to a not resident company or to a permanent establishment, if some conditions subsist.

[59] R.CORDEIRO GUERRA, *I limiti territoriali alla definizione dei presupposti imponibili, Il diritto trib. dei rapp. intern.*, Milano 2003, pag 103

It is necessary that the payment is made by companies and institutions which are incorporated in one of the forms established by the Annex A, or by permanent establishments of a not resident company with the requisite of paragraph 4 letter of the same art. 26 *quater* and that such subjects reside in the territory of the State and are subjects to Company Income Tax, without the benefit of exemption.

It is required that the beneficiaries companies and the beneficiaries permanent establishments have the requisite established by the same paragraph 4. Therefore, they must reside for tax purposes in a Member State; they must have the aforementioned forms of the Annex A, and have to subdue to one of the anticipated tax of the Annex B without benefiting of regimes of exemption.

For the purposes of the application of the discipline in matter, it is necessary that, at least from one year, one company has a participation (right to vote) in the other, not inferior than 25 percent.

The paragraph 4 of Art. 26 *quater* introduces, to the letter c), the clause of the beneficial owner for which, as it results from Art. 1, paragraph 4 of the directive, beneficiary of the exemption can only be the society that receives the payment as final beneficiary and not an intermediary, agent, delegated or fiduciary and, in the case of the permanent establishment, those to which indeed the right that produces the royalties is connected.

Besides, the circular n. 47/E of 2005 of the Tax Revenue Agency gives appropriate explanations regarding the definition of "beneficial owner" of the payments of interests and royalties. In this context, the agency draws attention to the circumstance that the receiver of interests or royalties is the beneficiary of the paid income in an “economic sense”. In particular, it is specified that "*for a subject to be considered as the actual beneficiary as provided by the Directive, it is necessary that the company that receives the interests or royalties takes an economic benefit from the transaction put in place*". Therefore, "*the society has the qualification of real beneficiary if it has the ownership, as well as the availability of the perceived income*".

The Court's jurisprudence is poor on the issue, considering it mostly in an incidental way. The most meaningful pronunciation is the judgment of the Court of Cassation n. 4600 of 26 February 2009 in which the request is subjective coincidence between the perceiver and the beneficiary owner.

In a recent case[60], the Tax Court of Turin, with the purpose to specify the concept of actual beneficiary, has recalled the Commentary and a report published in 1986 by the OECD on the societies "conduit", such as "corporate vehicles "*constituted ad hoc to get undue fiscal advantages, through the interposition with third subjects which are the beneficiaries of the economic benefits connected to the exploitation of the rights*". The absence of the risk of the beneficial enterprise, as well as the lack of incurring expences of maintenance or technological updating, represent meaningful parameters to exclude the qualification of actual beneficiary.[61]

2.3. THE "PATENT BOX" REGIME

The law n. 190, art. 1 Sections 37-45 of the 23rd December, 2014 introduced an optional tax regime, the so-called patent box, which, together with the tax credits (reconfirmed by Article 1, paragraph 35), tries to put an end to an Italian problem, *i.e.* the cases in which royalties deriving from the right of user were diverted into low-tax jurisdictions.

So, the patent box regime encourages investments in research and development and the placement and maintenance of intangibles in Italy[62]. The option can be taken out by holders of business income who are resident in Italy, as well as by taxable persons - as far as the company income tax is concerned- resident in countries with which there is an agreement in order to avoid a double taxation and a real exchange of information.

Whenever these persons carry out research and development aimed at the production of intangibles (the research activity can also take place through research contracts with other companies or universities and equivalent bodies), they can exercise an irrevocable option that will last five years. The optional scheme excludes from the taxable base - Companies Income Tax and Regional

[60] Comm.Trib.Prov. di Torino, sent. 124 19.10. 2010

[61] F. ANTONACCHIO, *Royalties corrisposte a soggetti non residenti per lo sfruttamento di diritti di proprietà intellettuale*, in *Il Fisco*, XXVIII, 2011

[62] P. TRIPOLI, L. FERRARI, "*Patent box". Regime di tassazione agevolata di marchi e brevetti*, *PMI*, III, 2015, p.28

Business Tax- the income derived from the direct or indirect use of “intellectual, industrial patents, trademarks as equivalent to patents (the marks are considered equivalent to patents when their maintenance or development requCompany Income Tax incurring expenses for research and development), as well as processes, formulas and information relating to experience acquired in the industrial, commercial or scientific field (know-how) legally enforceable ", to the extent of 30% of the amount in 2015, 40% in 2016 and 50% in 2017 (Art. 5 of decree 3/2015 extended the facility even to the income from brands not functionally equivalent to patents, the "trademarks", as well as to the designs; in this way the benefit is provided in relation to all the intangible assets). Capital gains arising from the sale of intangibles are also excluded (in the same amount), if the revenues arisen from such sale are reinvested in research and development programs.

The exclusion from the taxation is not only for the royalties arising from the right to use by third but also for the economic contribute to product income if a society uses its own intangibles to product goods or to provide services. This economic contribute will be determined by Revenue Agency, through a ruling procedure pursuant to art. 8 d.l. 30/09/2003 n. 269.

Anyway, the paragraph 42 fixes the height amount of tax deduction for each assessment period. It is determined as the comparison between the costs of research and development incurred for maintenance or development of intangibles, and the production costs as a whole[63].

For further explanation, a decree by the Ministry of economic development and the Ministry of Economics and Finance will be issued. Anyway, according to the major doctrine[64], the patent box should be a permanent tax regime because it causes a lot of economic advantages, also as regards to attraction of foreign investments.

[63] C. BENIGNI, *Incentivi per lo sfruttamento dei brevetti: regime del patent box*, Prat. Fisc.e Prof., IV, 2015, p. 53

[64] P. TRIPOLI- L. FERRARI, op. cit.; G. SALVI, “*Patent box”: anche l’Italia adotta il nuovo istituto agevolativo*, in *Amm. E Fin*., II, 2015, p. 19

CHAPTER 3
INADEQUACY OF THE PRESENT TAX PROVISIONS TO REGULATE THE DIGITAL ECONOMY

3.1. THE PERMANENT ESTABLISHMENT

3.1.1. THE MATERIAL PERMANENT ESTABLISHMENT

The document "*Clarification on the application of the permanent establishment definition in e-commerce: changes to the commentary on article 5*" adopted by the Committee on Fiscal Affairs on December 22nd 2000 added to the Commentary of the OECD Model tax Convention ten paragraphs (from 42.1 to 42.10).

These paragraphs are meant to clarify in which cases operations through electronic commerce can constitute a permanent establishment in the State of the source of the income.

Such verification has been conducted with respect to the structural and personal elements typical of such activity: the web site, the server and, under the subjective profile, the internet content provider and the internet service provider.

According to the Commentary art. 5 OECD model (42.2), the web site is not configurable as a permanent establishment. Being a software, it doesn't have material consistence and therefore it doesn't have a location that can represent a "fixed place of business."

This solution seems to be welcomed by the Italian legislature which, in the illustrative listing contained in the 5 paragraph of the art. 162, doesn't mention the web site. This omission induces the doctrine[65] to believe that it is not a simple omission but an implementation of the OECD rules.

Instead, with reference to the server, the opinion is different.[66] The server has a material structure, typically a computer or a complex of electronic machinery and for this reason the location and the verification of the requisite of material and temporal stability is easier.

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[65] A.M. GAFFURI, *Il concetto di stabile organizzazione nella nuova Company Income Tax*, in *TributImpresa*, 2004

[66] V .FICARI, *Regime fiscal delle transazioni telematiche*, *Rass. Trib.*, 2003

The equipment of which the server is composed, in fact, is situated in a delimited physical place. If the permanence in that place lasts for a period enough to guarantee the stability to the activity carried out, the server can be qualified as fixed place. Therefore, is not important the natural non-transferability of the server and therefore the possibility to move it from a territory to another. The Commentary OECD at paragraph 42.4 provides the following: "*Computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1*".

It is therefore admitted the flexible concept of the requisite of fixity to be intended as the permanence on a certain territory for a period of time necessary to attain the specific productive aims of the head office.

In order to have a permanent establishment, in addition to the place of business and to the requisite of fixity, it's also necessary the carrying out of the business activity and that the activity is not among those qualified as merely auxiliary or preparatory by the paragraph 4 of the art. 5 of the model OECD.

On the first point, we must make *an assessment on a case-by-case basis*. A company, in fact, can operate in a foreign market through the setting of a server of which it holds the full availability (under full ownership or an another basis), otherwise through a space on a server, shared with other users, including a web hosting contract with an Internet service provider.[67]

Such contract is similar to a contract to make up work, because of which the ISP makes available to the content provider a space in the server and also guarantees a certain result in terms of efficiency of connections and technological updating.

Only the server that is set in the full availability of the content provider can configure permanent material establishment of the foreign company. On the other side, the contract of hosting doesn't attribute rights to manage but only the right to

[67] E. BELLI CONTARINI, *Contratto di web hosting e stabile organizzazione*, in *Riv. Dir. Trib.*, 2008

enter to a virtual space: therefore, it is not possible to talk about a permanent establishment of the foreign enterprise.

Under Italian law, the mere legal ownership of a server, as well as the full faculty of its use, does not determine, by itself, the existence of a permanent establishment. The Income Tax Act, at Art. 162, 5th paragraph, provides that "*it doesn't constitute by itself permanent establishment the availability on any terms of computer-implemented and relative auxiliary equipments that allow the collection and transmission of data and information finalized to the sale of goods and services*".

The law actually is not very clear. It is important to underline its connection with the 4th paragraph, where are listed the hypothesis in which, despite the existence of a fixed place of business, such place cannot be considered as a permanent establishment because the carried out activities have a preparatory and auxiliary character. It can be hypothesized that the legislator wanted to merely underline the preparatory or auxiliary character (as activities viewed as non-commercial), in relation with the sale of goods and services, of the collection and transmissions of data, even when it is operated by computer-implemented and auxiliary equipments (as a server).

Thus, it seems reasonable to consider, even thought the law does not specify, that such rules apply unless the company core business is exactly the collection and transmission of data. The same commentary OECD paragraph 42.8, clarifies that there could be a permanent establishment, if the above mentioned preparatory and auxiliary activities "*represent essential and meaningful part of the activity of the company in its complex, or when other essential functions of the company are carried on by computer equipment*".

The revenue agency, with the Resolution n. 119 of May 28th 2007, has analyzed the qualification of the server as permanent establishment. The controversial situation concerns a French company that provides in Italy a service of video games for personal computer on-line through the formulas of the subscription to a catalog of titles or the purchase of the game when it is downloaded on the personal computer.

The company supplies its service in Italy directly to the final user, operating with its trade mark and receiving the payment directly from the client, or through an Italian Internet Server Provider. The client, who access to the service through an account and through the "player...." (on licensing) downloads the video-games and manages them on the hard-disk, but he is not authorized to copy, modify, extract the font code, fill up, create derivative products from the software, neither erase from it, partially or completely, the identification of the owner name/s.

Besides, the game downloading is granted for free only to allow the single consumer the use of the game. For the service given through the Italian Internet Service Provider, the French Company has installed two servers on which are listed the games that can be downloaded. The server handling, to be intended as the configuration of the same and the installation of the applications destined to the client, is operated directly from France and it is in this country that the games are uploaded for the download.

According to the applicant, the payments paid to the company for the commercial activity in Italy are to be intended as business income and are therefore taxable in France as the company doesn't have a permanent establishment in Italy. Besides, the French company sustains that, according to what clarified in the commentary OECD, the incomes for the purchase of the rights of author limited to the user for the running of the program must be considered as business income and not royalties and therefore on the same ones any deduction at source should not be applied.

The Revenue agency retains that the French Company has in Italy a permanent establishment. For the purpose of the definition of the fixed establishment is necessary the complete and exclusive availability of the equipment for a period that can represent assumption of the fixity and the carrying out of activities considered as principal within the general company activity. There is not a permanent establishment when *"the activity (…) has preparatory or auxiliary character"*.[68] (Art. 162, paragraph 4).

According to this, it is considered not as a preparatory or auxiliary activity, but as a direct expression of the main activity, the use of remarkable equipment as

[68] The Income Tax Act, art. 162 paragraph.4 letter e)

instrumental goods that allow to commercialize the good-commodity of the firm. In the events that a not resident has the ownership and exclusive use of these equipments, that these equipments have been installed for an undefined period of time in Italy and that through them the not resident subject carries out his business activity, the guaranteed services to Italian clients must be considered as services rendered by a permanent established in Italy, and as such subdued to tax regulation in the territory of the State.

In conclusion, for what concerns the purchase of the copyrights limited to enable the user to the running of the program, it must be clarified that the price paid should be considered business income. In fact, accordingly as indicated in the Commentary OECD, if the software purchase is finalized to personal and commercial use, putting aside from any form of reproduction and marketing of the same software, then the price paid will considered as business income or self-employment income – according to the nature of the receiver – and not as royalty. Considered, therefore, that the clients of the French company don't purchase any right to the reproduction or marketing of the software, the income received by the consulting company will be considered, as specified in the resolution by last quoted, as business income.

3.1.2. THE PERSONAL PERMANENT ESTABLISHMENT

With regard to personal permanent establishment, it is worthwhile highlighting that the commissionaire agreement provided by Italian civil code differs from the common law agency arrangement: while the latter normally entails that the agent has the authority to sign contracts in the name of principal, in the former case the commissionaire enters into sales contracts in his own name, becoming formally party of the contract. According to the article 1731 of civil code, the commissionaire agreement is a mandate aiming at buying or selling goods in the name of the commissionaire and on behalf of the principal.

The commissionaire does not receive title to the goods, which directly transfers from the principal to the customer. According to the article 1734 of the civil code the principal may withdraw his instructions until the deal is concluded by the commissionaire. The commissionaire assumes the risk for the performance of the contract.

The illustrated commissionaire agreement may entail the qualification of the commissionaire as a dependent agent PE of the principal.

It is worth recalling that article 5, paragraphs 5 and 6 of the OECD Model Double Taxation Convention stipulates for such a dependent agent PE, provides as follows: "*where a person –other than an agent of an indipendent status-is acting on behalf o fan enterprise and has, and habitually exercises, in a contracting state an authority to conclude contracts in the name of enterprise, that enterprise shall be deemed to have a permanent establishment in that state in respect of any activities which that person undertakes for the enterprise*".

The following paragraph 6 states as following: an enterprise shall not be deemed to have a permanent establishment in a contracting state merely because it carries on business in that state through a broker, general commission agent or any other agent of an independent status, provide that such persons are acting in the ordinary course of their business.

Anyway, as a consequence of such provisions, an agent constitutes a p.e. if two requirements, one positive and one negative one, are met: the agent has and habitually exercises the authority to conclude contracts binding on the foreign enterprise relating to the proper business of the foreign enterprise; and the agent does not have an independent status or does not act in the ordinary course of his business, as provided in article 5, paragraph 6 of the OECD model.

As regards the first requirement, OECD commentary, privileging the "substance over form" principle, provides that "the binding effect on the principal" has to be interpreted giving relevance not just to the formal aspect of the contract concluded in the name of the enterprise, being the paragraph equally applicable " to an agent who concludes contracts which are binding on the enterprise even if these contracts are not actually in the name of the enterprise".

OECD commentary at Article 5, paragraph 6 lays down the "independency test" clarifies that the agent operating on behalf of a foreign enterprise can be deemed as an independent agent. It's necessary: 1) economic and legal independence; 2) the nature and extent of the obligations which the agent must submit, as well as the instructions given and the control exercised by the company; 3) business risk, which must lie on the agent and not on the enterprise[69].

The status of independence is a necessary but not sufficient to the existence of the permanent establishment. In fact, this could exist if the agent carries on its ordinary activities, unless the activity is not among those in preparatory or auxiliary character.

One element that is relevant to the assessment of the independence of the agent is the number of principals that the agent represents. The fact that the agent performs its activity entirely or for the most part in favor of a single principal may be an indication of economic dependence but this is not a decisive factor.

3.1.3. THE ITALIAN CASE LAW ABOUT PERMANENT ESTABLISHMENTS

In the light of these requirements, we should also consider Italian case law.

A judgment of the regional tax commission in Milan n. 125/02/2011 ruled that the commissionaire of a non-resident company does not constitute a permanent establishment in Italy if it can be demonstrated that the activity is carried out in their own name, without binding the foreign entity to customers of the commissionaire and if it is proved that the commissionaire assumes the entire risk of the business. The same conclusion was reached the French Conseil d'État in the Judgment n. 304 715 of 31th March 2010 on the "Zimmer" case.

"[…] *a commissionaire acts "in its own name" and does not create a direct contractual relationship between the principal (the taxpayer) and the third-party customers (the French clientele). In this respect, the Court referred to Art. 132-1 of the French Commercial Code which provides that "a commissionaire is someone who acts in his own name or under a business name but for the account of his princip*al". Stated otherwise, a commissionaire does not entail a direct representation, which is a prerequisite to constitute a permanent establishment for the principal. The Supreme Administrative Court then observed that an exception to this rule could only be made, and, therefore, a permanent establishment could be deemed to be present, if it could be substantiated (by way of either the terms of

[69] P. VALENTE- L. VINCIGUERRA, *Stabile organizzazione occulta e distributore, in Fiscalità Intern.,*2013

the contract or any other element of the inquiry) that the principal was de facto personally bound by the contracts concluded by the commissionaire".

After clarification of the requirements of a personal permanent establishment, it is also important analyze some elements of the digital economy, in order to know if they also can be considered as personal permanent establishment.

The OECD commentary expressly excludes that the Internet service provider is a p.p.e., because the latter cannot be considered as a dependent agent. It hasn't the authority to conclude contracts on behalf of such enterprises and, even if this happens, the fact to provide services against multiple clients qualifies it as an independent agent who acts in his ordinary business activities (42.10) whose object typically consists in supplying internet services to commercial or private users.

Maybe, it could be considered as a permanent establishment only if between the foreign company and the provider there is an exclusive relationship, and then the same provider qualifies as a dependent agent of the foreign entity. In this case, it will play an exclusive benefit of the provider[70], but this case is rare.

It is not classified as permanent establishment of the foreign enterprise nor the website managed by it, even in cases where it has a software able to conclude contracts without the necessary mediation of a third party. The website, in fact, could not be qualified as a dependent agent of content provider because it does not fall within the meaning of the person by the Article 3 of the OECD model (42.10).

In truth, the Italian legislation is silent on the matter, merely Art. 162 of Income Tax Act reproduces in the provisions of paragraphs 5-6 and, with some differences, paragraph7 of the article 5 of the OECD model.

In fact, the paragraph 9 of art. 162 states as follows: *"The fact that a non-resident enterprise with or without a permanent establishment in the territory of the state controls a resident enterprise, or is controlled by that, or both companies are controlled by a third party operating or not in business , is not only for itself enough for considering any of these companies a permanent establishment of the other. "* As the similar provision in the Model, its function is evidently to make clear that the control relationships within the groups do not change the criteria

[70] C. GARBARINI, *La disciplina fiscale del commercio elettronico: principi ispiratori, problematiche applicative e prospettive di sviluppo,* in *Dir. E Prat. Trib*., 2000

using for check if the permanent establishment there is or not; so the enterprises of the same group may well be seen as permanent establishments of other companies of the group but only when are fixed business locations instrumentally used as agents of the others.

Even after the very well-known Philip Morris case[71], the jurisprudence of the Italian Supreme Court on PE matters is still controversial and not always in line with settled international standards. The Italian Supreme Court ruled that an Italian company belonging to the Philip Morris group, devoted to the manufacturing and distribution of cigarette filters as its main business, was a PE of foreign companies belonging to the same group. Based on the fact that the Italian company participated in the negotiations and supervised the execution of the licensing agreement between other two company of the same group, and performed agency and promotional activities in relation to sales of Philip Morris products in 'duty-free' areas, the Supreme Court took the view that the Italian resident company constituted a multiple PE of the foreign companies in the group, since it was involved in the business activities of the same group without having any autonomy. We will focus our attention on one recent interesting judgment from the Italian Supreme Court on the notion of PE.

In the Boston Scientific International case[72], the Italian Tax Authorities had audited the Italian subsidiary of a Dutch parent company being part of the Boston Scientific group. On the basis of a commissionaire agreement concluded with the Dutch parent, the Italian subsidiary was active in the sale of medical products manufactured by other entities of the group. Coherently with the structure of commissionaire agreements, the consideration for the Italian subsidiary was represented by a commission fee, whose amount was determined pursuant to the clauses of the agreement. Based on the lack of independence of the subsidiary both from an economical and juridical standpoint, the Tax Authorities concluded that the subsidiary itself constituted a PE of the Dutch entity. Both the first and second instance judgments rejected the position of Tax Authorities and, based on the functions performed and the risks born by the Italian subsidiary, declared the tax assessment served with the latter void. The Supreme Court upheld the second

[71] Italian Supreme Court, judgment n. 7862 of May 25, 2002
[72] Italian Supreme Court, judgment n. 3769 of March 9, 2012

instance judgment, confirming that the position of the Tax Authorities could not be accepted.

It seems nonetheless possible to highlight some crucial points relevant for the qualification of a subsidiary acting as a commissionaire pursuant to a commissionaire agreement as a PE of the principal. A first element on which the second instance judgment – with an analysis confirmed by the Supreme Court – bases conclusion that the Italian subsidiary does not constitute a PE of the Dutch principal regards the circumstance that the Italian subsidiary acted in its own name and not in the name of the Dutch parent. Rejecting the argument of the Tax Authorities – who supported that the conclusion of the second instance judgment was incorrectly based upon the formal criterion of lack of representative powers – the Supreme Court clarified that the conclusion of the second instance judgment was correctly based on a careful analysis of substantial elements, having the judges ascertained that the contracts concluded by the Italian subsidiary did not have a binding effect on the Dutch parent company[73].

This position is coherent with the OECD approach: even if according to certain interpretations of Article 5, paragraphs 5 and 6 OECD Model the mere lack of representative power could as such be sufficient to determine the exclusion of the commissionaire from the area of the dependent agent and, as a consequence, from the notion of dependent agent PE, as said OECD Commentary takes a different position, disregarding the formal aspects related to the conclusion of the contract in name of the enterprise, and attributing relevance to the actual conduct of the agent carrying on his activity. Even if the factual scenario underlying the judgment is not completely clear, it seems likely that the Italian subsidiary, being part of a larger and widespread multinational group, carried on its activity following a set of guidelines but the sole existence of such guidelines should not imply the qualification of the commissionaire as a PE of the principal.

The Supreme Court bases its conclusion regarding the Italian subsidiary on a careful analysis of the independence degree of the company from its Dutch principal[74]. As said, according to a certain interpretation of Article 5, paragraph 6

[73] A. PERSIANI, *Some remarks on the notion of permanent establishment in the recent Italian Supreme Court Jurisprudence*, in *Intertax*, XL, 2012

[74] A. PERSIANI, *op. cit.*

of OECD Model an agent, even if formally lacking the authority to conclude contracts, can be qualified as a PE of his principal where he is a not an independent agent or he acts outside of the ordinary course of his own business. The independent character should be ascertained having regard not only to the contract clauses, but also to the factual conduct of the agent. Apart from the guidelines that are so detailed and so comprehensive to influence the day-by-day activity carried on by the agent, the key criterion for the independency test should be identified in the correspondence between risks assumed and reward received by the commissionaire. In order to meet the independency test, the commissionaire should at least bear those risks which are closely linked to his selling activity, such as the market demand risk and to some extent the bad-debt risk. Another element which is correctly highlighted both in the second instance and the Supreme Court judgments regards the 'ordinary course of business' requirement. According to the Tax Authorities, the Italian subsidiary of the Boston Scientific group carried on activities which were exceeding the typical business of a commissionaire, while the judgment highlights that activities are by no means exceeding the ordinary business of a commissionaire.[75]

3.2. INDIRECT TAXES: THE TAXATION OF THE E-BOOKS UNDER VAT RULES

The application of the digital technologies, in different sectors of the cultural enterprise, brought to a kind of emancipation, of the work and the materials protected by the copyright from the physical supports that in the traditional analogical world necessarily incorporated them. It has made possible the realization, the transfer and the access through the Internet of identical copies and stackable to the original one.

We moved from a system for the use of the works and the materials protected by the copyright typically relates to the ownership, to the possession or also to the legitimate detention of the "corpus mechanicum" that incorporates the work to a system in which the rights on the analogical supports, necessary to the use of the content, have been replaced by the acquisition of the power of access to Internet.

[75] A. PERSIANI, *op. cit.*

In this big context of technological and cultural evolution, comes the e-book case. The name e-book points out the electronic and digitalized form in which a copyright is represented; there is a book resulting from downloading from a web site.

The e-books have been spreading in Italy from 2010, when, after the development of the production and the marketing of the e-reader, tied up to the evolution of the technology of e-ink; also the Italian publishing houses have begun to digitalize its own catalogues and to distribute e-book also in Italian language.

The case of the "electronic book industry" it is the more impressive case on which we could talk about a potential fiscal discrimination caused by the internet use. In fact, while for the printed format books the European law foresees the application of favoured rate - in Italy the percentage is of 4% - the VAT rate on e-book is the ordinary one (22%).

The reasons of this difference is based on the structural elements. It is necessary to consider, in fact, as mentioned in the first chapter, that the sale of paper book is an assignation while the sale of an e-book is classified as a supply of services.

This is expressly confirmed, as indicated by the circular 23/E of the Revenue, by the EU Regulation n. 282/2011 of 15th March 2011 laying down detailed rules for the implementation of the VAT Directive. The regulation, in Annex I, provides a listing of example of the operations classified as services supplies by electronic media, mentioning the "digitized content of books and other electronic publications".

The qualification as services supplies determines different treatment in relation to the applicable rates because the Art. 98 of the VAT Directive, paragraph 2, explicitly excludes the application of reduced rates to services supplied electronically, providing further that reduced rates apply only to transactions of the categories listed in Annex III.

As of June 1, 2009, Annex III, Section 6, of the VAT Directive has been reformulated so to the "supply of books", which is one of the transactions subject to a reduced rate, was added the specification "on any type of physical support".

This change has led some states to regulatory action that, subject to the judgment of the Court of Justice, were deemed contrary to Community law, in particular to Directive 2006/112 / EC.

We mention, in particular, the judgments of the Court of Justice C-479/13 and C-502/13 in which the Court has recently ruled in order to actions brought by the Commission, after the opening of infringement procedures, respectively, against the French Republic and the Grand Duchy of Luxembourg that beginning from January 1st, 2012 apply a reduced rate on books distributed in digital format.

The Court of Justice has argued in these terms. While the e-book needs a physical support to be read, such support is not yet included in the supply of the electronic book, for which the provision of these books cannot be included among the cases referred to in Annex III.

Finally, the Court provides that the inapplicability of the reduced rate is not contrary to the principle of neutrality which is the translation, in the field of VAT, of the general principle of equal treatment. On the subject, paragraph 25 of the judgment of the Court of Justice of the European Union, in Case C-219/13 of 11 September 2014 states that *"to determine whether goods or services are similar, account must be taken primarily of the point of view of a typical consumer. Goods or services are similar where they have similar characteristics and meet the same needs from the point of view of consumers, the test being whether their use is comparable, and where the differences between them do not have a significant influence on the decision of the average consumer to use one or the other of those goods or services"*.

The position of the Court of Justice about the rate applicable to e-books has raised a number of criticisms by the operators in this sector who ask a revision of the legislation with the purpose to make it less anachronistic.

The Article. 1, paragraph 667 of the "stability law" in 2015, through a rule of authentic interpretation of paragraph 18 of the attached Table A, Part II, the d.p.r. 633/1972, ordered the reduction of VAT for "*all publications identified by ISBN and transmitted through any physical support or by electronic communication*".

The ratio of the rule, as proposed, is the idea to implement not only those constitutional principles, aimed at the protection and promotion of education and culture, but also to encourage the purchase and distribution of texts transmitted through any media.

However, there are reasonable risks that Italy is called to change her provisions, moreover if we consider that, as the Court observed for Luxembourg, the censorship would be double. The Court recalled that, according to the VAT Directive, a Member State may apply reduced VAT rates below 5%, provided that the reduced rates are conformed to the EU legislation. As the Court concluded that the application of a reduced VAT rate to the supply of electronic books does not comply with the VAT Directive, the condition of compliance with EU legislation is not satisfied, so that Italy, like Luxembourg, could not apply a "super-reduced" VAT rate to the supply of electronic books.

CHAPTER 4
TAXATION OF DIGITAL ECONOMY IN ITALY: RECENT LAW CHANGES AND NEW PROPOSALS

4.1. THE GENERAL ANTI-AVOIDANCE PRINCIPLE AND THE ACTION 1 OF THE OECD REPORT ON BASE EROSION AND PROFIT SHIFTING

The electronic commerce has a peculiarity: it allows the execution of transactions regardless of the material elements - the asset sold and, sometimes, also the business seat - that, in traditional forms of commerce, are useful to individuate the connection between the transaction and a certain territory.

In this respect, it is important to point out all domestic and international measures to counteract the tax erosion, evasion and abuse in the field of digital economy.

With reference to international measures, in October 2013, the European Commission has appointed a group of experts on the taxation of the digital economy to propose new rules or, in any case, to adapt the preexisting rules concerning the location of income based on the physical presence to companies that act in the e-commerce field. It is clear that international taxation rules and principles, such as national ones, are referred to an economic environment characterized by a low level of cross-border economic integration, so, they are not suitable for situations involving global taxpayers.

The interaction between the different tax systems can entail a double taxation but also gaps that offer the opportunity for taxpayers to eliminate or reduce the level of taxation on income.

Trough gaps and information asymmetries, companies, especially multinational ones, evade almost totally different tax systems, shifting profits in low-tax countries.

An international action plan has been developed in order to face these practices: it has been coordinated and shared by several countries, including the OECD countries (the declaration of the project BEPS, presented on 30th May, 2013 during the OECD Ministerial Council Meeting, with the participation of 40 countries).

The first action highlights the need to identify a proper fiscal discipline for the digital economy, characterized by a growing dichotomy between the place where the sale of goods and services shall be carried out and the place of the income taxation. In fact, when a company earns profits by an online transaction with customers located in a State different from its tax residence State, there is an inadequate allocation of taxing rights, due to the lack of rules that lead this right to the jurisdiction of the State in which the business is carried on.

With reference to domestic measures, Italy has taken note of this international plan and issued the delegating law n. 23 of 11th March, 2014 "*for the creation of a fair, clear and growth-oriented tax system*".

For our purposes, Articles 5 and 9 of such law are particularly relevant.

Article 5 provides that "*the Government is delegated to implement, with the legislative decrees referred to in Article 1, the review of the existing anti-avoidance provisions in order to unify the general prohibition of abuse of rights*" through the application of a series of principles, including the one reported in subparagraph a), *i.e.* to "*define the abusive conduct such as misuse of adequate legal instruments to achieve a tax saving even if this conduct is not in conflict with any specific provision*". The principles and criteria must also be coordinated with the ones provided for in the European Commission recommendation on aggressive tax planning n. 2012/772 / EU of 6 December 2012.

Article 9 of the delegating law, in the first part, provides that "*the Government is delegated to introduce, with the legislative decrees of the Article 1, the rules for the strengthening of controls, according to the following principles and criteria: a) strengthen the controls of the financial administration through the correct and complete use of the data stored in the databases and providing, whenever it is possible, synergies with other public, national, European and international authorities, in order to improve the effectiveness of controls and act against fraud, abuse, money transfer and property transfer, the phenomena of faking tax bases through a distorted use of transfer pricing and fictitious relocation of enterprises, as well as the case of tax avoidance*". Article 9, to the letter i) of the same paragraph 1, lays down that the decrees should "*provide for the introduction, in line with the recommendations of international organizations and with any* *decisions at European level, taking into account the international experience, the taxation systems of the transnational activities, including those relating to advertising, based on appropriate mechanisms to estimate the shares of assets attributable to national fiscal sovereignty*".

We touch on a scheme of the legislative decree, which should be adopted in implementation of the criteria set out in the law n. 23 of 11th March 2014. This scheme provides for the repeal of the Article 37b of the Decree 600/73; such provision is the special anti-abuse rule, which consists of a series of exhaustive cases about abuse of rights, and states a substantial coincidence between this concept and the tax avoidance.

Anyway, apart from the provisions, in Italy a general anti-abuse principle exsists and it was pointed out by the Supreme Court.[76] In 2008, the United Chambers of the Supreme Court, in two cases, called the "twin cases" because they bear the same statement of reason, pronounced themselves on the existence of a general anti-avoidance principle[77]; they underlined that the source of this principle, about non-harmonized taxes, such as direct taxes, should be found not in the EU law but in the same constitutional principles that inform the Italian tax system. In fact, the principles of the ability to pay (art. 53, first paragraph of the Constitution) and of the progressivity of taxation (art. 53, second paragraph of the Constitution) constitute the foundation of Italian the tax rules and give the taxpayers any kind of fair benefits. As a result, directly according to Constitution, the taxpayer cannot draw undue tax advantages from the distorted use of legal instruments to obtain a tax saving, although it does not breach any specific provision, in absence of

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[76] According to the Court of Cassation, the practice of abuse of residence belongs to "abuse of rights" and its prohibition rises to a general principle in the European tax law. Even the court of Justice of the European Union interfered in the localization of the foreign tax residence of a legal person with the decision " Cadbury Schweppes" of 12th September, 2006 (C-196/04), which, with reference to the freedom of establishment provided for by the Treaty, stated that the "*fact that a company was established in a Member State to benefit from more favorable legislation does not constitute an abuse of that freedom. However, a national measure to restrict freedom of establishment may be justified when wholly artificial arrangements are designed to circumvent the legislation of the Member State concerned*".
The Supreme Court in the judgment n.2869 of 7th February 2013 underlines that the purpose of configuring an "*abuse of the right of establishment*" is necessary to establish if the operation carried out is "*purely artificial*", since it refers to a "*legal form that does not play a relevant and genuine economic reality*".

[77] Cass., 23th December 2008, n. 30055-30057

economically significant reasons that justify the operation, other than the mere expectation of the tax saving.

In any case, pending the effective enactment of the decrees, Italy has tried (and is still trying) to introduce some specific measures intended to face the practice of transferring income produced in Italy in low-tax jurisdictions by “digital” multinational enterprises.

4.2. THE “WEB TAX”

It is important to mention the law 147 of December 27, 2013 that introduced what was called (by the press) "*web tax*", applicable to B2B online advertising services, a mere ancillary activity that does not generate taxable income in Italy. Article 1, paragraph 33, of the law provided for the introduction, in the presidential decree 633/1972, of the article 17 b which explicitly imposed an obligation on buyers of advertising services online and, indirectly, on the non-resident providers. It provided for duty, for Italian resident customers, to purchase advertising services online (including online advertising and sponsored links that appear on Italian web pages of the search engines) only by providers who were registered in Italy at VAT aims, *i.e.* having a VAT registration number; such purchases could be made only through payments full traceable. These measures aimed to identify the company and to monitor his activities in the Italian marketplace. So, the rule ordered to non-residents (who wanted to provide such services in Italy) to open an Italian VAT that, in the absence of a permanent establishment, can be opened through the appointment of a tax representative or through direct identification, respectively governed by Articles 17 and 35b of Presidential Decree 633/72.

Article 1, paragraph 177 also provided for a novelty about digital enterprises and transfer pricing methods; pursuant to such rule, resident companies that provide on-line advertising services "*are required to use indicators of profit different from those applicable to costs incurred carrying on their business*", introducing, therefore, a limitation on the use of the transfer pricing methods.

Apart from the fact that such duties are not specifically sanctioned, the web-tax has caused perplexity on the basis of fundamental freedoms concerning the Freedom of Establishment and Freedom to Provide Services, as well as under EU

VAT laws (Dir. 2006/112/EC)[78]; because of several doubts regarding the (un)compatibility with the EU laws, its entry into force was first delayed and subsequently, by Decree Law 16 of 2014, the provision has been deleted. It was said that only a regulatory action at EU level could introduce such a rule.
Anyway, recently, as aforementioned, a (eventual) solution has been entrusted to Article 9 of law 11/03/2014 n. 23 (mentioned in the previous paragraph).

4.3. THE OPINION AND THE PROPOSALS OF ITALIAN LECTURERS. THE SPEECH OF PROF. FRANCO GALLO AT THE CAMBER OF DEPUTIES

The web tax has been a failure and the Italian parliament is looking for facing with two matters:

a) introducing a new tax, as a bit tax, on a totally new kind of ability to pay arisen in the new digitalized environment (which has no direct connections with the base erosion of multinational enterprises);
b) finding out new ways to identify the no-resident digital companies that carry on their activities in the Italian marketplace, in order to protect Italian taxing rights.

In February 2015, in a speech at the Chamber of Deputies, Professor Franco Gallo, an Italian tax law expert, expressed his opinion and his suggestions about these issues.[79]

With reference to the first matter, Professor Gallo confirmed his favorable opinion in relation to the introduction of a bit tax, first theorized by Arthur Cordell in the mid-90s. In virtue of the materialization of the digital industry, a new method of taxation has been developed: it is based on an index of "ability to pay" different from the traditional one. This index is identified in the transmission of digital information and is quantified in relation to the transmitted bits. So, taxpayers are those who own a computer and share information in the network. According to Cordell, the rate of tax should be of 0.000001 cents / $ for bit. Italy seems to agree with a tax which should be applied to the use of a broadband width of websites based on the number of bytes used, with reference to a progressive scale with different rates according to the company size and its turnover. Such a

[78] A. TOMASSINI - G. IASELLI, *"Web tax in cerca d'autore"*, in *Cor. Trib.*, IV, 2014
[79] www.camera.it

tax, appreciated by the prevailing doctrine, has been subjected to criticism because of the unsuitability of the taxable income to express an effective contribution, in contrast to art. 53 of the Constitution and to the difficulties occurred during the verification in phase[80].

With reference to the second matter, the dematerialization of the digital industry doesn't bring out a taxable income in the territory in which the company carries out its activity, so, it is difficult to identify taxation forms according to parameters different from the income production through a permanent establishment. Within the national framework, Professor Gallo proposes the application of a tax similar to the British Diverted Profit Tax, introduced in the UK in April 2015. It is the only tax adopted in application of the EU Commission Recommendation (2012) n. 8806, based on the aggressive tax planning in the field of direct taxation, which suggests the application of a general anti-abuse clause and the review of agreements that favor the double deduction or exemption. The tax should be applied in two cases. The first implies a non-resident company that makes significant operations in the State, providing goods and services for the benefit of users residing there but avoiding the creation of a permanent establishment. The tax authorities should therefore verify that this activity takes place and that it avoids the application of the rules on the income produced through a permanent establishment. The second hypothesis involves a resident company and a non-resident one, that pursues an activity that should be subjected to tax in the State, enjoys tax advantages thanks to agreements or to a third person without commodity. The situation that justifies the application of DPT on the stateless income and, therefore, the application of the penalizing rate of 25%, is the bypassing of the rules on permanent establishment pursued through technical, procedures and legal transactions. The tax authorities should perform a difficult task in order to establish the tax base: they will assess the profits diverted in tax havens, on the base that such profits should have been taxed in the State if a permanent establishment had been declared. It is possible to overcome this difficulty because of the small number of digital firms operating in Italy.

[80] A. URICCHIO, *Evoluzione tecnologica e imposizione: la cosiddetta "bit tax". Prospettive di riforma della fiscalità di Internet*, in *Dir. Inf.*, 2005

Professor Gallo points out that such a charge guarantees the right of the State to protect its tax.

4.4. THE NEW VAT RULES FOR TELECOMMUNICATIONS, BROADCASTING AND ELECTRONIC SERVICES. THE MINI ONE STOP SHOP

Finally, with relation to indirect tax, it is important to mention a European measure to solve a common practice. In fact, for saving tax, the taxable subject was useful to settle in the member states where there were low tax rates.

The decree 18/2010 has implemented in Italy the directive 2008/8/EC that has changed the directive 2006/112/EC, providing for the rules that define the common system of VAT.

Article 5 of directive 2008/8/EC has entered into force on the first January 2015. This article concerns the changes to the VAT place of supply rules with reference to telecommunication services, television and radio broadcasting services and electronical services supplied to a consumer.

According to previous legislation, in such cases VAT was applied in the member state where the supplier was established. To solve the aforementioned negative situation, Article 5 modified the territorial criteria of taxation and established that the VAT rules in force in the State of the consumer have to be applied. So, the VAT revenue is allocated to the State where customers are.

The same directive has established that this special regime will be applied not only to electronic services supplied by an extra-EU business, as it was until now (pursuant to the directive 2002/38/EC), but also to telecommunication services. Furthermore, the directive provides for a new web portal, the MOSS (Mini One Stop Shop). The mini One Stop Shop scheme is optional and, in case the operator opts for it, such regime is binding for three years. However, in choosing to use the MOSS, the taxable person must apply the scheme in all relevant Member States. It is not an optional scheme on an individual Member State basis.

A taxable person who opts for the MOSS is required to register in the Member State of identification to declare and pay VAT. This Member State will be the

Member State in which the taxable person has established its business. If a taxable person has not established its business in the EU, the State of establishment will be the Member State in which it has a permanent establishment. If the taxable person has more than one permanent establishments in the EU, he is entitled to choose one of those Member States as Member State of identification. For the non-Union scheme, the taxable person (who has neither a business establishment, nor a fixed establishment, nor is registered or otherwise obliged to register, in the EU) can choose any Member State to be the Member State of identification.

It is clear that MOSS is a facilitation measure because it allows business to do only one vat declaration and to pay the VAT at one time, applying different rates (and ruled), depending on the consumer States.

Italy has implemented such regime and the tax administration has introduced on July 29th an explanatory circular, the CM 37/E/2011, regarding the territoriality of tax services. In light of Reg. 282/2011, the revenue Agency in this circular explains the EU taxation criteria for the B2B (business to business) or B2C (business to consumer) transaction introduced under Decree 18/2010 .

Moreover, to facilitate the implementation of the new regime, the Regulation (UE) n. 967/2012 of October 9 th 2012 of the Council of the European Union, having obligatory character and directly applicable in every of States members, sets detailed rules applicable beginning from January 1st 2015. The Revenue Agency with the provision of September 30th 2014, implementing the provisions of Regulation No. 967/2012, defines the operational procedures to allow the submission of the application registration, exclusively in electronic and direct way, for the accession to these special regimes.

4.5. THE “FAIR COMPENSATION”

Among the patrimonial measures other than tax ones, it is important to underline that the legislative decree of 9 April 2003 (the so-called Bondi decree by the name of the proposer minister), named "*implementation of Directive 2001/29 / EC on the harmonization of certain aspects of copyright and related rights in the information society*" has implemented the principles of law of 5 February 1992 n. 93, which has institutionalized in Italy the so-called "private copy" for the first time. The“ Bondi decree” has provided for a more complete regulation. It modified the law of 22 April 1941, n. 633, with reference to the remuneration for private copying for personal use of sound recordings and video recordings.

Directive 2001/29/EC provides that the general rule, according to which it is recognized to the "*authors the exclusive right to authorize or ban the direct or indirect, temporary or permanent copy, in any manner or form, in whole or in part, of their works*", is countered by the exceptions provided for the directive. The Member States can introduce these exceptions as limitations to the rights of the author.

One of these exceptions relates to the exclusive right of the author on his work in the case of recordings made by any private for a strictly personal purpose, that is without any direct or indirect commercial aims. The condition to permit this exception, which is called "private copying", is that the author of the work receives a fair compensation.

Only under the conditions mentioned, i.e. if the copy is made for personal use only, starting from the source of which the subject is in legitimate possession and that for it has paid a fair compensation, individuals are authorized to the reproductions of sounds and videos without the prior consent (license) of authors, artists and producers. The otherwise constitutes an infringement of the exclusive right of reproduction due to the subjects mentioned in last and is therefore punishable by law.

The compensation for private copying is due by the manufacturers or importers in the State recording equipment and blank media suitable for the sound recordings and video recordings (CDs and DVDs, as well as USB keys, tablets and smartphones). In the case that the manufacturer and the importer does not pay the fee due, the law provides a several liability for the payment by the distributor of equipment and media.

The article 71-*octies* of the law on copyright that has been introduced, as anticipated, by the “Bondi decree”, entrusted to the aforementioned SIAE the task of collecting the compensation for private copying and distribution among beneficiaries considered by the same law. To carry out this task, the SIAE has the supervisory powers on activities related to the manufacture, import and distribution of equipment and media.

The compensation is determined, in most cases, based on the capacity of each media. A Court of Justice judgment has stated that the compensation cannot be determined taking into account the illegal copy activities. The measure of compensation has recently been updated by a decree of MIBAC June 20, 2014.
With judgment n. 823 of 2015, the Supreme Administration Court issued an opinion on the appeals against several judgments of the TAR of Lazio in 2012 by manufacturers, importers and distributors against the "Bondi decree". The court rejected the appeals, stating that fair compensation is legitimate, and postponed the examination of the Court of Justice of the solution of certain issues of interpretation. First, in the case of devices and media used for clearly different purposes than the private ones, the Court must consider whether the domestic regulation that commit the determination of the exemption criteria to the private negotiation is contrary to the Community law.
Likewise, the Court of Justice will be called upon to assess the compatibility of national legislation with Community law, if the first does not provide that the right to a refund (paid in order to devices whose use is unrelated to private copying) can be requested from the manufacturer rather than only to the user.
It is important to refer to the judgment of the European Court of Justice of 5th March 2015 (Case C-463/2012), which seems to confirm the legitimacy of private copy for as regulated in Italy. The Court, first, reiterates the logic of the system of private copying: the reproductions of a work without prior authorization to the author get him an inevitable injury. This is why compensation is up to the owner of the work.
Again, according to the Court it is not required to consider if the individuals truly realize private copies. It is legitimate to assume that the subject who has the availability of equipment for the copy equipment will exploit sooner or later the availability.
It is also for this reason that it is irrelevant if the support is for only one use or for multifunctional use, because it is the simple ability to make copies that justifies the application of the compensation for private copying. And this is a benefit to the private individual who would otherwise, every single time, request a new authorization.

It must be considered that there is an exception; only the devices that are currently reserved for a manifestly different use than the private one (so-called "professional use ") are deserving of exemption.
The Court of Justice also makes the rule clear, with reference to operators (such as is the case of importers or distributors or resellers) who buy equipment for professional activity or playback devices and then sell them on the market without knowing what will be their end use (whether professional or private). It is right that the regulatory system allows the private copying exemption if the operators can demonstrate that they have supplied the devices to others than individuals and therefore from the final users and for purposes clearly unrelated to private copying. And it is also right that the regulatory system provides for a right to give back the payment of private copying (always and only in the case of professional use) that is not difficult to realize.
The nature of such fair compensation is controversial.
The Administrative Court of Lazio, in judgment no. 2159 of 2/3/2012, has statued that the payment of fair compensation for private copying, although having a clear mutually binding and indemnity function (at least potentially) for the use of works protected by copyright, is included into the category of economic duties imposed by law under Article 23 of the Constitution. Its provision, such as the determination of its amount, is imposed in an authoritative way and there is no possibility for the parties to avoid payment. Therefore it would be a fee.
SIAE continues to argue that it cannot be considered as a tax, meaning precisely a payment for the provision of public and divisible services supplied by a public entity, but rather as a compensatory measure of private law, paid to the author for using his creative work.

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Tax incentives and base erosion and profit shifting

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INTRODUCTION

The OECD's "Action Plan on Base Erosion and Profit Shifting"[1] has remarked the necessity of providing modifications to domestic tax regimes in order to reduce profit shifting. Action 1, in particular, focuses on the challenges arising within the digital economy, which may hinder the capability of tax provisions to deal with the specificities of e-commerce.

E-commerce primarily impacts on companies behavior, allowing them to extend their operating network and easing their connection with foreign markets. The role of tax incentives is therefore improved, since they may represent a key element in companies' choices (e.g. those related to the place of residence).

As a consequence, the ability of a State to deal with tax incentives, i.e. by attracting foreign investments and by reducing the advantages related to foreign tax regimes, is crucial to avoid profit shifting.

CHAPTER 1 – TAXATION OF COMPANIES AND DIGITAL ECONOMY CHALLENGES

1.1 Taxation of companies

The identification of the tax regime applicable to companies requires a preliminary distinction between corporations ("società di capitali") and partnerships ("società di persone"):

- "Partnerships" are firms which lack of legal personality and limited liability. In regard of these entities the so-called "transparency principle" applies: therefore, the partnership's income is not directly taxed on the company, but on its partners (proportionally to their share-holding in the partnership).
- "Corporations" are firms characterized by legal personality and limited liability; the related income is subject to the corporate income tax ("IRES").

Following paragraphs will provide a general overview about the Italian corporate income tax system, which is included in decree 917/1986 (Income Consolidated

[1] The Action Plan on BEPS is available at http://www.oecd.org/ctp/BEPSActionPlan.pdf

Tax Act - hereinafter: ICTA): however, it is firstly necessary to distinguish between “resident” and “non-resident” corporations. According to Article 73(3) of ICTA, a certain company is qualified as “resident” if, for more than a half of the tax period, it had its legal headquarters, place of effective management or main business purpose in Italy.

Income earned by resident corporations is subject to the so-called “IRES”: the principle of “worldwide taxation” applies, so that all the income (wherever derived) legally attributable to such entities contributes to calculate the tax base.

IRES also applies to the income generated in Italy by non-resident companies, whether they are corporations or partnerships (principle of “territorial taxation”).

Our analysis will first focus on the tax regime of resident corporations, and will then move on to discuss the tax system of non-resident corporations.

1.1.1 Resident corporations

IRES provides taxation of the global income generated by resident corporations, with a tax rate of 27,5%. However, corporations may choose to apply the transparency principle instead of the ordinary regime, so that the corporation taxable income would be directly attributed to each shareholder, proportionally to the share held in the company.

Within the context of IRES ordinary regime, the source of income has no relevance to find out which tax regime is applicable[2]: all the income received by a certain resident corporation is indeed qualified as “corporate income”, and therefore taxed according to Art. 83 ff. of ICTA.

In order to calculate the relevant (i.e. taxable) income, some fundamental principles have to be considered:

- Income is taxed on a net basis;
- According to Article 83 of ICTA it is necessary, first, to take into consideration the results of the “profit & loss account” (P&L, which is one of the financial statements corporations are yearly asked to draw up):

[2] According to Article 6 of ICTA, the income earned by a certain person may be referable, alternatively, to one of the following categories: investment income, real property income, corporate income, compensation of employees, income from self-employment, other income. Depending on the category, specific rules will apply in order to calculate the tax basis.

IRES is charged, in other terms, on the total net income there reported (adjusted according to the following provisions of ICTA);

- Art. 109 of ICTA requires the application of the accrual method of accounting: therefore, positive and negative components contribute to generate the taxable income of a certain tax period only if the economic transactions they are related to take place in that tax period. However, there are a few exceptions to this provision, where the cash accounting method applies (e.g. dividends paid by other corporations, see Art. 89 of ICTA).

Since IRES applies to net income, a brief overview about the main positive and negative components seems appropriate.

Positive components include, among others:

1. Revenues – income primarily derived by the sale of goods and the supply of services whose production is the main activity of the corporation;
2. Capital gains – income primarily derived by the sale of non-current assets;
3. Dividends – profits produced by a company and distributed to the participating corporation; as already stated, the cash accounting method applies.

To both capital gains and dividends the so called "participation exemption" method may apply[3], in some circumstances, so that:

- 95% of capital gains realized by a corporation on the disposal of a share (or assimilated financial instruments) held in another corporation (resident in a State other than a tax haven); and
- 95% of dividends realized as a consequence of the participation in another corporation (resident in a State other than a tax haven[4]),

are, respectively, "exempted" and "excluded" from taxation (with a different tax regime applicable to related costs[5]).

[3] Article 89, paragraphs 2 ff. of ICTA

[4] The 95% exclusion may apply also to dividends distributed by companies located in tax havens, where through a preliminary ruling the beneficiary demonstrates that the participation does not have the main effect of locating the income in a low tax jurisdiction. See Article 89, para. 3 of ICTA.

Negative components are those components which can be (normally) deducted from the taxable income, if business-related (Article 109, para. 5 of ICTA – inherence principle, see note n. 4) and resulting from the P&L (Article 109, para. 4 of ICTA)[6].

Such components include, among others:

1. Capital losses – losses derived by the sale of non-current income;
2. Interest expenses – Article 109, para. 4 of ICTA does not apply in this case: such interests can be deducted in an amount equal to receivable interests. The excess may be deducted up to 30% of the "Gross Operating Profit" (GOP) resulting from P&L.

If the taxable income includes income earned abroad, corporations are entitled to deduct any tax paid abroad on that income (Art. 165 of ICTA): therefore, for instance, where a withholding tax applies on the income (earned abroad and) received by a resident corporation, such a tax will allow the corporation to get a reduction of its tax base.

Deductions may also derive from tax losses arisen in previous tax periods: tax losses, indeed, can reduce the tax base related to a following tax period, up to a maximum of five years.

1.1.2 Non-resident corporations

The existence of a permanent establishment (PE) is a key element to evaluate which tax regime applies to non-resident corporations. The notion of "permanent establishment" is given by Article 162 of ICTA and it equals the one provided by the OECD model (Article 5). Namely, it defines a PE as "a fixed place of business through which the business of an enterprise is wholly or partly carried on".

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[5] Article 109, para. 5 of ICTA allows negative components to be deducted from the taxable basis in two cases:

- if they are related to activities which contribute to produce the taxable income; or
- if they are related to activities which do not contribute to produce the taxable income cause they are "excluded".

Therefore, with regard to dividends and capital gains subject to the "participation exemption" method, only costs related to dividends will be deductible.

[6] By requiring the inclusion within the P&L to allow the reduction of negative components, Article 109, para. 4 excludes that the distributable income may exceed the taxable one.

Where a PE does not exist, income tax regime will depend on the specific category (investment income, real property income, corporate income, compensation of employees, income from self-employment, other income[7]) that income is referable to[8].

Where a PE exists, on the contrary, income earned by the foreign company through the PE is qualified as "corporate income", and taxed according to the aforementioned IRES provisions[9] [10].

The tax regime provided for non-resident corporations applies also to non-resident partnerships.

1.2 E-commerce companies

The peculiar features of e-commerce have contributed to the development of some remarkable challenges within the context of tax law: how to adapt ordinary regulatory schemes to these new business models, without allowing tax abuses or tax frauds?

E-companies may adopt several business models. OECD provides for the following distinctions[11]:

- Physical e-commerce models - a physical product is made in S (source country) and sold online to a customer in D (destination country). Because

[7] See Art. 6 of ICTA .
[8] See Art. 152, paragraph 2 of ICTA.
[9] See Art. 152, paragraph 1 of ICTA.
[10] A significant debate arose, among Italian scholars, about the role of PEs: namely, it is widely discussed whether a PE only contribute to *localize* (i.e. allow to tax in Italy) a certain income, or it also provides for a *qualification* (i.e. as corporate income) of that income. In other terms, it is debated whether a non-resident company is entitled to earn corporate income in Italy even when it does not operate through a PE; however, even if such a corporate income exists, it would not be taxable, according to Art. 23 of ICTA.
According to some scholars, a PE only contributes to localize the income: therefore, a non-resident entity may produce corporate income in Italy even in the absence of a PE, but it would not be taxable in Italy (nor it could be included in a different income category ex Art. 6 of ICTA). Such a thesis is supported by the Supreme Court (see judgment n. 9197 of 2011), which considers the PE as a "mere condition of localization of the income".
Other scholars point out, on the contrary, that a PE also contribute to qualify a certain income: therefore, a non-resident entity could not earn corporate income unless it operates in Italy through a PE.
For a wider analysis of the above debate see G. MELIS, *Le interrelazioni tra le nozioni di residenza fiscale e stabile organizzazione: problemi ancora aperti e possibili soluzioni*, 2013 , page 293 ff. Available at http://www.uckmar.net/circolari/altro/volumeattistabile.pdf.
[11] See OECD, *Commission expert group on taxation of the digital economy*, 2014, page 21.

the product is physical, the location of sales, distribution and support is typically in the same country as the customer, i.e. also in D, even though it may have been produced elsewhere;

- Digital e-commerce models - the "product" is not physical but digital. It is either distributed over the web as a product or it is kept at a central data centre and distributed as a service;
- Cloud models - consumers access the central data centre from a location of their choosing (D), but the central data centre itself can be located in any S country provided there is internet access.

Within the above categories, further distinctions can be made[12].

First, e-companies may operate as “market-makers”, i.e. bringing buyers and sellers together (see Amazon): income, in this case, usually come from a fee charged on each transactions they enable.

Another popular business model is the so-called “advertising model”: a broadcaster company provides content through a website (usually for free) and mix it with advertising messages, which represent the main (or only) source of income for the broadcaster (see Google).

Finally, companies may decide to adopt the “manufacturer model”: in this case the web allows the manufacturer to reach customers more easily, compressing the distribution channels. The use of licenses is an example of manufacturer model: companies allow customers to use a certain product, but related ownership rights are not transferred (see Whatsapp).

These business models allow e-companies to easily operate on a transnational scale: since this phenomenon turns into a strong increase of the impact of non-resident companies on the economy, it is essential for national tax systems to provide solutions in order to adapt ordinary tax provisions to those business models. According to OECD reports on e-commerce[13], three main challenges

[12] All the following examples are based on M. RAPPA, *Business models on the web* (2010), available at http://digitalenterprise.org/models/models.html.
[13] See OECD, *Electronic commerce: the challenges to tax authorities and taxpayers* (1997) and OECD, *OECD action plan for electronic commerce* (1998).

arise: these challenges and related solutions provided within the Italian context will be discussed in the following paragraphs.

1.2.1 Permanent Establishment

As already discussed in the above, according to Art.162 of ICTA and Article 5 of the OECD Model, a "permanent establishment" (PE) is *a fixed place of business through which the business of an enterprise is wholly or partly carried on.*

It is extremely relevant to establish when e-commerce operations set up a PE, since the existence of a PE is a necessary requirement to levy tax in Italy (= source State) on the corporate income produced by a non-resident company[14].

According to OECD[15], a mere website can't be qualified as a PE[16], since it's a "software[17]" and therefore inconsistent with the concept of "place of business", which requires instead the existence of stores and equipments; on the contrary, a server may represent a proper place of business.

Such a place of business is "fixed" where a non-temporary economical or functional link between the server and the area where it operates exists.

Finally, to be qualified as a PE the server has to allow the exercise of the business of the company. It is then necessary to distinguish:

- ISP (Internet service provider, i.e. a company which provides consumers and businesses access to the Internet) – in this case the server is the vehicle through which business (i.e. web hosting) is carried on. Therefore, a server is a PE if located in a State different from the residence State of the ISP;
- ICP (Internet Content Provider, i.e. who creates content for the Internet) - a server can be qualified as a PE only if the ICP has "control" (meaning

[14] See Article 23 of ICTA.

[15] See *Commentary on Art. 5 concerning the definition of permanent establishment* from OECD, *Commentaries on the article of the Model Tax Convention.*

[16] G. MELIS, *Commercio elettronico nel diritto tributario,* in Digesto delle discipline privatistiche Sezione Commerciale, Torino, 2008, page 68.

[17] "A program, or series of programs, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishment of other tasks (application software)", see par. 12.1 of OECD Commentary on Article 12(2), in *Commentary on Art. 12 concerning the definition of permanent establishment* from OECD, *Commentaries on the article of the Model Tax Convention..*

installation, maintenance and control of the accesses to the server) over it[18].

Article 162, par. 5 of ICTA has implemented these findings into a specific provision. It states, indeed, that the mere possession of a server which permits collection and transmission of data and information does not constitute itself a PE, but it is furthermore necessary:

- a fixed place of business through which the business is wholly or partly carried on; and
- that such servers are not only used to exercise those activities included in Article 162, par. 4 ("preparatory or auxiliary activities": in other terms, the qualification as a PE requires the activity exercised through the server to be the core business of the company).

Article 162 implicitly excludes the possibility to qualify a *website* as a PE, while it admits that a *server* may, in the aforementioned circumstances, receive such a qualification.

While this provision seems to be reasonable from a formal point of view, practical problems arise. It is evident, indeed, that a taxpayer can easily avoid the constitution of a PE by "hosting arrangements through which the non-resident taxpayer does not rent the server as such but an amount of disk space to store his or her website"[19].

Furthermore, it is debatable whether the control of a server can be considered sufficient or not, by itself, to state that a proper connection between the non-resident company and the economical life of a certain State exists[20]. Within the Italian tax system, the taxation of a certain person is legitimate when it complies with Article 53, paragraph 1 of the Constitution, which states that "every person shall contribute to public expenditure in accordance with his ability to pay": therefore, several scholars state that such a contribution may be imposed only where a "reasonable link" exists[21], i.e. only on those who can be considered part

[18] G. MELIS, *Commercio elettronico nel diritto tributario,* cit., page 68.
[19] E.E.LOPEZ, *An opportunistic, and yet appropriate, revision of the source threshold for the twenty-first century tax treaties,* in Intertax, 2015, I, page 10.
[20] E.E.LOPEZ, *An opportunistic, and yet appropriate, revision of the source threshold for the twenty-first century tax treaties*, cit., page 10.
[21] G. FALSITTA, *Corso istituzionale di diritto tributario,* Verona, 2012, page 58.

of the (Italian) community by the fact they have an interest in the existence of the community[22]. The fulfillment of these conditions by the sole presence of a server is, therefore, controversial.

The application of the notion of PE to the new challenges provided by the digital economy seems therefore to be inadequate.

OECD already promoted further studies about this topic, with the creation of Technical Advisory Groups (TAG). The TAG work was intended to provide new solutions within the context of taxation of e-commerce operations, but the issues expressed in his final report have not turned into provisions. The recent Action Plan on Base Erosion and Profit Shifting (BEPS) aims to restart related discussions, moving from TAG's proposals.

In order to better challenge the above issues, the OECD is promoting the development of a multilateral treaty to amend bilateral tax treaties and to speed up the adoption of measures which comply with the Action Plan on BEPS. About PE, the treaty should include changes to the definition of "permanent establishment" to enhance its compliance with the aforementioned new models of the digital economy.[23]

1.2.2 Qualifying the income

Qualifying the income produced by companies rises relevant issues within e-commerce. Transactions involving (digital) patented goods seem to be particularly controversial, when it comes to determining whether these transactions produce corporate income or royalties.

As previously highlighted, indeed, according to Article 23 of ICTA the corporate income produced by a non-resident company is taxable in the source State (i.e. Italy) only when the company operates through a PE in Italy; on the contrary, taxation in the source State of the royalties earned by a non-resident company doesn't require the existence of a PE[24].

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[22] P. RUSSO, *Manuale di diritto tributario*, Milan, 2007, page 119.

[23] D. AVOLIO & B. SANTACROCE, *La stabile organizzazione e l'"Action 7" dell'OCSE: la figura del commissionario*, in Corr. Trib., 2015, XI, page 831.

[24] See Article 25, paragraph 4 of Presidential Decree 600/1973. A withholding tax applies in these cases (with a tax rate of 30%) unless bilateral agreements provide different tax regimes or

According to Article 12 of the OECD Model, a "royalty" is a payment of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

Therefore, a payment will be qualified as a royalty where carried out for the "use of, or the right to use" a certain property; on the contrary, where the transaction involves the transfer of the full ownership of such a property, the related payment will represent a corporate income[25]. The OECD Commentary on Article 12 of the OECD model does not provide specifications about the difference between "use" and "right to use"; according to some scholars[26], the two notions allow to apply Article 12 not only to payments related to contractual obligations, but also to those which arise from an illegal use of the property.

Within the context of digital economy, as pointed out by the OECD Commentary on Article 12 of the OECD Model:

- payments[27] related to the purchase of a digital patented good through download represent corporate income: in these cases, indeed, the download is merely the means by which the digital signal is captured and stored, while the transaction is aimed to acquire data transmitted in the form of a digital signal for the buyer's own use or enjoyment[28].
- payments related to the transfer of the full ownership of the rights in the copyright represent corporate income;

Directive 2003/49/CE applies. In this last case, taxation in the source State is not allowed: the Directive only admits, indeed, taxation in the residence State of the seller. The Directive applies when both the part of the transaction involving royalties are resident in a Member State, and when the seller is the "beneficial owner" of the payment (which means the seller is not an intermediary, but the final beneficiary of the payment).

[25] See paragraph 8.2 of the Commentary on Article 12(2) in *Commentary on Art. 12 concerning the definition of permanent establishment* from OECD*, Commentaries on the article of the Model Tax Convention.*

[26] M. PIAZZA, *Guida alla fiscalità internazionale*, Milan, 2004, page 768.

[27] The notion of "payment" means "the fulfillment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom". See par. 8.3 of the Commentary on Article 12(2).

[28] See par. 17.2 of the Commentary on Article 12(2) of the OECD Model, in *Commentary on Art. 12 concerning the definition of permanent establishment* from OECD, *Commentaries on the article of the Model Tax Convention.*

- payments related to the transfer of a part of the rights in the copyright – i.e. licenses to reproduce, distribute or modify the software incorporating the copyrighted programme - represent a royalty, since such a transaction is considered transferring a “right to use” a certain good;
- payments that are solely made in consideration for obtaining the exclusive distribution rights of a product or service in a given territory do not constitute royalties as they are not made in consideration for the use of, or the right to use, an element of property included in the definition;

The situations which allow a taxation in the source State are, in conclusion, extremely limited[29].

1.2.3 Attribution of income to PEs

Assuming that a PE does exists, it is then necessary to analyze when income is effectively attributable to the PE.

According to Article 7(2) of the OECD Model, “the profits that are attributable in each Contracting State to a permanent establishment are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise”.

The TAG works have adopted the so-called “functionally separate entity approach”[30]: the PE is considered as an independent entity from the parent company, therefore able to so that transactions between the parent company and the PE are relevant in a tax perspective.

The attribution of profits to a PE requires a two-steps analysis[31]:

[29] G. MELIS, *Commercio elettronico nel diritto tributario,* cit., page 8.
[30] **The TAG has therefore rejected the “relevant business activity approach”, according to which the attributed profits could not exceed the profits that the whole enterprise earns from the relevant business activity. The profits of the whole enterprise would be those earned from transactions with third parties and those earned from transactions with associated enterprises; the transactions between the PE and the parent company have no tax relevance**.
[31] C. GALLI, *Primi orientamenti dell’OCSE in materia di attribuzione di utili ad una stabile organizzazione nel contesto del commercio elettronico,* in Riv. Dir. Trib., 2001, V, page 80 ff. See also OECD, *Report on the attribution of profits to permanent establishments*, 2006.

- a functional and factual analysis in order to determine which economically relevant activities are carried out by the whole enterprise and which ones are directly attributable to the PE;
- a comparison between the dealings and “uncontrolled” transactions, according to Article 7(2) of the OECD Model, in order to price such dealings on an arm’s length basis. Here, the functions performed and the risks attributed to the PE will have to be taken into account.

As noted by the OECD, the above approach seems to narrow the chances to attribute profits to a PE, especially when a mere server comes into relevance since it may be hard to provide the comparison required by step 2; that contributes, therefore, to limit the possibilities to tax the income related to e-commerce operations in the source State, since only in a few cases the above requirements will be fulfilled.

1.3 Conclusions

As the above paragraphs have shown, e-commerce generates new challenges for tax systems. The solutions ordinarily provided in the Italian tax system (and, generally speaking, within the EU) are still inadequate to face new business models, turning into marked limitations into the field of taxation of profits produced by non-resident e-companies.

CHAPTER 2 – DIGITAL ECONOMY AND TAX INCENTIVES WITHIN THE ITALIAN LEGAL FRAMEWORK

The peculiar characteristics of e-commerce make profit shifting activities easier, allowing companies to take advantage from more favorable tax regimes. The analysis of tax incentives is therefore extremely relevant within the context of digital economy.

First, this chapter will take into consideration the IP rights legal framework and related incentives; then, other tax incentives related to digital economy and provided by the Italian tax system will be examined.

2.1 Intellectual property rights: an overview on patents & copyrights

Intellectual property (IP) rights represent a core element within the context of digital economy and e-commerce: it's IP rights, indeed, which stimulate developments of some digital goods (e.g. software and mobile apps) by providing legal protection to their right of use.

It is therefore evident that taxation of IP rights may become a key-criterion for e-companies to choose their place of establishment; in other terms, IP rights tax regime may be the source of profit shifting operations.

This paragraph will analyze the Italian tax-environment provided for intellectual property rights, focusing on patents and copyrights.

A "patent" is an exclusive right, granted by the government, that authorizes the business owner to make use of an "industrial invention" for a specific period of time, allowing him to benefit from the commercial advantages that may derive from it[32]. The notion of "industrial invention" refers to those inventions which provide original solutions to a certain technical problem[33].

The protection related to a patent can be requested for the national territory only or for a wider area, taking advantage of some international agreements; within the

[32] See Article 66 of d.lgs. 30/2005 ("Code of the industrial property" - CPI).

[33] For further specifications, see Article 45 of CPI.

European Union, for instance, it is possible to require the "Community Patent" (which grants protection in the whole EU area).

A "copyright" is, on the other hand, the exclusive original right to distribute and use literary and scientific works. It has to be noted that software are considered and protected as literary works[34]. Protection of copyrights is automatic, no formal procedures are required.

Remunerations received for the use of or the right to use copyrights and patents are defined as "royalties".

2.1.1 The ordinary tax regime of royalties

The tax regime of royalties paid by Italian resident companies depends on the place of residence of the beneficiary.[35]

Royalties paid to other resident companies are not subject to any withholding tax; they are qualified, instead, as corporate income (and taxed accordingly, see previous paragraphs)[36].

Royalties paid to non-resident companies (without a PE in Italy) are generally subject to a withholding tax (30% on the 75% of the gross amount of the payment); where the non-resident company receives such royalties through a PE owned in Italy, on the contrary, the same taxation rules provided for resident companies will apply[37].

However, the withholding tax may not apply within EU member States: according to Directive 2003/49/CE, where some circumstances are fulfilled no withholding tax is levied in the source State and taxation is only possible in the residence State of the beneficiary. Namely, the Directive applies if:

- both the company paying the royalty and the beneficiary company are resident in a EU member State; and

[34] See Article 2 of law 633/1941.
[35] Where an Italian company earns royalties abroad, a tax credit may be granted, depending on the tax paid abroad.
[36] See Article 25, paragraph 1 of Presidential Decree 600/73.
[37] See Article 25, paragraph 4 of Presidential Decree 600/73.

- the company receiving the payment is the "beneficial owner" of the payment, i.e. the receiving company is the final beneficiary and does not act as an intermediary.[38]

2.1.2 Recent reforms: the IP box

The 2015 Budget Law (Law 190/2014) has provided some innovations within the context of IP, by introducing an "IP box" regime, which allows resident and non-resident companies subject to corporate taxation to benefit from a reduction of the taxation on the royalties earned.

The application of the regime is elective, and turns into an exemption from IRES on those income related to some intangible assets (such as patents)[39][40]: the exemption will be equal to 50% since 2017.[41] Paragraph 39 specifies that, when the qualifying assets are directly used by the producing company, the 50% exclusion can apply only following a preliminary ruling between the company and the Tax Authority, aimed at calculating the total income arising by the qualifying assets .

Taxpayers who intend to adopt the regime must perform R&D (research and development) activities aimed at developing the qualifying assets: indeed, the qualifying income on which the exemption is applied is determined in light of the R&D activities performed by a certain taxpayer. Such a solution well fits with the indications provided by BEPS Action 5, which requires "substantial activity for any preferential regime" (so-called "Nexus approach"). Therefore, the IP box regime is intended to promote R&D activities, by providing a beneficial tax treatment of qualifying income elements derived from R&D[42].

The regime can be adopted, as already mentioned, by resident and non-resident companies: about non-resident companies, however, it is necessary that the

[38] See also Article 26-quarter of Presidential Decree 600/73.
[39] See Art.1, paragraphs 37 ff.
[40] According to paragraph 44, the concrete enforcement of the IP box regime is subject to the issue of a specific decree by the Ministry of Economy and Finance (which hasn't been provided yet).
[41] The exemption will be equal to 30% in 2015 and 40% in 2016.
[42] J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* in EC Tax Review, 2014, V, page 258. Promoting R&D activities means attracting intellectual capitals, and benefit from related positive externalities.

residence State of the company has a bilateral treaty providing an effective exchange of information with Italy.

2.1.2.1 IP boxes and State Aid rules

With respect to Member States' IP box regimes, the EU Commission is examining the compatibility of some of these regimes with EU laws. While no specific examinations are actually going on towards the Italian IP box regime, a brief overview of some past analysis conducted towards other IP box regimes may help to find out possible critical points of the Italian regime.

About the compatibility with State Aid rules, the qualification of a certain tax regime as "state aid" requires the fulfillment of 4 conditions[43]:

1. the existence of an "advantage", which may consists even in a reduction of the taxes normally borne from the recipients' budgets[44];
2. the advantage must be granted by the State or through State resources;
3. the advantage must affect trade between Member States by providing distortions to competition;
4. the advantage must favor certain undertakings or certain productions.

About criterion n. 3, it is debatable whether an IP box regime may provide distortions of competitions or not. There's no need for actual distortions: the possible risk of it has to be consider sufficient to fulfill the concerned condition.

The range of potential causes for distortions is extremely wide: tax advantages which benefit large categories of undertakings are therefore likely to provide distortions, since some of these undertakings are probably active in sectors where intra-EU trade takes place[45].

In other terms, a distortion of competition may arise wherever a measure strengthens the competitiveness of the recipient in comparison with his

[43] See Article 107 of TFEU.

[44] J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 260.

[45] F. MANG, *The (in)compatibility of IP box regimes with EU Law, the Code of Conduct and the BEPS Initiatives*, in European Taxation, 2015, II, page 3.

competitors within the EU, with no relevance on the amount or the size of the aid.[46]

Therefore, the Commission never examined such a criterion thoroughly, presuming this condition to be fulfilled whenever a certain regime may be considered "selective" according to condition n. 4.[47]

Condition n. 4 ("selectivity"), indeed, is a crucial issue while evaluating if a certain measure constitutes a (prohibited) State aid. Such an evaluation is based on the "comparison test": selectivity exists where a measure favors certain undertakings *in comparison* with other undertakings "which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question"[48]. In other terms, in order to classify a certain measure as "selective", it will be primarily necessary to identify the normal regime applicable in the Member State concerned; then, this regime will have to be compared with the one provided by the measure discussed to find out whether discriminations between enterprises which are in a comparable situation exist or not.

The choice of the normal regime (i.e. the reference system) is a debated issue[49]. On the one hand, some scholars[50] state that comparable undertakings are only those engaged in R&D activities, since the IP box regime is aimed at supporting these activities; according to this thesis, it seems unlikely that the Italian IP box regime will be considered as fulfilling the selectivity requirement, since the regime is available to any enterprise with no restrictions in respect of its size, legal form or sector.

On the other hand, other scholars[51], as well as some ECJ judgments[52], opt for a definition of the "general system" that includes all the undertakings subject to

[46] M.KRONTHALER & Y.TZUBERY, *The state aid provisions of the TFEU in tax matters*, in M. LANG & OTHERS, *Introduction to European tax law: direct taxation*, London, 2013, page 107.

[47] P. CROCIONI, *Can state aid policy become more economic friendly?,* in World Competition, 2006, I, page 102.

[48] See CJEU, 8 Nov. 2001, *Adria-Wien Pipeline* case (C-143/99).

[49] Also, the ECJ practice is not straightforward on the matter.

[50] F. MANG, *The (in)compatibility of IP box regimes with EU Law, the Code of Conduct and the BEPS Initiatives*, cit., page 3.

[51] See J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 267.

[52] See CJEU, 8 Sep. 2011, *Paint Graphos* case (joined cases C-78/08 to C-80/08).

corporate tax within the reference system[53]: in this case chances for a qualification of the Italian IP box regime as "selective" may increase. However, in some cases (such as the Spanish one, see page below) the Commission observed that the fact that not every undertaking decides to develop the qualifying assets is just the reflection of an economic reality (and not the reflection, therefore, of a "selective" measure)[54].

However, even a measure resulting to be "selective" according to the test above (*prima facie* selectivity) may be justified "if the Member State concerned can show that the measure results directly from […] the guiding principles of its tax system"[55], i.e. those principles (e.g. progressiveness of taxation) which are necessary for the achievement of the objectives of the tax system.

Furthermore, it has to be noted that under the selectivity criterion, a violation of State Aid rules may arise even in the case of a "general measure", i.e. a measure which formally covers every enterprise: indeed, as highlighted in the *Gibraltar* case, general measures could be *de facto* selective[56] when their application favors certain undertakings in comparison with others[57].

IP boxes implemented by Spain (2008) and Liechtenstein (2011)[58], for instance, have been considered non-selective and therefore fully compatible with State Aid provisions, for similar reasons.

Focusing on the Spanish case, the Commission stated that condition n. 4 (selectivity) was not fulfilled, since the incentives didn't strengthen the position of any particular class of undertakings. Namely, the Spanish IP box provided a 50%

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[53] J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 268.

[54] As some scholars underlined, the Commission practice in respect of R&D tax incentives is not always reflected in the ECJ case-law. See again J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 266.

[55] See CJEU, 8 Sep. 2011, *Paint Graphos* case (joined cases C-78/08 to C-80/08).

[56] J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 261.

[57] In the *Gibraltar* case (CJEU, 15 Nov. 2011, joined cases C-106/09 and C-107/09), namely, the ECJ stated that the exclusion of certain enterprises from taxation was not a random consequence of the discussed regime, but "*the inevitable consequence of the fact that the bases of assessment are specifically designed so that companies […] have no tax base under the bases of assessment*".

[58] About Liechtenstein, verifications are implemented by the EFTA Surveillance Authority and not by the Commission; also, the relevant notion of "State Aid" is provided by Article 61, para. 1 of the European Economic Area Agreement, but it is nearly identical to the one provided by Article 107 of the TFEU.

exemption to income derived from certain intangible assets, such as patents, knowhow, models and designs; it was open to any undertaking subject to corporate taxation which developed qualifying intangible assets through R&D activities. As already said, the Commission observed that the fact that not every undertaking decides to develop those assets is just the reflection of an economic reality[59].

Considering the similarities between Spanish and Italian IP box regime, it is likely that further analysis by the Commission may turn into a declaration of compatibility of the Italian regime with State Aid rules[60].

However, a crucial point in the assessment of the Italian IP box regime under the selectivity criterion will be the issue of a decree by the Ministry of Economy and Finance providing implementation rules which will allow further analyses. It seems necessary, for instance, to provide specifications about the ruling procedure (Article 1, par. 37 of the Budget Law 2015) to ensure that the Tax Authority is not granted discretionary powers which may lead to *de facto* selectivity.

Should the IP box regime be qualified as "State Aid" according to Article 107(1), it may however comply with EU law in light of Article 107(2)(3), which provide some exceptions to the general prohibition of Paragraph 1. The way such exceptions are interpreted within the context of R&D incentives[61] is explained by the Commission through the 2014 Commission's *Framework for state aid for research and development and innovation* (hereinafter: R&D Framework). The R&D Framework provides rules intended to support and spread research and development initiatives, since the EU aims to make R&D investments to reach 3% of GDP within 2020[62].

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[59] See Commission decision n. C(2008) 467.

[60] Some authors, however, suggest that the EU (and the ECJ, in particular) may adopt a more stringent approach towards the evaluation of compatibility, in order to fight potential distortions on the internal market. See J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 267.

[61] As already mentioned, indeed, by providing the IP box Italy meant to support R&D activities (namely, those R&D activities aimed at producing the qualifying assets).

[62] In order to support R&D activities, the Commission has also developed the "General Block Exemption Regulations" (GBER), which exclude the necessity of a prior notification to the Commission in case of benefits whose intensity does not exceed certain thresholds, therefore allowing the qualifying measures to be immediately implemented within the Member State. See Regulation n. 651 of 2014.

Namely, such rules refer to[63]:

- R&D projects (i.e. fundamental research, industrial research, experimental development[64]);
- Feasibility studies (i.e. evaluation of the potential of a project);
- Research infrastructures (i.e. facilities which are used by the scientific community to conduct researches in their respective fields);
- Innovation clusters (i.e. structured or organized groups of independent parties designed to stimulate innovative activities through sharing of facilities and exchange of knowledge);
- Process and organizational innovation (i.e. the implementation of a new or improved production or delivery method and the implementation of a new organizational method in an undertaking's business practices);
- SMEs innovation aids; in this case, eligible costs shall be those used for obtaining intangible assets (such as patents), for secondment of highly qualified personnel and for innovation advisory.

The Commission's "R&D Framework" specifies the criteria which have to be evaluated in order to determine whether the R&D incentive may fall within the scope of Article 107(2)(3) or not.

It is considered to be "compatible" with the internal market the aid which leads to increased R&D activities without adversely affecting trading conditions in a manner contrary to the common interest.

Namely, whether the R&D regime is compatible with State Aid provisions or not, it will depend on the fulfillment of the following conditions:

1. the aid must promote an objective of common interest;

[63] R&D Framework, par. 1.2.

[64] According to GBER's definitions, f*undamental research* means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any direct practical application or use in view; *industrial research* means planned research or critical investigation aimed at the acquisition of new knowledge and skills for developing new products, processes or services or for bringing about a significant improvement in existing products, processes or services; *experimental development* means acquiring, combining, shaping and using of existing scientific, technological, business and other relevant knowledge and skills for the purpose of producing plans and arrangements or designs for new, altered or improved products, processes or service.

2. the appropriateness of aid compared to alternative measures must be shown;
3. Member State must demonstrate that the aid changes the behavior of the beneficiary;
4. It has to be verified that the aid amount does not exceed the minimum necessary for the aided project to be sufficiently profitable;
5. The aid must not violate some fundamental rules such as those on the free movement of goods and services.

It is specified, furthermore, that “when State Aid is granted for projects that are also funded by the EU, there will be a presumption of a contribution to the objective of common interest, the presence of a market failure and appropriateness of aid”, thereby increasing the chances of a declaration of compatibility.

Some scholars pointed out that the application of such R&D rules to IP boxes may be not straightforward: it has been noted, indeed, that it could be hard for IP boxes “to completely fall within one or more of the research categories” and “to provide a calculation of the aid intensity”[65], so that an IP box regime qualified as State Aid according to Article 107(1) “will unlikely be declared compatible under paragraphs 2-3”.

2.1.2.2 IP boxes and the Code of Conduct

Another relevant topic is the compatibility between the IP box regime and the “Code of Conduct on Business Taxation[66]” (hereinafter: Code), a soft law code introduced by the Commission in 1998. The Code states that tax competition may have, in some cases, harmful effects: therefore, Member States have committed themselves not to introduce harmful tax practices.

The Code suggests that tax measures may be qualified as “harmful” when producing a significantly lower effective level of taxation than those levels which generally apply in the Member State in question; it then provides several

[65] J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 274.

[66] The Code of conduct on business taxation is available on the EU website at http://ec.europa.eu/taxation_customs/resources/documents/coc_en.pdf.

indicators, whose presence leads to the presumption of the "harmful" nature of the measure (see paragraph B of the Code[67]).

Among those criteria, the "lack of economic substance" seems to be crucial: advantages can't be granted without a real economic activity carried on. Namely, this condition requires the measure to impose beneficiaries to manage IP from the country providing the benefits or, in other terms, an "economic reason to place the IP in the particular country" concerned.[68]

Recently, the Commission has assessed the UK IP box regime[69]: it allows certain companies (and not individuals) to benefit from a lower corporate tax rate on income from patents granted by the UK IP Office, by the European patent office or by EEA member state with patentability criteria similar to those adopted in the UK.

The Commission initially argued that the measure may have been considered as "harmful", since it provided a favorable tax regime (10% tax rate on profits deriving from the above qualifying rights) without requiring any real economic activity to be exploited within the State offering the tax advantages[70]. The Commission then withdrew its investigations, in light of the joint proposal provided by UK and Germany and aimed to ensure that such regimes require substantial economic activities to be undertaken in a given jurisdiction by connecting tax benefits with research and development expenditure in that same jurisdiction.

However, such an interpretation may turn into problems: IP box regimes, indeed, provide tax incentives in connection with R&D activities implemented by companies, but the majority of IP box regimes (such as the Italian one) do not

[67] Namely, such indicators are: 1) the lack of transparency, 2) advantages granted without economic substance, 3) advantages only accorded to non-residents, 4) profits calculated at variance with internationally accepted principles, 5) ring-fencing of the regime.

[68] F. MANG, *The (in)compatibility of IP box regimes with EU Law, the Code of Conduct and the BEPS Initiatives,* cit., page 5. The absence of such a link would easily allow enterprises to shift profits.

[69] See J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct,* cit., page 280; F. MANG, *The (in)compatibility of IP box regimes with EU Law, the Code of Conduct and the BEPS Initiatives,* cit., pages 4-8.

[70] The Commission's argument is however controversial: indeed, requiring the beneficiary to develop IP within the UK may turn into a breach of the fundamental freedoms. See F. MANG, *The (in)compatibility of IP box regimes with EU Law, the Code of Conduct and the BEPS Initiatives,* cit., page 4.

require this activity to be carried out in the same Member State which grants the tax exemption. [71]

This issue may be relevant also in light of the aforementioned BEPS Action 5, which aims to tackle the lack of substantial activity requirements in tax systems. By introducing the “Nexus approach”, OECD stated that the place of substantial activity is the one where the expenditures are located.

Even if the aforementioned indicators may allow to consider a measure as “harmful”, paragraph A of the Code will then have to be considered in order to state the effective incompatibility with the Code of Conduct; in other terms, incompatibility requires the measure to affect the location of business activity in the EU. Considering that many EU member states have implemented similar IP box rules, the chances for a violation of the Code of Conduct seem to be narrow.

2.2 Other tax incentives

The following paragraphs will discuss other relevant tax incentives, namely those provided to support research and development investments and those aimed at fostering the digitalization of SMEs..

2.2.1 Research and development activities[72]

Italy grants a tax credit to companies for certain qualifying research and development (R&D) costs[73]. Namely, the tax credit covers up to 25% of the incremental eligible R&D expenses[74]; qualifying activities include:

1. Fundamental research, i.e. the experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of

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[71] J. LUTS, *Compatibility of IP box regimes with EU State aid Rules and Code of Conduct*, cit., page 281.

[72] For an overview on Italy’s tax incentives towards companies within the field of R&D activities, see DELOITTE, *2014 Global survey of R&D tax incentives*, London, 2014. See also A. SACRESTANO, *Un nuovo credito d’imposta per la ricerca e sviluppo,*in Corr. Trib., 2014, XLIV, page 3389 ff.

[73] Such incentives are granted in Italy since 2008, in the form of tax credits; however, the related legal framework has been recently modified

[74] The “increment” has to be calculated taking into account the average expenses of the last three tax periods.

phenomena and observable facts, without any direct practical application or use in view;

2. Industrial research, i.e. the planned research or critical investigation aimed at the acquisition of new knowledge and skills for developing new products, processes or services or for bringing about a significant improvement in existing products, processes or services;
3. Experimental development, i.e. acquiring, combining, shaping and using of existing scientific, technological, business and other relevant knowledge and skills for the purpose of producing plans and arrangements or designs for new, altered or improved products, processes or service;
4. Experimental production and testing of products, processes and services are also eligible, provided that these cannot be used or transformed to be used in industrial applications or commercially.

Eligible expenses include the following (Article 3 of Law 145/2013):

- costs for high-qualified personnel;
- costs of instruments and equipment, to the extent and for the duration period used for the project;

The incentives are granted to *all* the undertakings carrying out R&D activities, regardless of their juridical form or the economic sector they operate in, but only to the extent they carry out investments in R&D activities in the minimum amount of € 30000.

The measure allows a maximum credit of € 5 million per each beneficiary.

Such a tax incentive falls within the ground of GBER, since both the eligible activities and the eligible costs match with those indicated by the Commission in order to admit the exclusion of a prior notification to the Commission (see Article 25, “Aid for research and development projects”): therefore, it is allowed to be implemented within the Italian market without need for a preliminary approval from the Commission.

However, in some cases GBER provide for ex-post evaluation of exempted state aid schemes, in order to verify whether the assumptions and conditions underlying the compatibility of an aid scheme have been complied with, whether its objectives have been realized and what impact it had on competition and trade. Within the field of R&D, evaluation is required for schemes with an average annual budget exceeding EUR 150 million (see Article 1 of GBER).

While Law 145/2013 does not provide specifications about the budget, the previous R&D tax regime (2013) set a EUR 200 million-budget per year: therefore, the Italian regime may be subject to an evaluation process.

To this effect, it has to be highlighted that, while analyzing (and confirming) the compatibility of the tax incentive introduced in Italy in 2007 with State Aid rules, the Commission pointed out that R&D tax incentives are not selective if their potential beneficiaries are not restricted in terms of size, location or sector[75]. In this respect, some concerns may arise about the fulfillment of the selectivity criterion: indeed, by limiting the tax credit to those entities which invest a minimum amount of € 30000[76], the tax incentive may restrict the range of beneficiaries in terms of size and may be qualified, therefore, as "*de facto* selective".[77]

2.2.2 SMEs and digitalization[78]

Tax incentives are provided by law 145/13[79] also within the context of small and medium enterprises' (SMEs) digitalization.

A tax credit is indeed granted to SMEs to promote the development of Internet and digital technologies in the field of communication services; such an incentive covers up to 65% of related non-deductible costs, with a maximum credit of € 20000 for each SME. The measure allows a maximum total investment of € 50 millions.

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[75] C. MONACO, *Gli incentivi fiscali per l'innovazione nel quadro della rinnovata strategia di Lisbona: problemi e prospettive,* in Rivista di diritto finanziario e scienza delle finanze, 2008, III, page 444.

[76] No similar limitations were provided by the R&D tax incentive regime introduced in 2007 and analyzed by the Commission.

[77] C. MONACO, *Gli incentivi fiscali per l'innovazione nel quadro della rinnovata strategia di Lisbona: problemi e prospettive*, cit., page 432. The author notes that those tax exemptions limited to enterprises which make high investments in R&D activities are undoubtedly "selective".
See also A. SACRESTANO, *Un nuovo credito d'imposta per la ricerca e sviluppo,*in Corr. Trib., 2014, XLIV, page 3389 ff, which notes how the tax incentive seems to be provided especially for medium enterprises.

[78] See A. SACRESTANO, *Piano "Destinazione Italia": per "invertire la rotta", misure fiscali per ricerca e digitalizzazione delle PMI*, in Corr. Trib., 2014, IV, page 314 ff.

[79] See Article 6, para. 10.

The EU is fostering the development of digital technologies within the context of SMEs: according to the GBER, "SMEs play a decisive role in job creation and, more generally, act as a factor of social stability and economic development."[80]

The incentive provided in Italy matches the *de minimis* rules (Regulation 1998/994/CE)[81], which exclude the necessity to priory notifying to the Commission those aids which do not exceed, within a period of 3 fiscal years, the amount of EUR 200000 per undertaking. Such aids, indeed, are considered not distorting competition, and therefore unable to fulfill the conditions provided by Article 107(1) of TFEU.

2.3 Italian tax incentives and services of general economic interest (SGEI)

A special regime applies within the field of "services of general economic interest" (SGEI): if some conditions are fulfilled, indeed, State funding towards SGEI may be allowed.

Communication C-17/2001 from the Commission qualifies SGEI as "market services [i.e. services provided under payment[82]] which the Member States subject to specific public service obligations by virtue of a general interest criterion".

In order to determine the actual situations where State funding towards SGEI are allowable, a "double standard" of assessment is provided[83].

First, the legitimacy of such aids can be assessed *ex ante* under the "Altmark test": in the *Altmark* case, the ECJ was asked to decide whether a compensation received by the German company "Altmark Trans" was compatible with State Aid regime or not, and ended up providing a test to verify the legitimacy of compensations within the context of public services. Namely, where the following four conditions are met, the funds provided to the public companies have to be

[80] GBER, page 8.

[81] See also A. SACRESTANO, *Aggiornate le norme UE sugli aiuti "de minimis"*, in Corr. Trib., 2014, XXI, page 1652 ff.

[82] M. PELLECCHIA, *I servizi di interesse generale,* in L. SALVINI (a cura di), *Aiuti di stato in materia fiscale*, Padua, 2007, page 277.

[83] N. FIEDZIUK, *Towards a more refined economic approach to services of general economic interest*, in European Public Law, 2010, II, page 277

considered legitimate and will not constitute State Aids according to Article 107(1):

1. SGEI must be clearly defined by a public authority; there are no specific limitations on the situations which can be included within the "SGEI" context. The Commission can challenge such a definition only in cases of manifest errors[84];
2. The parameters for compensation are objectively prearranged;
3. There must be no over-compensation, i.e. the compensation provided must not exceed the amount which is necessary to cover the costs required by the SGEI;
4. The level of the compensation is set through public procurement procedure or by taking into account the costs which a typical undertaking would have incurred in.

The fulfillment of such conditions exclude the necessity to notify the implementation of the measure to the Commission for a prior assessment.[85]

Second, the legitimacy of aids funding SGEI can be assessed *ex post.* According to art. 106(2) of the TFEU, a certain State Aid may be compatible with the EU legal framework if it is necessary to the operation of the "services of general economic interest" (SGEI) and does not affect the development of trade to such an extent as would be contrary to the interests of the EU.[86] Article 106(2) operates, therefore, as a derogation to Article 107(1): it allows State Aids in the field of SGEI where the following conditions are met:

a) SGEI must be clearly defined (see condition 1 above);
b) Public service obligations must be specified, through an official act;
c) There must be no over-compensation (see condition 3 above).

[84] D. GALLO, *Finanziamento dei servizi di interesse economico generale e aiuti di stato nel diritto comunitario*, in Riv. it. Dir. pubbl. Comunit., 2007, V, page 900.

[85] See N. FIEDZIUK, *Towards a more refined economic approach to services of general economic interest*, cit., page 277

[86] See N. FIEDZIUK, *Towards a more refined economic approach to services of general economic interest*, cit., page 275.

To sum up, whether the Altmark conditions or the ones provided by Article 106(2) are met, the state funding towards SGEI will have to be considered lawful.
However, it is unlikely that SGEI rules are applicable to the tax incentives analyzed above.
First, if we assume that R&D incentives and SMEs tax credit comply with EU Law, the evaluation about the applicability of SGEI rules is unnecessary.
Even in the context of the IP box regime a negative conclusion seems preferable. Indeed, the aforementioned conditions 1) and a) require a clear definition of SGEI, i.e. they ask a public authority to specify where a certain activity has to be regarded as "service of general economic interest": despite the fact that Member States are granted (high) discretionary powers to define SGEI, no similar statements exist within the context of R&D activities aimed at promoting the development of the qualifying assets listed by the 2015 Budget Law, and the 2009-2011 Italian Report about implementation of SIEG did not include R&D activities among the services of general economic interest.

CHAPTER 3 – TACKLING FOREIGN TAX INCENTIVES

3.1 Anti-abuse measures as mentioned in the Action Plan on Base Erosion and Profit Shifting

The following paragraphs will address anti-abuse measures provided within the Italian context in light of those listed in the Action Plan on Base Erosion and Profit Shifting (hereinafter: BEPS report).

3.1.1 Neutralizing the effects of hybrid mismatch arrangements (action 2)

BEPS report calls for the development of domestic rules aimed to neutralize the effects of hybrid mismatch arrangements, i.e. "arrangements exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries"[87]. Such arrangements, indeed, may lead to "double non-taxation" (which may not be intended by either country) or to a long-term tax deferral, therefore significantly reducing overall tax on certain taxpayers[88].

Hybrid mismatch arrangements may be based on:

- *Hybrid entities*. i.e. treated as "transparent" in one State and as "non-transparent" in another State;
- *Hybrid instruments,* i.e. instruments which are treated differently for tax purposes in the countries involved.[89]

"Hybrid entities", in particular, represent an extremely relevant issue, since differences in how States apply the "transparency principle" may rise difficulties in the application of tax conventions, especially those aimed at challenging double taxation or double non-taxation.[90] In order to tackle these mismatches, OECD suggests that income derived by or through hybrid entities could be considered as income of a resident of a Contracting State only to the extent that the income is taxed in the hands of a resident of that State.[91]

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[87] See OECD, *Hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 6.

[88] S. CIPOLLINA, *I redditi nomadi delle società multinazionali nell'economia globalizzata,* in Rivista di diritto finanziario e Scienza delle finanze, 2014, I, page 32.

[89] OECD, *Hybrid mismatch arrangements: tax policy and compliance issues,* cit., page 7.

[90] OECD, *The application of the OECD Model Tax Convention to Partnerships",* 1999.

[91] R. DE BOER & O. MARRES, *BEPS Action 2: neutralizing the effects on hybrid mismatch arrangements,* in Intertax, 2015, I, page 32.

According to the OECD proposal and to the OECD Model, some mismatches may arise within the Italian tax system. For instance, where a certain Italian hybrid entity, which is tax-transparent under the Italian law, distributes dividends to a partner resident in another Contracting State (where the Italian entity is qualified as "non-transparent"), those dividends may not be taxable, since they will not be qualified as "dividends" under Article 10 of the OECD Model: indeed, Article 10 applies to "dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State", but the transparent entity can't be qualified as "Italian resident" according to Article 4(1)[92] of the OECD Model, since it lacks of the required link.[93]

Mismatch arrangements may be tackled through several policies: general anti-avoidance rules (GAAR) and specific anti-avoidance rules (SAAR)[94] can reduce the impact of such arrangements on the erosion of tax revenues, but several countries have introduced rules specifically aimed at addressing certain hybrid mismatch arrangements. Within the Italian legal framework, two measures are directed to tackle these issues:

- Profits distributed by non-resident entities are 95% exempt for tax purposes only if the profits are not deductible in the foreign country where the issuer is resident.

  The condition that the income distributed is non-deductible in the issuer's jurisdiction must be proved by a declaration from the issuer itself or by other appropriate evidence[95];
- In the case of Repurchase agreement (Repo) and Securities lending or other transactions that yield similar effects, the Italian taxpayer (borrower) receiving dividends, interests or other proceeds is entitled to a foreign tax

[92] Article 4(1) of the OCSE model: "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein".

[93] S. GRILLI, *Brevi note in tema di applicazione delle convenzioni contro le doppie imposizioni alle società di capitali trasparenti ai fini Ires*, in Riv. Di Dir. Trib., 2006, IX, page 158.

[94] GAAR and SAAR will be specifically analyzed further on.

[95] See Articles 89, para. 3 and 44, para. 2 of ICTA. See also OECD, *Hybrid mismatch arrangements: tax policy and compliance issues*, cit., page 19.

credit, only if these benefits would have been granted to the beneficial owner (lender) of the said income flows (i.e. if the lender is subject to the same tax regime of the borrower). As a consequence, the borrower can claim a foreign tax credit only if the lender is an Italian entity or a foreign entity with a permanent establishment in Italy.[96]

Hybrid mismatches are extremely relevant within the context of the digital economy: as suggested by the OECD, "existing structures within the digital economy take advantage of hybrid mismatch arrangements to achieve BEPS by stripping income from a market […] or by avoiding application of controlled foreign company (CFC) rules or other anti-abuse regimes"[97].

It is doubtful whether the provisions aimed to tackle hybrid mismatches within Italian legal framework are efficient or not within the digital economy; indeed, such provisions are based on the concepts of "residence" and "permanent establishment", which generate several issues about their interpretation when applied to e-companies (see chapter 1).

3.1.2 Limit base erosion via interest deductions and other financial payments (action 4)

BEPS report aims to prevent base erosion (in the form of double non-taxation) through the use of interest expenses. Action 4 considers two different perspectives:

- *Inbound perspective*, i.e. lending from a related entity that benefits from a low-tax regime, to create excessive deductions for the issuer without a corresponding interest income inclusion by the holder, thereby generating double non-taxation;
- *Outbound perspective*, i.e. using debt to finance the production of exempted or deferred income thereby claiming a current deduction for interest expense while deferring or exempting the related income.[98]

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[96] See legislative decree 461/1997, Article 2, para. 2. See also OECD, *Hybrid mismatch arrangements: tax policy and compliance issues*, cit., page 20.
[97] OECD, *Addressing the tax challenges of the digital economy*, in OECDiLibrary, 2014, page 116.
[98] See E.C. MILLAN & M.T. S. ROCH, *Limit base erosion via interest deduction and others*, in Intertax, 2015, I, pag. 59.

Many digital economy players often finance new ventures or acquire start-ups by using debts, so that interest expenses may play an extremely relevant role in order to provide significantly tax base reductions.

In order to avoid interests to turn into a base erosion vehicle, limitations on the deductibility of interests may represent a solution.

In Italy, interest expenses can be deducted (by resident corporations and non-resident companies) within the limit of interest income; if the former exceeds the latter, its deductibility is limited to 30% of the so-called Gross Operating Profit (GOP), as resulting from the P&L.[99]

Such a measure, by limiting deductions on interests, provides similar treatment of debt and equity, and therefore (at the income level) of interests and dividends.

3.1.3 Preventing treaty abuse (action 6)

BEPS Action 6 requires the adoption of treaty and domestic rules in order to prevent "treaty abuse", i.e. the granting of treaty benefits in inappropriate circumstances[100].

The denial of treaty abuse "will ensure that the market country will be able to apply its domestic law unconstrained by treaty rules aimed at preventing double taxation. This is of relevance both where the foreign company has claimed not to have a taxable presence in the form of a PE or when there is indeed a taxable presence in the form of a PE […], but the relevant taxable income is reduced by deductible payments. In cases where such deductible payments would be subject to a withholding tax under domestic law, the market country will be able to apply such a withholding tax without any treaty limitation."[101]

Namely, treaty abuse may turn into:

- Circumvention of limitations in a tax treaty; or
- Circumvention of domestic tax rules using treaty benefits.

[99] See Article 96 of ICTA.
[100] OECD, *Preventing the granting of treaty benefits in inappropriate circumstances,* 2014, page 17.
[101] OECD, *Addressing the tax challenges of the digital economy,* cit., page 113.

Several measures may be implemented to tackle treaty abuses[102]:

1. It is recommended that tax treaties include a clear statement that the contracting States intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or treaty-shopping arrangements[103];
2. It is recommended to include in tax treaties a "limitation on benefits" rule (i.e. specifications of the conditions necessary to be included within the "qualified persons"[104]);
3. It is recommended to add to tax treaties a more general anti-abuse rule based on the principal purposes of transactions or arrangements.

Sometimes, however, in order to prevent some peculiar hypothesis of treaty abuse, addressing the treaty issues may not be sufficient, but changes in domestic laws will be also necessary[105]; in particular, issues that such changes should address include:

- Hybrid mismatches arrangements (*see paragraph 3.1.1)*;
- Tax deductions (*see paragraph 3.1.2)*;
- Transfer mispricing (*see paragraph 3.4.3*).

The above topics will be analyzed, from an Italian perspective, in the specified paragraphs.

3.1.4 Tackling the artificial avoidance of PE status (action 7)

BEPS Action 7 aims to tackle base erosion by developing changes to the definition of "PE" provided by the OECD Model (see Article 5). Indeed, such a definition may sometimes ease the artificial avoidance of PE-status and profit shifting arrangements, by limiting the application of domestic laws related to the

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[102] See A.P. DOURADO, *Aggressive tax planning in EU law and in the light of BEPS: the EC recommendation on aggressive tax planning and BEPS actions 2 and 6,* in Intertax, 2015, I, page 155.

[103] "Treaty shopping" refers to "arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State", see OECD, *Preventing the granting of treaty benefits in inappropriate circumstances,* cit., page 20.

[104] P. VALENTE, *Evasione fiscale e abuso del diritto tra normativa nazionale e internazionale*, in Ipsoa Quotidiano, 2014.

[105] OECD, *Preventing the granting of treaty benefits in inappropriate circumstances,* cit., page 86.

taxation of business profits of non-resident companies.[106] Four main issues are specifically addressed: artificial avoidance of PE status through commissionaire arrangements and similar strategies, artificial avoidance of PE status through the specific activity exemptions, splitting-up contracts and insurance.

These issues may be relevant, also, within the context of the digital economy where, for instance, an online seller of tangible products uses a local subsidiary to conclude sales with clients[107]; the peculiar features of e-companies may even increase the chances to artificially avoid the PE-status.

The artificial avoidance of PE-status through "commissionaire arrangements" seems to be particularly significant within the OECD.

Indeed, the interpretation of the notion of PE provided by the OECD Model may allow contracts for the sale of goods belonging to a foreign enterprise to be negotiated in a certain country by a local agent of that foreign enterprise, without the profits of such a sale being taxable to the same extent as they would be if the sales were made by a distributor (i.e. a PE). Therefore, many enterprises have replaced their proper distributors with "commissionaire arrangements", which according to the OECD have been put in place, in many cases, to erode the taxable base of the State where a certain sale took place; interventions are therefore needed.

Considering Articles 5(5)[108] and 5(6)[109] of the OECD Model, two conditions have to be met in order to qualify an agent as a "PE":

a) the agent acts on behalf of the enterprise and has and habitually exercises the authority to conclude contracts *in the name of the enterprise* relating to the proper business of that foreign enterprise; and

[106] OECD, *BEPS Action 7: preventing the artificial avoidance of PE status*, in OECDiLibrary, 2014, page 2.

[107] OECD, *Addressing the tax challenges of the digital economy*, cit., page 113.

[108] "Where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise."

[109] "An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business."

b) the agent does not have an independent status or does not act in the ordinary course of his business, as provided in Art. 5, par. 6 of the OECD Model.

Condition sub a) is subject to different interpretations among national courts, while it is intended by the OECD Commentary in light of the "substance over form" principle: it is fulfilled where the agent has the authority to conclude contracts *binding on the foreign enterprise*, regardless the fact that those contracts are formally concluded in the name of the foreign enterprise or not.

In other terms, "where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by the foreign enterprise, that enterprise should be considered to have a sufficient taxable nexus in that country, unless the intermediary is performing these activities in the course of an independent business"[110].

Since condition sub a) is variously interpreted, however, condition sub b) is a key element to qualify an agent as a PE. According to the OECD, an agent may be qualified as "independent" if two conditions are met[111]:

1. he is independent of the enterprise both legally and economically. Several criteria may be used to evaluate the fulfillment of this condition, but the OECD highlights that it is unlikely to deem an agent as "independent" if instructions received from the principal result in a deep control of the agent's work;
2. he acts in the ordinary course of his business when acting on behalf of the enterprise, i.e. he performs activities for which he assumes risks and is correspondingly rewarded, "having regard to the business activities customarily carried out within the agent's trade"[112].

Within the Italian context, problems arise especially from condition sub a).

The Italian legal framework provides no specific measures to counter treaty abuse; however, Article 1731 of the Civil Code states that "the commissionaire

[110] OECD, *BEPS Action 7: preventing the artificial avoidance of PE status*, cit., page 11.
[111] See OECD Commentary.
[112] A. PERSIANI, *Some remarks on the notion of permanent establishment in the recent Italian Supreme Court jurisprudence*, in Intertax, 2012, XII, page 679

agreement is a mandate aimed at buying or selling goods *in the name of the commissionaire* and on behalf of the principal"[113]. A strict interpretation of the provisions of the OECD Model may lead to exclude the commissionaire from the area of the PE, since he is not allowed to conclude contracts in the name of the enterprise.

While the aforementioned "substance over form" principle may reduce the chances to use commissionaire arrangements as a base erosion vehicle, a (partial) replacement of Article 5(5) of OECD Model with a less generic provision seems anyway appropriate.[114] The necessity of such a replacement especially arises in light of recent domestic judgments, which have excluded, in several cases, the possibility to qualify an agent as a PE.

The *Boston Scientific International BV v. Italian revenue agency* case[115] concerned an Italian subsidiary (Boston Spa) of a Dutch parent company (Boston BV), with both the enterprises being part of the "Boston Scientific" group. The Italian subsidiary, through a commissionaire agreement, was entitled to sale medical products manufactured by other enterprises of the group, in exchange for a commission fee calculated according to the agreement.

The Tax Authority concluded that the Italian subsidiary should have been qualified as a PE of the Dutch enterprise, since the former lacked of independence of the latter.

The first and second instance judgments, however, rejected the position of the Tax Authority. Namely, the second instance judgment[116] pointed out that a PE is deemed to exist only to the extent the agent is capable to bind Boston BV as if it were one of its employees. Within the *Boston case*, on the contrary:

- Boston Spa "acts with third parties by spending its own name", and "it acts therefore on its own";

[113] A. PERSIANI, *Some remarks on the notion of permanent establishment in the recent Italian Supreme Court jurisprudence*, cit., page 679.
[114] This necessity is clearly stated by the OECD in OECD, *BEPS Action 7: preventing the artificial avoidance of PE status*, in OECDiLibrary, 2014, page 4.
[115] Italian Supreme Court, judgment n. 3769 of March 9, 2012.
[116] Tax court of Lombardia, judgment n. 137 of December 2, 2009. See also M. PIAZZA & A. DELLA CARITA', *Quando il commissionario agisce come stabile organizzazione?*, in Corr. Trib., 2011, V, page 365 ff.

- Boston Spa acts in its own interests, “which is earning the fee linked to each order and represents its main source of proceeds”;
- Boston Spa autonomously manages the business risks related to the sale of the products, as shown by the existence of a factoring contract (which allows Boston Spa to transfer its customer receivables to another enterprise) and of an insurance contract (which covers the risks for any contract breach caused by the actions of the promoters).

These elements demonstrate the existence of “a situation of manifest autonomy of Boston Spa towards the group to which it belongs”; therefore, Boston Spa is unable to exercise a binding effect on Boston BV.

The Supreme Court upheld the second instance judgment, confirming that a commissionaire does not constitute a PE if he acts in his own name and under the applicable general law of a State that does not legally bind the principal; namely, considering that the commissionaire entered into contracts in its own name, “no deemed PE could exist since as a matter of law the commissionaire does not enter into contracts in the name of its principal”[117].

The Tax Court of Lombardia ruled on the relationship between Boston BV and Boston Spa also in other cases, providing similar conclusions. In 2011[118] and 2012[119], the Court pointed out that the existence of an autonomous management of the business risks and the fact that Boston Spa acts in his own name, as explicitly established within the contract concluded between Boston Spa and Boston BV, exclude the PE-nature of the agent to the extent the agent’s activities do not exceed the contractual provisions.

More recent judgments confirm as well the aforementioned rulings. In judgment n. 1520 of March 24, 2014, the Tax Court of Lombardia, while analyzing the relationship between a German company and an Italian entity entirely controlled by the former, stated that the Italian company could not be qualified as a PE since

[117] UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS, *Comment letter on the OECD discussion draft on BEPS action 7*, in Comments received on public discussion draft on BEPS action 7, 2015.

[118] Tax Court of Lombardia, judgment n. 125 of October 20,2011.

[119] Tax Court of Lombardia, judgment n. 139 of October 29, 2012.

it was not allowed to conclude contracts in the name of the German enterprise, therefore having no binding powers on the parent company.

In judgment n. 6464 of July 2, 2014, the Tax Court of Milan dealt with the relationship between a Belgian company (VF Europe) and an Italian company (VF Italia), both part of the "VF Corporation" group. The above relationship is regulated by a commissionaire agreement; while stating that the existence of a PE depends on the substance of the connection existing between the companies (i.e. regardless of formal aspects), the Court then points out that VF Italia can't be qualified as a PE, since it acts in its own name, through its own employees and facilities. The fact that the arrangement between the companies provides for some guidelines aimed to regulate the commercial policy of the Italian entity is not sufficient in order to state the existence of a PE: indeed, such guidelines are necessary in order to avoid possible conflicts of interest within the group and do not exclude, by themselves, the independence of the agent.

To sum up, according to the above rulings provided by Italian courts a commissionaire arrangement does not necessarily constitute an artificial avoidance of a PE (even if it may be considered so, in some cases). Tackling profit shifting based on such arrangements, therefore, calls for more specific and effective provisions from the OECD.

3.1.5 Collection of data on BEPS (action 12)

Action 12 deals with providing disclosure rules for aggressive or abusive transactions or arrangements, in order to improve the information flow towards tax administration.

In 2013 the Italian Tax Authority introduced a "cooperative compliance programme" intended to establish a relationship between the Tax Authority and "Large business taxpayers" (i.e. taxpayers who have a minimum total turnover of EUR 100 million) grounded on cooperation and transparency, in order to promote voluntary compliance.

The programme allows the taxpayer to jointly examine with the Tax Authority some relevant issues related to its tax risks management system. By applying to the programme, also, taxpayers agree to adopt transparent behaviors while dealing with the tax administration and benefit of legal certainty on specific transactions, therefore reducing litigations.

In exchange, the Tax Authority "should be prepared to meet taxpayers' needs and to resolve relevant issues in a timely and effective manner"[120].

3.1.6 Treaty shopping and withholding taxes on interests and royalties

As already mentioned, "treaty shopping" deals with arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State.

The targets such arrangements may tend to include the circumvention of withholding tax on interests and royalties.

Several measures (unilateral/bilateral) can be adopted in order to tackle these arrangements; within the Italian context, no specific unilateral measures are adopted, while the majority of bilateral treaties stipulated with other States include clauses to reduce treaty-shopping impact, e.g. the "beneficial owner" clause (see also chapter 2, par. 2.1.1).

The beneficial owner clause denies the application of treaty provisions when the beneficiary is a mere intermediary between the final beneficiary and the subject who provides a certain payment.[121]

3.2 GAAR and SAAR

A "general anti-avoidance rule" (GAAR) is a principle aimed to counteract the avoidance of tax, by allowing tax authorities to deny a certain tax benefit when related to transactions which lack of purposes different from the creation of the benefit. Within the Italian context, the question whether a GAAR exists or not has been broadly discussed, as it will be explained in the following paragraph.

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[120] See Italian Revenue Agency's "Cooperative compliance programme for large business taxpayers in Italy – Launch of a pilot project", available at http://www.agenziaentrate.gov.it/wps/content/nsilib/nsi/documentazione/regime+di+adempimento+collaborativo+-+grandi+contribuenti/pilot+project+-+english+version.

[121] P. VALENTE, *Convenzioni internazionali contro le doppie imposizioni*, Milan, 2012, page 112; C. SACCHETTO, *Diritto tributario (convenzioni internazionali),* voce in *Enciclopedia del diritto*, 2007, Annali I, pag. 528.

A “specific anti-avoidance rule” (SAAR) is an anti-avoidance rule aimed to deal with particular situations or transactions; within the Italian legal framework, examples of SAAR are the rules concerning transfer pricing, CFC and thin capitalization[122].

GAARs and SAARs applicable within the Italian legal framework are discussed in the following paragraphs.

3.2.1 GAAR – Article 37-bis of decree 600/1973 and following developments

In 1997, Italy introduced Article 37-bis within decree 600/1973. It states that “all acts, facts and agreement, either connected or not, made without a sound-business purpose, aimed at circumventing obligations or prohibitions provided for by the tax laws and at obtaining tax reductions or refunds otherwise undue, cannot be opposed to tax authorities”[123].

Article 37-bis only deals with direct taxation, therefore it lacks of an all inclusive scope of application; however, due to the width of its application, this provision has been considered as a sort of GAAR[124].

The matter changed between 2005 and 2008, due to some rulings of the Supreme Court (SC): indeed, the SC introduced[125] the notion of “abuse of law”, i.e. a fundamental principle expressed by the ECJ which aims to fight undue benefits obtained by a certain taxpayer through an abusive use of laws. Namely, according to Ministerial Circular 320/E, a certain transaction may be considered as fulfilling an “abuse of law” scheme when the taxpayer use “manipulations, loopholes and stratagems that, even if formally lawful, distort the general principles underlying the tax system”.[126]

The SC stated that all Member States should exercise their powers in order to grant the compliance of domestic laws with EU principles; since the prohibition of abuses of law is one of such principles, tax authorities are therefore entitled to

[122] R. ZIELKE, *Anti-avoidance legislation of mayor EC member countries with reference to the 2014 corporate income tax burden in the thirty-four OECD member countries: Germany, France, United Kingdom and Italy compared,* in EC Tax Review, 2014, XII, page 111.
[123] A. MANZITTI, *Abuse of tax law across Europe (part two)*, in EC Tax Review, 2010, III, page 124.
[124] A. MANZITTI, *Abuse of tax law across Europe (part two)*, cit., page 124.
[125] Italian Supreme Court, case 20398 of April 29, 2005.
[126] A. MANZITTI, *Abuse of tax law across Europe (part two)*, cit., page 125.

deny the legitimacy of transactions under this point of view, even if no specific (*rectius*: written) provisions exist.

These conclusions have been partially modified in 2008[127]: the SC stated that EU laws may be considered as a basis to tackle abusive behaviors only to the extent they are related to harmonized taxes (e.g. VAT).

About non-harmonized taxes (e.g. direct taxation), abusive transactions may be challenged, instead, by applying Article 53 of the Constitution[128]: according to the SC, the "ability to pay" principle expressed by this provision excludes the chance for a taxpayer to benefit from a tax advantage deriving from the misuse of legal instruments. On the ground of Article 53, direct tax abuses may be challenged even when they fall outside the scope of application of Article 37-bis[129].

To sum up, despite the fact Italy has no proper anti-avoidance (written) rule, the tax authority is however able to deny the tax advantages obtained through transactions which lack of valid economic reasons and are intended to obtain tax savings by circumventing the applications of Italian laws.

According to some scholars[130], Italian anti-abuse provisions and principles may also apply to international situations, even where treaty provisions come into play. Some bilateral agreements explicitly exclude the application of certain provisions where taxpayers are intended to use them for tax avoidance purposes.

3.2.2 SAARs

Within the Italian legal framework, several specific anti-avoidance rules are provided:

1. CFC rules – Articles 167-168 of ICTA deal with the income earned by companies located abroad which are controlled by Italian enterprises, by stating that, in some circumstances, such a income is directly imputed to

[127] Italian Supreme Court, judgments n. 30055, 30056, 30057 of December 23, 2008.

[128] This provision requires a link between taxpayers' "ability to pay" and the overall taxation imposed on them.

[129] G. MELIS, *Abuso del diritto (rectius, elusione) ed interpretazione nel diritto tributario*, 2015, page 34.

[130] A. MANZITTI, *Abuse of tax law across Europe (part two)*, cit., page 127.

the Italian enterprise, regardless of dividend distributions. Namely, this regime applies first to the income (whether active or passive) earned by companies located in "low tax jurisdictions"; secondly, it may also apply to income earned by companies located somewhere else, where come conditions are fulfilled. This regime will be further analyzed in paragraph 3.3;

2. Black list costs – according to Article 110, paragraphs 10-11 of ICTA, costs arising from transactions between an Italian enterprise and an enterprise located in a low tax jurisdiction may be deducted, but heavier information requirements are provided. See paragraph 3.4.4.
3. Thin capitalization – until 2007, Article 98 of ICTA provided a proper "thin capitalization" rule, aimed to tackle the base erosion deriving from the use of debt capital instead of risk capital (thereby taking advantage of the more favorable tax regime provided for interest expenses than for dividends – indeed, while interests are deductible, dividends are not). However, as already said, Article 98 has been eliminated in 2007; actually, the tax regime of interest is provided only by Article 96 of ICTA (see par. 1.1.1);
4. Dividends and tax havens - the 95% tax exclusion does not apply to dividends distributed by enterprises located in tax havens, unless through a preliminary ruling the beneficiary demonstrates that the participation does not have the main effect of locating the income in a low tax jurisdiction (see par. 1.1.1).

3.3 CFC and digital economy

The "controlled foreign companies" (CFCs) rules have been introduced in a large number of countries, in order to attract to domestic taxation the income earned by entities located in "tax havens" and controlled by domestic companies. CFC provisions can therefore help tackling base erosion produced by the deferral of taxation on income accumulated by subsidiaries located in countries where they are allowed to benefit from an extremely favorable tax treatment.[131]

3.3.1 The Italian tax regime on CFCs

The Italian CFC tax regime was introduced in 2001 and is provided by Article 167 of ICTA. CFC legislation aims to provide regulation about the taxation of the income earned by CFC entities (i.e. foreign entities located in low-taxation countries) controlled by Italian shareholders, in order to avoid base erosion arrangements.

CFC provisions apply to all resident taxpayers (whether they are individuals or companies; Italian PE of non-resident persons are however excluded) which control enterprises, companies or other bodies located in low tax jurisdictions; in these cases, the income earned by the CFC entity will be imputed to the Italian shareholder, regardless of the actual dividend distribution and proportionally to the participation held, and therefore taxed at the Italian ordinary tax rate.[132]

The notion of "control" is the one provided by Art.2359, par. 1-2[133] of the Civil Code; it exists where a certain entity:

a) holds more than 50% of the voting rights in another entity;
b) holds enough voting rights (less than 50% however) to exercise a "prevailing influence"[134] in another entity.

On the contrary, the notion provided by Article 2359, par. 3, which describes "control" as prevailing influence due to contractual agreements, seems to be not applicable within the context of CFC. Indeed, a control without participation would not comply with the objective of Article 167 of ICTA, i.e. would not allow the CFC's income to be imputed to the Italian entity. Therefore, "control" requires the possession of a participation in the CFC enterprise[135].

[131] S. SERBINI, *The new Italian legislation on controlled foreign companies*, in Intertax, III, 2001, page 86.
[132] P. VALENTE & M. MAGENTA, *Italy: new CFC legislation*, in Intertax, II, 2001, page 52
[133] Art. 167, par. 3 of ICTA.
[134] P. VALENTE & M. MAGENTA, *Italy: new CFC legislation*, cit., page 53
[135] D. STEVANATO, *Controlled Foreign Companies: concetto di controllo e imputazione del reddito*, in Riv. dir. trib., 2000, I, page 778.

CFC rules apply whether in case of “direct control” and “indirect control”, through nominees or through interposed persons as holding or sub-holding companies[136].

As already mentioned, CFC entities are entities “located” in “low tax jurisdictions”. Namely:

- the notion of “location” means that such a regime applies with respect to qualifying participations held in entities subject to a low-tax regime, regardless of potential limitations related to the notion of “residence” adopted in the low tax State;
- the notion of “low tax jurisdictions” refers, first, to the countries included in the “black list” (see DM 21/11/2001): such countries present a taxation which is substantially lower to the Italian one, or lack of appropriate exchange of information.

  A recent reform[137], however, introduced further specifications about the notion of “substantially lower” level of taxation, by précising that such a situation exists where the taxation level applied in the foreign country is at least 50% lower than the Italian one.

  Furthermore, Art. 167, par. 4 states that CFC rules must be applied to those *special* tax regimes which provide a taxation level which is at least 50% lower than the Italian one (regardless of the fact that the foreign States where they are applied may have a *general* tax regime which does not require the application of CFC rules).[138]

  Therefore, some amendments to the black list seem to be necessary, in order to comply with this provision; however, it has to be highlighted how the new Art. 167, par. 4 will turn into a reduction of the countries qualified

[136] S. SERBINI, *The new Italian legislation on controlled foreign companies*, cit., page 88. See also Circular n. 207/2000 of the Italian Revenue Agency.
[137] See new Art. 167, para. 4 of ICTA.
[138] L. MIELE, *CFC, taglio alla black list*, in IlSole24Ore, 24/12/2014. Available at http://www.ilsole24ore.com/art/norme-e-tributi/2014-12-24/cfc-taglio-black-list-064031.shtml?uuid=ABBhQCVC.

as "low tax jurisdictions" (and consequently included in the list)[139], thereby narrowing the applicability of the CFC regime.

The whole CFC income has to be allocated to the Italian controlling entity; it has to be calculated according to Italian legislation governing business income[140] (i.e. Article 55 ff. of ICTA).

Dividends distributed by the CFC entity to the Italian shareholder are not subject to tax up to the amount which has already been taxed as a consequence of the application of CFC rules[141]; such a provision is aimed to avoid double taxation.

The Italian shareholder is also entitled to benefit from a foreign tax credit for taxes paid abroad by the CFC on income included in the one which is allocated on the Italian shareholder.[142]

In two cases the application of the CFC regime can be excluded[143]:

1. the Italian controlling entity gives evidence that the CFC carries on an actual commercial or industrial activity within the country where it's based;
2. the Italian controlling entity may prove that the holding of the participation in the CFC entity does not have the main effect of locating the income in a low tax jurisdiction.[144]

According to Art. 167, par. 5-bis, condition n.1 may be inapplicable where CFCs receive "passive income" (e.g. dividends, royalties) and fees from intra-group services which represent more than 50% of the CFC's proceeds[145]. Such a provision intends to attract to domestic taxation the income earned in tax havens by enterprises which, despite being formally autonomous, only carry on "passive" activities (i.e. consisting in the simple exploitation of assets).

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[139] L. MIELE, *CFC, taglio alla black list*, in IlSole24Ore, 24/12/2014. Available at http://www.ilsole24ore.com/art/norme-e-tributi/2014-12-24/cfc-taglio-black-list-064031.shtml?uuid=ABBhQCVC.

[140] S. SERBINI, *The new Italian legislation on controlled foreign companies*, cit., page 89.

[141] S. SERBINI, *The new Italian legislation on controlled foreign companies*, cit., page 89.

[142] P. VALENTE & M. MAGENTA, *Italy: new CFC legislation*, cit., page 55.

[143] Art. 167, paragraph 5 of ICTA.

[144] P. VALENTE & M. MAGENTA, *Italy: new CFC legislation*, cit., page 53.

[145] R. LUGANO & M. NESSI, *Le recenti novità e gli aspetti critici relativi alla disciplina delle "controlled foreign companies"*, in Riv. Dottori comm., 2011, I, page 72.

However, as specified by the Italian tax authority, Article 167(5-bis) only introduces a presumption, which may be overcome through a preliminary ruling.[146]

Since 2010, the CFC regime may be applied also to CFC which are not located in low tax jurisdictions (see Art. 167, paragraphs 8-bis and 8-ter), where:

- the tax-rate levied on the CFC entity is at least 50% lower than the tax rate the entity would have been subject to if it had been resident in Italy; and
- CFCs receive passive income and fees from intra-group services which represent more than 50% of the CFC's proceeds.[147]

However, the Italian controlling entity may avoid the application of the CFC regime by giving evidence (through a ruling procedure) that the establishment of the CFC entity does not represent an artificial arrangement aimed at achieving an undue tax advantage. Such a provision was introduced in order to make CFC rules consistent with the freedom of establishment granted by EU laws[148], since it is grounded on a principle stated by the ECJ.[149] According to ECJ conclusions, a controlled entity located in a EU member states can be qualified as an artificial arrangement if:

- Has a physical presence acknowledgeable by third parties;
- Undertake a genuine economic activity.[150]

3.3.2 CFC: addressing the challenges of the digital economy

In its report about BEPS Action 1 ("Addressing the tax challenges of the digital economy"), OECD highlights the importance of CFC rules in order to tackle base erosion within the digital economy: "income from digital products and services provided remotely is frequently not subject to current taxations under CFC

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[146] See C.M. 51/E, 6/10/2010.

[147] P. SCARIONI & S. MUNI, *The new Italian CFC rules: EU holding companies challenge the artificial arrangement assessment,* in Intertax, 2010, X, page 527; S. GARUFI, *La nuova disciplina delle CFC,* in Rass. Trib., 2010, III, page 619.

[148] P. SCARIONI & S. MUNI, *The new Italian CFC rules: EU holding companies challenge the artificial arrangement assessment,* cit. , page 528

[149] See *Cadbury-Schweppes* case (C-196/04). In this case, the ECJ discussed the compatibility between EU laws and CFC rules.

[150] A. DRAGONETTI, V. PIACENTINI & A. SFONDRINI, *Manuale di fiscalità internazionale*, Milan, 2008, page 141.

rules"[151]. According to OECD, namely, modifications of CFC rules must be provided to make them appropriate to address the taxation of mobile income typically earned in the digital economy.[152]

In chapter 1, the main tax challenges related to the digital economy have been highlighted; since e-commerce fosters the interactions with foreign markets, enterprises can easily operate worldwide regardless of their place of residence and even in the absence of a fixed place of business abroad. Thus, chances to take advantage of low tax regimes provided by low tax jurisdictions are increased.

The *Amazon sales model*, for instance, is based on several enterprises located all over the world; however, sales are mostly made by a company located in Luxembourg, while the other enterprises are deemed to carry out "order fulfillment" operations[153]. This model allows Amazon to benefit from the low tax regime provided by Luxembourg.

Therefore, regardless of the specific features of each State's CFC legislation, it seems that such (preliminary) problems limit the chances for any CFC framework to avoid base erosion properly.

With the above in mind, the Italian CFC system provides tackling of base erosion on a wide scale: indeed, all the income produced by the controlled entity is taken into account ("jurisdictional approach"), and CFC provisions apply not only within the context of tax havens, but may be used in a larger amount of situations (see Art. 167, par. 8-bis, and Art. 168, which deals with collateral entities).

Also, as mentioned in the above, some provisions aim to specifically regulate passive income (e.g. royalties and dividends), which may be extremely relevant within e-commerce.

[151] OECD, *Addressing the tax challenges of the digital economy*, cit., page 120.
[152] OECD, *Addressing the tax challenges of the digital economy*, cit., page 120.
[153] S. CIPOLLINA, *I redditi nomadi delle società multinazionali nell'economia globalizzata*, cit. page 42.

3.4 Cost-sharing arrangements

"Cost-sharing arrangements" (CSAs) are contracts agreed among business enterprises to share the costs and risks of developing, producing or obtaining assets, services, or rights, and to determine the nature and extent of the interests of each participant in those assets, services, or right.[154]

In such agreements, each participant's share of the overall contributions will be consistent with each participant's share of the overall expected benefits to be received under the agreement.

Cost-sharing arrangements may be used, for instance, to share the costs arising from the development of intangible goods, allowing the participants to avoid licensing fees. Indeed, within such CSAs it is possible ("buy-in payment" system) that only one of the participants is the legal owner of the goods developed, while economically all the other participants are co-owners (and not licensees) as a consequence of the contribution paid. Therefore, no royalty (or similar considerations) will be necessary.[155]

CSAs involving intangibles have become increasingly popular among MNEs[156] and represent, as a matter of fact, a major issue within the digital economy.

CSAs not only allow successful parent companies to exploit their market dominance, but may also turn into tax avoidance in the form of profit shifting: indeed, although transfer pricing rules apply to such situations, calculating the market value according to the arm's length principle may be hard (*see paragraph 3.4.3)*, therefore increasing chances for enterprises of the group to shift profits and benefit from a lower overall taxable income.[157]

Within the Italian legal framework, costs related to CSAs are deductible if some conditions are fulfilled. Namely, these conditions relate to:

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[154] OECD, *Transfer pricing guidelines for multinational enterprises and tax administrations*, 2010, page 220.

[155] OECD, *Transfer pricing guidelines for multinational enterprises and tax administrations*, 2010, page 221.

[156] Y. BRAUNER, *Cost sharing and the acrobatics of arm's length taxation*, in Intertax, 2010, XI, page 555.

[157] S. CIPOLLINA, *I redditi nomadi delle società multinazionali nell'economia globalizzata*, cit. page 39.

1. The “inherence” principle;
2. Formal requirements;
3. The adequacy of the costs under transfer pricing rules.

These issues will be analyzed in the next paragraphs.

3.4.1 Inherence

The concept of “inherence” provided by Article 109 of ICTA relates to the concept of “utility” provided by OECD[158]: they both admit costs deduction if they are linked to the global activity conducted by the enterprise (regardless, therefore, of the fact that those costs have turned into specific proceeds[159]).

3.4.2 Formal requirements

In order to be deducted, the enterprise must comply with some documentary requirements; namely, the company has first to give evidence of the existence of the costs and of the fulfillment of Article 109, par. 4 of ICTA, which asks for the inclusion of these costs in the P&L (*see chapter 1).*

Moreover, the enterprise will have to disclose the cost-sharing agreement (which is also relevant to evaluate the adequacy of these costs, *see paragraph 3.4.3*).

Furthermore, a brief analysis of recent case law[160] suggests that, in order to avoid objection from the tax authority within the context of documentary requirements, the enterprise should give evidence that the accuracy of its financial statements has been checked by a board of auditors.[161]

3.4.3 Adequacy under transfer pricing rules

[158] S.CARMINI & R. LUPI, *Accordi per la ripartizione dei costi tra inerenza e prezzi di trasferimento*, in Dialoghi Tributari, 2011, I, page 88.

[159] S.CARMINI & R. LUPI, *Accordi per la ripartizione dei costi tra inerenza e prezzi di trasferimento*, cit., page 87. In this article the authors analyze sentence 299/2010 from the Milan’s Provincial Tax Commission.

[160] Italian Supreme Court, judgment n.5926 of March 12, 2009.

[161] S.CARMINI & R. LUPI, *Accordi per la ripartizione dei costi tra inerenza e prezzi di trasferimento*, cit., page 89.

Since they refer to multinational groups, CSAs will have be consistent with transfer pricing (TP) rules[162], which aim to regulate transactions between companies of the same multinational groups.

Namely, TP rules apply in the following cases:

1. Transactions between resident companies and non-resident companies, where the non-resident company has (direct or indirect) control over the resident one;
2. Transactions between resident companies and non-resident companies, where the resident company has (direct or indirect) control over the non-resident one;
3. Transactions between resident and non-resident companies, where they are both controlled by the same company.

The notion of "control" is the one provided by Article 2359 of the Civil Code.

According to TP regime, the aforementioned transactions are deemed to occur at the "normal value" for tax purposes, (see Article 9 of ICTA), regardless of the price declared by the company involved.

Such a normal value is determined according to the "arm's length principle", and it's therefore equivalent to the "market value". From CSAs' perspective, this means that "a participant's contribution will have to be consistent with what an independent enterprise would have agreed to contribute under comparable circumstances, given the benefits it reasonably expects to derive from the arrangement"[163]. The Italian tax authority, however, considering that in some circumstances it may be extremely hard to find out a comparable market value due to the lack of similar transactions, has listed other parameters to take into account while evaluating the adequacy of the price agreed between the parties (e.g. balance between benefits and contribution[164]).

[162] See Article 110, paragraphs 7 ff of ICTA.

[163] OECD, *Transfer pricing guidelines for multinational enterprises and tax administrations*, 2010, page 222.

[164] M.C. 22/10/1980. See also G. VASAPOLLI & A. VASAPOLLI, *Inerenza e congruità degli addebiti intercompany*, in Bilancio e reddito d'impresa, 2014, VII, page 11; C. BUCCICO, *La tassazione dei gruppi di impresa*, Sant'Arcangelo di Romagna, 2014, page 328.

3.4.4 Costs deduction & low tax jurisdictions

The deduction of costs related to transactions between an Italian enterprise and an enterprise located in a low tax jurisdiction (according to the "black list", *see paragraph 3.3.1)* is subject to a special regime[165]. Namely, in order to be allowed to deduct these costs, the Italian enterprise will have to give evidence that, alternatively:

- The non-resident company primarily carries out a business activity;
- The transactions have been effectively concluded and relate to business interests.

In such situations, therefore, a heavier burden of proof will arise on the Italian enterprise in order to be allowed to deduct the aforementioned expenses.

[165] See Article 110, paragraphs 10-11 of ICTA. However, this regime does not apply where the provisions about CFC (Articles 167-168 of ICTA) are applicable, according to paragraph 12.

APPENDIX

The following issues have been considered non-relevant from an Italian perspective:

- *Add-back taxation [C1, letter h)];*
- *Check-the-box regulations [C1, letter h)];*
- *Profit split [D1, letter e)];*
- *Switch-over clauses [D3, letter e)].*

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IMPACT OF THE DIGITAL ECONOMY ON TAXATION

VAT, sales tax and other (indirect) taxes

Francesco Capogrossi

107393

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INTRODUCTION

The society and its mores have over time been sources of inspiration for the Law. With the evolution of morals and the intellectual, cultural and technological developement, the law is updated in an attempt to regulate the new situations emerged. The development of information technology and Internet have caused controversy and legal discussions, especially in the sphere of taxation.

Tax Law, in my opinion, is the branch more complex to adapt to e-commerce. It has faced great challenges to figure out how to render the electronic transactions and if the existing taxes were sufficient or whether it was necessary to introduce a new tax system.

The major problem faced by the Italian tax system has been the mode of application of VAT to electronic commerce, taking in the view that this tax is a tax within the Community as the harmonization of tax legislation is an essential requirement. The facilitation of distance communication, brought about by Internet, has intensified and facilitated not only the exchange of information, but also the production processes, business and trade in goods and services.

In this scenario, Internet has given rise to new concepts of trade and services, where intangibles or incorporeal goods represent an important innovation in economic and social relations with specific tax implications for these activities. Electronic commerce has changed all economic profiles going from a closed market and localized to an open and global market, creating new opportunities for small, medium and large enterprises, also involving the private citizen, encouraging a large movement of goods and riches.

In addition to the numbers, the fact remains, that the rapid and in some ways unexpected spread of Internet has produced, in no time, the economic, commercial and financial of exceptional before which the States and the international organizations concerned with the phenomenon, could not remain insensitive. The growth and the rapid spread of the Internet creates a new “cyber enterprise” every day, that uses virtual reality in various ways for commercial purposes.

As it will be seen below, the situation is still not very clear and delineated, but the encouraging signs are not lacking. There’s no reason not to hope for a continued evolution of the tax system, to make it that there will be a real equivalence between the traditional and the digital economy, thus determining a mutual benefit for either consumers and for entrepreneurs but especially also for the national economy.

CHAPTER 1

DIGITAL ECONOMY

The definition "digital economy" refers to an economy that is based on digital technologies.

The digital economy is also sometimes called "Internet economy", "new economy", or "web economy". More and more often, however, the new economy is interwoven with the traditional techniques of management and business. The boundaries then always appear Less Defined.

According to *American Chamber of Commerce in Italy* and the scientific contribution of *McKinsey & Company*, the first data confirm the positive trend: the impact of the digital economy on Italian GNP (Gross National Product) is 2% and 14% of the contribution to GNP growth in the last years. Internet indeed has created nearly one million jobs[1].

Companies who consider Web as the favorite channel for selling products and services, or undertake new relationships with potential customers, have 10% average annual growth compared to those not yet digitally active. For those visionary which offer services abroad, the expansion is 200% thanks to the exports "web enabled".

The very surprising fact is that the greater part of the economic impact of Internet comes from traditional sectors than those born with the proliferation of Internet.

Since the Web was born, Internet has become a great resource for people, public organizations and companies: firstly for its innovative services such as communication channels, purchasing behaviours (e-commerce), household

[1] A. BEGNINI, *Una rete per potenziare la digital economy italiana*, Milano 2013.

accounts (banking and financial services online) and secondly for the classic mode of exchange of information (forums, newsletters , corporate websites).

Despite the fine premises, the development of digital economy in Italy is still very much lagging behind more developed countries of Europe. According to the index called *Web Intensity Index* created by *McKinsey*, which evaluates three aspects:

- the *engagement*, namely the intensity of Internet use by individuals, businesses and governments;
- the *environment*, that is access to infrastructure and the spread of broadband; and
- the *expenditure*, namely the volume of e-commerce and online advertising,

Italy will find it only under the 20th place.

In the Digital Europe, Italy, Greece, Bulgaria and Romania are the taillights. The new index of the digital economy and society (Desi - Digital economy and society index), developed by the EU Commission, sais this. Putting together 33 indicators contained in five main categories (connectivity, digital skills, online activities, integration of digital technologies, digitization of public services) Italy is 25th on the 28 EU countries.

For the EU, Italy is in the group of countries with “low performance”. With 0.36 for the total score (ranging from 0 to 1), the country tread, Denmark, is far removed (0.68) while the worst, Romania (0.31), is really close.

In general, the majority of EU citizens now use the Internet regularly and to connect to the network in 2014 it was as much as 75% of the population compared to 72% in 2013. But this average falls within a range that sees at the head Luxembourg with 93% and at last Romania (48%). That said, on the first three steps of the podium in the ranking of Digital Europe. the European Union puts

Denmark, Sweden and the Netherlands. The UK is in sixth place, Germany in tenth, twelfth Spain, France in fourteenth. All are above the European average (0.47).

Per l'Italia la strada disegnata dall'indice Desi è invece indubitabilmente in salita. Il Italy has the lowest level of coverage of the EU for fast internet connections: 2.2% of subscriptions of the total number of subscribers to fixed broadband is far from the 22% of the EU average.

In addition, 59% of the population uses Internet (aged between 16 and 74 years) compared to 75% of the EU average. The rate is among the lowest in Europe. In addition to this, we must say that there is a 31% of the Italian population that has never used Internet.

Who surfs Internet makes little reading (60%, 26th place) of the newspapers online, low use of TV on the Internet (0.5%, the last in EU) and video on demand (20%, 21st place), few social network (58 %, 22 nd). Although online shopping and home banking increased[2].

In order to analyze the real problems and find a solution, we could start for example by removing the barriers that prevent the development of broadband. The digital division is in fact still the main reason of poor utilization of services such as social networks, video streaming, file exchange. Moreover, companies that decide to sell their products online should offer more guarantees to users, or communicate with greater intensity the absence of dangers in the purchase, so to overcome the cultural problems.

Another serious problem is the lack of specialized digital skills. The absence of e-skills qualified reduces the possibility of evolution and emersion of start-ups as it happens in most of the world. Responsibility must be attributed also to the lack of attention paid by Italian universities: the number of graduates in disciplines related

[2] A. BIONDI, *Italia fanalino di coda nella Ue digitale*, in Il Sole 24 Ore, February 25th, 2015.

to the internet tecnologies remained nearsly constant while it has soared in the other advanced economies.

Taken into account this brief identification of the digital economy and the italian situation, it is necessary to define the e-commerce.

Electronic commerce, commonly known as e-commerce, consists of the buying and selling of products or services over electronic systems such as Internet and other computer networks.

The World Trade Organization defines e-commerce as "*the production, distribution, marketing, sales or delivery of goods and services by electronic means*"[3].

The Organization for Economic Co-operation and Development (OECD) defines e-commerce as commercial transactions, involving both organizations and individuals, that are based upon the processing and transmission of digitized data, including text, sound and visuals images and that are carried out over open networks (like, the Internet) or closed networks (like, AOL or Mintel) that have gateway onto an open network[4].

E-commerce may thus be defined as those commercial transactions carried out using electronic means, in which goods or services are delivered either electronically or in their intangible or tangible form[5].

The indirect electronic commerce is the form of commerce easier to handle, given that the physical delivery of the asset at the consumer is done by mail or courier, and allows, therefore, to easily identify the place in which the transaction is made.

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[3] *Work programme on electronic commerce*, Adopted by the General Council on 25 September 1998, www.wto.org.

[4] A. TIWARI, S.R. DINODIA & Co., *International taxation of E-commerce*, HG Legal Resources, 2014.

[5] P. PISTONE, *Centro di attività stabile e stabile organizzazione: l'IVA richiede un'evoluzione per il XXI secolo?*, in *Diritto Tributario*, Milano, anno IX, n.1, january 1999, p.28.

Regarding the direct e-commerce, on the other hand, the whole business transaction (purchase, sale and delivery) is done via computer, that is, through the supply of virtual products. This sector is characterized by reason of the fact that the services (e.g. Software) are intangible at the start by the lender and materialized on arrival by the recipient (download).

According Pullino [6], the direct e-commerce is charachterized by the dematerialization of goods and services.

Art. 7, par. 1, Reg. 282/2011 EU, states that "*The services supplied by electronic means*"[7] shall include services provided through Internet or an electronic network, the nature of which renders their supply essentially automated together with minimal human intervention and impossible to ensure in the absence of information technology.

Par. 2, Art. 7, Reg. 282/2011 EU, defines transactions falling within the direct electronic commerce (e.g. supply of digitized products generally, including software and changes and updates), while the subsequent paragraph 3 identifies the types excluded.

In the end we find the multi-dimensional models, that regard free or discounted services delivered electronically to a specific group of users in order to generate data and advertisement opportunities, like cookies, to be delivered to another group of users for cosideration (for example the search engines or the social networks).

A search engine is an automated system that analyzes a set of data (often collected by itself), and returns a table of contents available classifying them automatically based on statistical and mathematical formulas that indicating the degree of relevance given a particular search key (i.g. Google, Bing, Yahoo!).

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[6] E. PULLINO, *Aspetti territoriali del commercio elettronico*, in *Il fisco*, n.27, 14 July 2003, p. 4266.

[7] As defined in Directive 2006/112/EC.

Nowadays the social networks are extremely important. The term “social network” identifies a computer online service that allows the creation of virtual social networks. These are websites or technologies that allow users to share text content, images, videos and audio and interact with each other (i.g. Facebook, Twitter, Instagram, Pinterest, LinkedIn and others). Generally, social networks provide a recording by creating a personal profile protected by password and the ability to search the database of the information structure to locate other users and organize them into groups and contact lists. The information that is shared may change from service to service and may include personal data, sensitive (religious belief, political opinion, sexual orientation etc.) and professional. On these, users are not only consumers but also content creators. The social network becomes an interactive hypertext through which to spread thoughts, ideas, links and multimedia content.

The nature of the goods exchanged is not the only aspect to consider. Subjects of the transaction and their category are also fundamental.

In general, the subject of an electronic commerce transaction belongs to the category of final consumers or the category of companies.

Note also that, in relation to the two parties of the transaction, in the roles of buyer and seller, such as a category, we can identify various types of electronic business. If the purchaser user and the seller are both companies, this is called the “*business to business*” (B2B).

It is called “*business to consumer*” (B2C) if the seller is a company or a professional seller and the buyer is a private. The deal is aimed at the end consumer; in this category are offered to all network users both goods and services of the most varied categories. The task of these negotiations is to attract the consumer, creating, thus, to a system of e-commerce operators (business or companies). It is called “*consumer to consumer*” (C2C) when electronic exchanges are made between final consumers. This is a newer form of e-commerce and is increasingly popular due to the activation of several sites that handle online auctions (eBay).

In this case, the site manages the environment in which users interact, and the amounts of the transactions are of a limited value, since usually only one article is exchanged for a time. The methods of regulation of transactions are set by the seller with buyer. The great example of this service is *e-bay* site.

We can consider also “*public agencies to business*” when electronic transactions take place between companies and public administration (non-commercial entities), where the public administration is considered more as a user of technology and information services, which as a provider of innovative services for a fee.

Then there is the “*Public Administration and citizens*”, which is the electronic delivery of services to citizens. The relationship between the public administrations and the citizen is represented by the practices and procedures that provide technologies such as electronic documents, electronic signature, electronic payment (for example, tax returns and payment of taxes)[8].

The traditional definitions of supply of goods and provision of services, even if they continue to pursue the same goals, undergo significant alterations regarding their areas of influence, because the dematerialisation changes in “*provision of services*” what traditionally was considered instead “supply of goods”:

the traditional area of service providers, with e-commerce, expands dramatically.

Since the concepts of materiality and physicality do not belong to almost nothing the world of electronic commerce, and because these concepts are also key points

[8] F. SANTORO, *Il commercio elettronico: Aspetti fiscali e giuridici*, Milano, 2000.

of reference for taxation in the traditional economy, new serious problems arise in relation to fiscal and economic sovereignty of States[9].

Described the main characteristics and types of e-commerce, before moving to a careful analysis of indirect taxation, we need a brief description of the key features of the digital economy and their potential impact on the taxation of consumption.

On March 24th 2014, the OECD has published, in the context of the work BEPS, the "Public Discussion Draft" - BEPS Action 1: Address the Tax Challenges of the Digital Economy[10], which provides a thorough overview of the most significant developments that in recent years have affected the technologies of communication and information, due to the increasing "digitization" of the economic environment in which multinational enterprises operate.

The paper focuses on the description of new business models that have emerged as a result of these developments, with particular reference to e-commerce, which makes possible the realization, in an efficient and fast transactions falling within the models "business-to-business", "business-to-consumer" and "consumer-to-consumer".

The Discussion Draft makes specific reference to the "Key features" of the digital economy, which may be of particular relevance in terms of tax. These features include:

- Mobility, which concerns both the "intangibles" transferred as part of the digital economy, both the "users", able to purchase online goods and services from different places, and finally, the functions of the enterprises themselves, which can be easily coordinated and transferred "at a distance";

[9] P. ADONNINO, *Il commercio elettronico via internet e la fiscalità: gli aspetti generali delle attività transnazionali e nazionali,* in *Enc. giur.*, *Agg.*, XI, Roma, 2003.
[10] Public Discussion Draft - BEPS Action 1: *Address the Tax Challenges of the Digital Economy*.

- The “massive” use of data (so-called “Reliance on date”), which can be easily obtained thanks to the new technology and used for the improvement of products or services;
- The presence of “Multi-sided business models” (search engnes and social networks), based on a market in which distinct groups of individuals interact through an intermediary or a platform, and the decisions of each group or individual influence those of the other group;
- The tendency to create monopolies or oligopolies, caused by the combination of content and incremental costs “network effects”, which determines, in some specific areas of the digital economy, the possibility for companies to achieve a dominant position in a short time;
- The volatility caused by the speed of innovation processes, which can result in a loss of market share in the short term by companies that were controlling a substantial part of that market.

The Discussion Draft identifies, with regard to both the direct taxes to indirect taxes, the tax planning strategies that can lead to erosion of the tax base through profit shifting.

In terms of indirect taxes, it is stressed that, under certain conditions, may arise opportunities for tax planning and consequent “BEPS concerns” related to the “remote digital supplies” to VAT exempt businesses, as well as a “remote digital supplies” from companies involved in exempt from indirect taxation[11].

Among the measures to counter the erosion of the tax base related to the digital economy, these are important:

- Identifying the ways to establish direct taxation of the “stateless income”, by contrast to the phenomena of treaty abuse and neutralizing the effects of hybrid

[11] BEPS Action 1: Address the tax challenges of Digital Economy, April 16th, 2014.

mismatch arrangements;

- The establishment of provisions contrast to the erosion of the tax base resulting from the transfer pricing policy, with particular reference to the transfer pricing of intangibles;
- The precise definition of the concept of permanent establishment, which has been the subject in recent years, a lively debate in the OECD, and in particular in the work of the Business Profits Technical Advisory Group.

CHAPTER 2

GENERAL CONSUMPTION TAXATION (VAT, SALES TAX)

2.1. GENERAL CONSUMPTION TAXATION IN DIGITAL ECONOMY – BRIEF INTRODUCTION

The indirect taxes are that whole series of measures that hit the wealth not directly but when it is transferred or consumed. The indirect tax therefore applies to the sale of an asset or the use of a particular service or a benefit. Therefore, unlike direct taxes, these may be transferable to other persons different than those who are required to pay them. Therefore they can be subjected to a gap between the price previously established by the manufacturer with respect to that undergone by the consumer.

This happens because this type of tax goes to hit the wealth when it emerges in an indirect manner, i.g. where it is precisely transferred to the subject in the subject or consumed. That's why indirect taxes are also called consumption taxes or transfers.

The main indirect taxes in the Italian background are:

- Value added tax (VAT), whose discipline is regulated at Community level by detailed directives[12], in order to standardize the indirect taxation in the entire European Union. At a national level it is regulated by DPR n. 633 of October 26th 1972.
- Registration tax, regulated by the "*Testo unico sull'imposta di Registro*", the DPR n. 131 of 26 April 1986.
- Mortgage tax; is regulated by Decree. October 31, 1990 n. 347, entitled "*Testo unico sulle disposizioni concernenti le imposte ipotecaria e catastale*".

[12] VI EEC Directive of 1977 and the following.

- Cadastral tax.
- Excises.
- Stamp duty.
- Tax on advertising[13].

The value added tax, in acronym VAT is a tax on the value added of the State applied to each stage of production and exchange of goods and services. It is in force in 63 countries.

The European Directive 2006/112 / EU aims to make uniform indirect taxation across the European Union and states that Member States must set the VAT rate in an amount equal to at least 15 %. To date, the top rate, set by Hungary, is 27%[14].

The text contains a systematic recapitulation of previous provisions in cd VI EEC Directive of 1977.

The italian VAT legislation is contained in the DPR n. 633 of 26 October 1972, and amended several times. Upon entry into force, on 1 January 1973, the standard rate, that applies to most goods and services, was 12%, then grew among years up to 2011: in fact with the D.L. n. 138 of 13 August 2011, the ordinary rate rose to 21 %. Finally with the Law 228 of 24 December 2012, on 1 October 2013 there had been another increase of a percentage point and VAT has reached 22%.

The VAT is a tribute:

- "General" because it affects all the goods and services, except for certain exempt explicit legal provision.
- "Transparent" because it can be easily distinguished on the occasion of each transaction.
- "With fractionated payments" because at each step the revenue authorities

[13] G. MARONGIU, A. MARCHESELLI, *Lezioni di Diritto Tributario*, Torino, 2012.
[14] P. BORIA, *Diritto Tributario Europeo*, Milano, 2010.

collect a fraction of the overall contribution due[15].

It is a general consumption tax, its calculation is based only on the increased value that a good or service purchased in each step statement (added value), starting from production up to the final consumption of the good or the service itself. In value added are included any excise tax that is on the production or provision that the seller turns to the final consumer.

The transactions relevant for VAT purposes only exist when there are all the conditions of taxation: the objective condition, the subjective condition and the territorial assumption. Along with the objective and subjective profile the territorial thus constitutes one of the three profiles on which is based the assumption of VAT[16].

These assumptions are identified if the transactions are subject to tax (taxable), but also other transactions relevant for VAT purposes, which do not fall within the scope of the tax (as non-taxable or exempt) produce other effects on the formal ground. If one of the conditions above is absent, the operation is considered out of range or excluded.

In the VAT system, the objective condition regarding the qualification as sale of goods or provision of services in the transfer of dematerialized products by electronic means is a matter that is particularly important. The objective condition occurs when it is held a supply of goods or provision of services. The subjective condition occurs when the operation of the provision of service or supply of goods is carried out as part of a business activity or operation of art and profession. Given the identification of this assumption, particular specificity does not discloses due to the fact that it operates through Internet.

[15] F. TESAURO, *Istituzioni di Diritto Tributario (Parte speciale)*, Torino, 2014.
[16] R. BAGGIO, *Il principio di Territorialità ed i limiti alla potestà tributaria*, Milano, 2009.

Moreover a transaction is VAT taxable when as well as having the objective and subjective conditions, there is also the territorial condition: it must take place in the territory of the State, according to criteria of territorial connection identified by law. The assumption is verified according to different criteria to establish whether it is a provision of service or a supply of goods. The VAT legislation makes a basic distinction between the supply of goods and provision of services, which States, along with other elements such as nationality and status of the parties to the transaction, for the location of the operation, if there is applicability of the tax.

Through a system of deduction and redraft, the tax burden is on the final consumer, instead for the taxable entity - like the entrepreneur or professional - VAT is neutral. In fact, the tax payer, that is the one that sells goods or services, shall deduct the tax paid on purchases of goods and services made in the exercise business, art or profession, from the tax charged (by way of compensation) to buyers of goods or services provided.

The VAT is therefore a cost only for individuals who can not exercise the right of deduction and thus, in general, for the end consumers.

In the application of VAT we should therefore distinguish the taxpayer in fact (the consumer), which although is not a taxable person bears the economic burden, and the taxpayer in law (usually a business owner or a professional) which affect the obligations of the taxable person, though for him the tax remains neutral.

An example will clarify this mechanism: A trader buys raw material for a value of € 1.000,00, which will pay for € 1.220,00, as the VAT amounting to € 220,00 (22 %). Suppose that, as a result of a series of processes performed on it, the value of the processed product is € 2000,00. At the time of sale the final consumer will pay the merchant a sum of € 2440,00 (2000 + 440). The sum that the trader must pay to the State is 440-220 = € 220,00 (VAT which the dealer has received from the final consumer, net of that paid to buy the raw material).

In this sense, the dealer is subject to tax and can deduct the tax paid on purchases (€ 220,00 paid to the purchase of raw materials) from the tax charged on sales (€ 440,00 paid by the final consumer to the merchant). In addition, the dealer is neutral with respect to VAT: received by the final consumer € 440,00, has paid € 220,00 purchase of raw material and € 220,00 to the state (then in terms of VAT he has not lost anything)[17].

Three conditions must be met for a transaction is subject to VAT:

- objective: it must be a supply of goods or provision of services;
- subjective: it must be done in business, the arts or professions are not subject to tax sales made between individuals;
- territorial: must be made within the State.
- The operations are considered performed, and then the tax must be applied in the next moment (moment of taxation):
- for the supply of real estate, when the deed is signed or when the property or real right is transferred;
- for the supply of movable property, at the time of the delivery or shipment of the goods, or when there is the effect of translating the right of property;
- for services, upon payment;
- prepayment before the moments just described implies that the transaction is deemed to be made at the time of payment in relation to the amount paid;
- the operation shall be regarded as performed for the operations for which it was emitted the invoice.

Note that at the time of the transaction, the tax debt comes to the State (it is said that the tax becomes chargeable) and the taxpayer has to pay it to the revenue

[17] G. FALSITTA, *Manuale di Diritto Tributario*, Padova, 2011.

authorities with the periodic payments.

Moreover from the time tax operations shall commence the terms required by law to comply with accounting obligations, such as the issuance of the invoice or receipt or tax receipt.

Some immediate operations make an exception to the rule: for them the tax debt is not born at the time in which the invoice is issued but upon payment of the consideration. These are the operations carried out by businesses and professionals with a turnover not exceeding € 2.000.000 for which they exercise the option, as well as those carried out in favor of public administrations.

These operations have very long payment times and therefore, applying the ordinary rules, their creditors would have to pay a tax that would retake only after some time.

Regarding imports, namely the purchases of movable from countries not belonging to the European Union, which have to pay VAT at the time of entry into the EU, it is responsibility of the customs authorities to issue a document called customs bill, in which it is indicated the amount of the asset is subject to VAT and any duty of competence: the total amount must be paid by the importer.

Only upon payment of VAT and any Customs duty on goods cease from the customs warehouse, entering the availability of the importer.

For goods exported, the transferor (the vendor) does not require the payment of tax to the buyer, but it must issue the invoice, specifying explicitly the non-taxability of the transaction. In any case, the transferor must maintain and track invoices and obtain proof of removal of goods from the national territory by a customs stamp on the invoice or transport document.

A subject that is a usual exporter (and therefore do not charge VAT on exports of goods), after the issuance of a letter of intent to the supplier or the Customs Office, may request that on his purchases or imports of goods is not applied the tax within a certain limit established by law (plafond)[18].

Regarding the trades into the European Union, since 1993 have been abolished customs barriers between member countries of the European Union, and within the VAT it was introduced a transitional system of taxation in the Member State of destination of the goods to be exchanged between Member States.

Under this rule, the person who buys a chattel by another entity belonging to another state of the European Union is obliged to supplement the invoice received with VAT. Through the reverse charge, the amount of VAT is, on the one hand, paid to the State with a recording on the sales ledger; on the other hand, the same amount can be deducted with a recording on the register of purchases.

Any exchange of goods relevant to intra-Community VAT must be indicated in the model summary of purchases and sales, to be presented to the Customs Agency. The VAT taxpayers of EU Member States wishing to undertake intra-community transactions must apply at the Tax State office the subscription to the VIES (VAT Information Exchange System), the system of exchange of information on VAT[19].

2.2. SUPPLIERS AND CUSTUMERS IN THE DIGITAL ECONOMY

In e-commerce, an obstacle certainly difficult to overcome for tax administrations is to distinguish professional sellers from those occasionals and then return to tax all the income generated by the firsts with their business.

On the other hand, the volatility of electronic commerce lends itself much more than the traditional one to the abusive practice of the same. If with the real online stores there are not any problem of identification and taxation, those who sell through vast sized platforms, such as ebay, can easily evade the tax rule qualifying

[18] F. TESAURO, *Istituzioni di Diritto Tributario (Parte Speciale)*, Torino, 2014.
[19] G. FALSITTA, *Corso Istituzionale di Diritto Tributario,* Padova, 2014.

themselves as occasional sellers and not professional.

Regarding this point, the CTP (*Commissione Tributaria Provinciale*) of Florence (Tax Court at first Instance) intervened more than once, trade exerted on the Web under disguise is in fact a malpractice that features more than a decade the most famous platforms dedicated to B2C with clear advantages - for who they uses - both contractual and tax.

With specific reference to the latter aspect the judgment of the CTP of Florence n. 03/19/2012[20], tracing its earlier judgement of June 2011 and a jurisprudence already known in the field of tax assessment, made it clear that:

the tax notion of operating commercial enterprises is not the same as civil one, because Art 55, TUIR[21] intends as such exercise for usual occupation, although not exclusively, of the activities listed in Article 2195 civil code, although not structured in the form of enterprise, and therefore is independent from the organizational requirement, essential for the qualification of civil law firm. The intermediation activities carried on online sale portals qualify, therefore, the business activity, when there is a significant number of transactions: income, consequently, are not business income and other income, although it lacks the "organization"[22].

As is evident the ruling focuses the difference between the concept of commercial enterprise relevant to the tax authorities and that includes, among others, the activities provided by Art. 2195 of the civil code (hereinafter: c.c.) even if it is not

[20] Commissione Tributaria Provinciale di Firenze, 23 January 2012, judgement 03/19/2012.
[21] Income Tax Code, *Testo Unico sulle Imposte e sui Redditi*, L. 917 of December 22nd 1986.
[22] *"La nozione tributaristica di esercizio di imprese commerciali non coincide con quella civilistica, perché l'articolo 55 del Testo Unico delle imposte sui redditi (Tuir) intende come tale l'esercizio per professione abituale, ancorché non esclusiva, delle attività indicate dall'articolo 2195 cc, anche se non strutturate in forma di impresa, e prescinde quindi dal requisito organizzativo, fondamentale per la qualificazione civilistica di impresa. L'attività di intermediazione effettuata su portali di vendita on line qualifica, pertanto, l'attività di impresa, quando vi sia un numero rilevante di transazioni: i proventi, di conseguenza, sono redditi di impresa e non redditi diversi, anche se manca l''organizzazione".*

structured in the form of enterprise, such as:

- industrial activity is the production of goods or services;
- intermediary activity in the movement of goods;
- the activities of transport by land, water or air;
- the banking or insurance;
- other activities auxiliary earlier

and the stiffer notion of Art. 2082 civil code supported by the taxpayer recipient of that judgment, to justify its continuous trading online operations and thus evade tax rate imposed. The norm considers entrepreneur "*who exercises a professionally organized economic activities in order to produce or exchange goods or services*".

The facts of the dispute is due by sending to an eBay user of a questionnaire, together with an invitation to be heard, so that proves that he declared, for the purposes of direct taxes, VAT and IRAP (regional tax on productive activities), revenues from more than 1500 transactions concluded between year 2005 and year 2009 on the online auction site. In response to these requests, the taxpayer had claimed not to be registered for VAT, of not declaring income derived from its sales via Internet for the purposes of tax retold, but above all to have undertaken the activity online to play, i.g. trading sundries (including fur) provided by relatives and friends and passing later purchase via PayPal goods on foreign sites for resale in Italy.

The Court of first Instance of Florence has indeed shown that the requirements to qualify a company allowing to define it in the eyes of the tax authorities as commercial are:

- the return of the areas described by art. 2195 cc or between agricultural activities referred to in subparagraphs *b)* and *c)*, par 2, Art. 32, that exceed the limits established therein;

- the exercise of activity for usual occupation although not exclusive, though not organized in the form of enterprise.

With the obvious consequence that only the occasional performance, falling between the cd other income, is excluded from the scope of VAT and IRAP and that, therefore, not relevant self-definition of “private seller”.

The Court of Florence, with the n. 56/06/2011 judgment of 16 June 2011, had already laid down an important principle of law, now confirmed by another section of the same Commission with the judgment of 23 January n. 03/19/2012: the tax notion of exercise of commercial enterprises is not the same as legal.

This because Art. 51, TUIR, as such intends to exercise the usual occupation, although not exclusively, of the activities listed in Art. 2195 civil code, although not structured in the form of enterprise, and therefore is independent from the organizational requirement, essential for the qualification of civil enterprise.

The brokerage business carried on portals online sales qualification, therefore, the business activity, when there is a significant number of transactions: income, consequently, are not business income and other income, although it lacks the “organization”.

The Court of Florence, with the judgement n. 56/02/2011, also rejecting the instance of the taxpayer, thus observes that in the course of the debate between the parties, the same applicant acknowledged to sell goods online on the foreign market with the their pay-pal account, implementing a real business activities, as defined by Art. 2195 civil code, that is, as “*intermediary activities in the movement of goods, carried out in the usual manner and not occasional*”.

Transactions carried out, in fact, increased from 7 in 2005 to 598 in 2009, “*are to confirm the presence of a real business activity*”.

The commission continue arguing that the specific point the same Supreme Court ruled in favor of the thesis of the Office in a case very similar to that treaty.

The same configuration, as mentioned, was given by the same Provincial Tax Commission, in a similar and more recent case.

With judgment n. 19/03/2012, the Court of Florence, while accepting the use of the taxpayer for other reasons of legitimacy, has dismissed claims by the appellant in point of merit.

In fact, the judges, reaffirmed the non-coincidence between the notion of civil and commercial enterprise that tax. They felt that, for tax purposes, some are the requirements to qualify an enterprise as a commercial enterprise. First of all it should carry on the activities indicated by Art. 2195, civil code or agricultural activities referred to in subparagraphs *b)* and *c)*, Art. 32 that exceed the limits established therein; secondly the enterpreneur should exercise it for usual occupation although not exclusiv, and it does not matter if it is not organized in the form of enterprise.

Therefore, that judgment has established that,contrary to the claims counterpart, the brokerage business conducted with e-Bay is classified as business income and only in the case of occasional services, as defined in paragraph 2, Art. 61, of Presidential Decree 276/2003, the compensation received goes into in the category of other income pursuant to Art. 67, TUIR.

The Court, with the two sentences highlighted, therefore offers the opportunity for a qualifying income arising from trade carried on portals online sales.

This incomes, if eit depends on usual business, although not exclusively, are classified as business income, regardless of the organizational requirement, essential, however, to qualify the term contractor for statutory purposes. The question is not absolutely secondary, just think that, only in Italy, in 2007, online sales had doubled over the previous year, when the turnover was 720 million euro (but today movements are more that duplicates). According to optimistic estimates, 85% of sellers on auction on the Net does not issue any tax document.

The “trick”, in essence, is to sign up as an occasional operator, while in reality it is put in a real professional resale.

When transactions exceed a certain threshold, the seller must therefore open the VAT and pay tax on the gain obtained.

Only the provision for only occasional, however, falls in other income and is excluded from the scope of VAT, for lack of subjective condition (Art. 5 of DPR 633/1972), and IRAP. What matters, then, is not so much the definition of private seller as that of non-habitual. The merchant is not of the “profession” of the web is, for example, the one who sells its own right (the scooter, guitar or any other object), a fact easy to prove to those who sell, for example, an old collection of LPs, more difficult to prove the occasional when the sale process becomes a systematic fact.

2.3. PLACE OF TAXATION IN DIGITAL ECONOMY

Art. 5, of the OECD Model Convention[23] on tax residence, for the application of the conventions against double taxation, prefers the criterion of the effective place of management of a company, that is what our art. 73, TUIR called “administrative seat”. This term does not identify the country where you keep accounts, it is collecting from customers and paying suppliers (ie the administration and finance), but one where you administer the company, that is where you take the strategic decisions and the most important management decisions.

It should also be noted that our country, in paragraph 25, of the OECD commentary to art. 4[24] of the Model Convention against double taxation remains firm on the principle that, in order to determine the residence of an enterprise, it must be taken

[23] See Art.5, OECD Model Convention, 2014.
[24] See Art.4 para. 25, OECD Commentary, 2014.

into account, not only the place where decisions are made, but also the place where is the turning point 'main activity and substantial. That is exactly opposite of what happens in its review of tax, where companies located and operating with a significant structure in countries other than Italy are assessed as falsely foreign, by the mere fact that Italy can catch emails that give precise directives.

The notion of “displacement” of income, to more generous places, calls for the identification of a fixed point from which the company would transfer instrumentally one or more functions, resulting in the imputation of income. The starting point can be found fairly easily in the event that a firm produces goods. The cases are obvious, from our car that moves in the UK legally and fiscally in the Netherlands, as far as the fashion houses that relocate productive source of royalties for the brand. In companies that produce goods with high differential between the selling price and the production, the allocation of the share of income in each of the countries involved in the value chain (production, promotion, marketing) is certainly a theoretical exercise, which lends elusive maneuvers (then BEPS), as the result of an aggressive tax planning.

But when we talk about digital economy we can not even use the above rules, because it is difficult - if not impossible - to identify with sufficient certainty the place of establishment of the company, with reference to which we can speak of shift.

With the advent of e-commerce online, not as use of the communication system to make an order and generate the shipment of a good, but as an open system in which the contractor can charge virtual items, from book to film, from being online training to the “game room”, the company may be in any place, can go on-line at any place and the user of the service can also be in any place.

The OECD model continues to use the notion, now over fifty years, the headquarters and a permanent organization that will implement a policy of territorial connection, from which the State ownership of the share of income. The latest version of the commentary[25] on art. 5 on the permanent establishment, states in section 42.2 that the server where your website resides and where so you can identify a physical location can be treated as a permanent establishment.

But it is clear that this policy is not fulfilling. If it was decisive, who does not pay taxes would place the server on a ship outside the territorial waters or on a satellite in orbit, to avoid any power to impose taxes.

The possible new criteria of location of income must also take into account the issue of compliance, that is the fulfillment, left to the diligence of the person domiciled in the many countries where there are still no mutual assistance arrangements, both information that coercive execution. In this sense, the OECD report believes that the compliance in the provision of online services to consumers is based on the mere voluntariness of compliance on the part of the service, in the knowledge that very unlikely to suffer a tax assessment.

And this assumption identifies a clear trend: whereas the supplier could easily circumventing the taxing powers of the States who consider themselves owners of this right, it is assumed to pay the tax to those who have the income, but who corresponds income in the country of purchase of the service. Which means applying a withholding.

The main problem with the taxation of a share of income in the State where the good or service is consumed concerns the very nature of the tribute: to tax consumption is no VAT or sales tax (GST = General Sales Tax), the income tax is something more sophisticated and more difficult to determine.

[25] See Art.5, OECD Commentary, 2014.

Despite the apparent distrust of the business world to a tax income in the place of consumption, which would lead to a significant complication in fiscal management and, in fact, the loss of the main rules of treaties against double taxation, we must remember, however, that the European project of common consolidated tax base of business income - CCCTB - provides that the total income produced in the European Union has allocated taking into account the value of the plant (production site - however insignificant in the context of online services, because their execution can also rely completely on facilities of third parties), labor (one share in number and in value, so that the income goes to the European countries with higher wages) and the amount of revenues, whose location is based on the place where it concludes the shipment of goods, while for services back a criterion not fulfilling, that of the place "where the services are rendered physically"[26].

An important point of the OECD project addresses the issue of expanding the notion of permanent establishment, to try to tax the income according to the place where the company has a significant share of the market or have computer equipment. The theme of "permanent establishment" had been evoked in Italian Law December 23rd 2013 n.190, at paragraph 177, definitely linked to paragraph 33, now suppressed, while 177 survived in the original text. This provision begins by invoking the notion of permanent establishment Art. 162 TUIR[27], which remains stationary. Therefore the rules indicated below are applicable only if the supplier of these services is established in our country, as we speak of the transfer price for permanent establishments that deal with the collection of online advertising and services auxiliary to it.

For this purpose, it is stated that for the calculation of the transfer price must be used indicators of profit different than those applicable to costs incurred for the

[26] M. LANG, P. PISTONE, *Introduction to European Tax Law*, Spiramus, 2014.
[27] See Income Tax Code (*Testo Unico sulle Imposte e sui Redditi*), D.P.R. n. 917/1986.

conduct of its business. It is not clear what, given that the definitions in the negative ("other") admit solutions endless.

The next paragraph 178 gives the criteria for full traceability of these payments, however, founded on the obligation for Italian businesses to buy online advertising only if the supplier is a Italian VAT subject, it suppressed the obligation contained in paragraph 33. Taxation of online goods is also involved in the enabling act for tax reform: Art. 9, paragraph 1, letter *i)*, in the framework of control activities, provides for the introduction, in line with the recommendations of international organizations and with any decisions at European level, taking into account the international experience, systems of taxation transnational activities, including those related to advertising (back to the issue of the stability law), based on appropriate mechanisms to estimate the shares of assets attributable to the national fiscal sovereignty.

The reference to this conjectural criterion could conceivably lead - and this is also reflected by the OECD study - to establish a tax on online services purchased by businesses, or at least on a defined range internationally.

With regard to VAT, from January 1st, 2015, we have new rules within the European Union, which will apply to the tribute of each country of the customer "private", in analogy with what happens - unless the verification of compliance - for lenders non EU. The system will not lead to the multiplication of VAT, since, despite charging sets specific to each country's private client, each provider will establish the formalities with your tax office, which will become a Mini One Stop Shop, that is a small shop where you enter only once and you do everything: from which the acronym MOSS.

As above mentioned, from January 1, the tax on transactions of direct electronic commerce, made to private consumers in the EU, has changed the place of taxation will not be the country of the supplier, but that of the customer[28].

Consequently, consumers who purchase products Italian assets "on line" - for example, audio, video or text, downloaded from the internet - pay in any case the domestic VAT of 22%, regardless of the country of establishment of the supplier.

Symmetrically, from suppliers in Italy, when someone will sell electronic services to private consumers in other EU countries, he or she will have to charge VAT in the country of destination.

On the substantive, in short, has the equal performance with B2C and B2B, which are already taxed in the country of destination according to the general rule of the place of establishment of the customer; it also creates uniformity of discipline with similar services provided by companies extraUe, already taxed "at destination".

From a procedural standpoint, however, the mode of application of the tax is different: while in relations B2B intra-Union tax is payable in the country of destination by the taxable purchaser with the reverse charge mechanism, so that the supplier does to issue the invoice without evidence of VAT pursuant to Art. 7-*ter,* DPR n. 633/1872, B2C tax obligations in the country of destination will weigh necessarily on the part of suppliers.

The shift from the country of origin to the destination of the place of the transaction B2C not only cover services provided by electronic means, but also those of telecommunications and broadcasting. It should be noted in this regard that Art. 6-*bis),* EU Regulation n. 282/2011 of March 15th 2011, inserted by the EU Regulation n. 10422013 of October 7th, 2013, provide specifications about the notions of telecommunications and broadcasting. This regulation also contains

[28] Official Journal n. C 337 E, of November 28th, 2000, pp. 63-64.

provisions to regulate certain specific situations, as well as issues of transitional law, for the application, from January 1st 2015, the new criterion of localization based on the consumer's country.

Even for TLC services is also possible to use the special scheme of "MOSS", which allows suppliers to work with consumers throughout the EU area through a single VAT identification number issued by the member country in which are established.

The most significant impact, however, concerns the services of e-commerce direct, as defined by the Union legislation, whose circulation has grown enormously with the development of the internet, involving not only the vast consumer market "on line", but a increasing number of companies, also small.

According to the first example given in Annex II to the VAT Directive, the concept of services supplied by electronic means in particular include: providing websites and web hosting, distance maintenance of programs and equipment; supply of software and updating; supply of images, text and information and making available of databases; supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment; the supply of distance teaching.

As stated in Art. 58, VAT Directive, the mere fact that the supplier of a service and his customer communicates via electronic mail does not mean that the service performed is an electronic service.

Additional information for the identification of e-commerce are contained in EU Regulation n. 282/2011.

Article. 7 of the Regulation, in par. 1, states that the services in question include those provided through the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure without computer technology.

Par. 2, then clarifies that the term also includes the following services:

- the supply of digitized products generally, including software, related changes and updates
- services providing or supporting the presence of a company or an individual on an electronic network such as a website or a web page
- services automatically generated from a computer via the Internet or an electronic network, in response to the data input by the recipient
- the granting, for a consideration, of the right to sell a good or service on a website that acts as the online market, where potential buyers are offered through an automated process and in which the parties are advised to a sale by electronic mail automatically generated from a computer
- the package offers Internet service, in which the telecommunications component is an ancillary and subordinate in the sense that the flat-rate does not include the easy access to the internet, but also other elements such as content pages provide access to current news, weather information or tourist, games or online debates, site hosting, etc.
- the services listed in Annex I to the Regulation; This annex provides detailed examples with reference to each of the five main categories identified in Annex II to the VAT Directive.

Finally, par. 3 Art. 7, as amended by Regulation n. 1042/2013 with effect from January 1st 2015 in relation with the innovations described above, makes it clear that you do not consider the services provided by electronic means: the broadcasting services; telecommunications services; goods whose order is on or electronically processed, ie material goods sold using the internet as a tool of contact or negotiation (cd indirect electronic commerce); CD-ROMs, floppy disks and similar tangible media; printed materials such as books, newsletters, newspapers or magazines; CDs and audio cassettes; DVDs and videotapes; games on CD-ROM.

The United target acquire as revenue only the VAT on services to private consumers, while the tax on business purchases is a mere game around, unless quantitatively insignificant advertising for people who can not deduct the exempt tribute.

Each state wants to acquire a share of income taxes, as he realizes that the deduction of costs by the buyers of their companies normally corresponds revenue probably not taxed at the origin, or very little taxed, as the immateriality of online services it makes the connection territorial difficult, if not impossible.

It will not be short time for a political choice in international contexts, for which we must find a legal instrument for fast implementation, to prevent regulatory uncertainty is prolonged long-own in an industry that evolves so quickly. Think of renegotiating the conventions against double taxation, with its multi-year process, would have the effect of delaying the decision on land that then you would have already moved forward.

2.4. EXCHANGE OF INFORMATION AND ASSISTANCE IN COLLECTION OF TAXES IN DIGITAL ECONOMY

Before speaking in detail about the exchange of information concerning the digital economy, we must remember that last September 2014 in Cairns (Australia), it was concluded the meeting of finance ministers of the G20[29]. As stated at the end of the meeting, the finance ministers of the G20 reiterated the strong commitment to provide a comprehensive response that contrasts effectively elusive international

[29] http://g20australia.org.

practices by increasing transparency in the tax area and by regaining resources for economic recovery.

In particular, one of the themes that already during the preparation received more comments from the business community and the work of the participants was that regarding the digital economy

The recommendations published by the OECD[30] show - among others - the challenges posed by the evolution of the digital economy in tax, for example, with the development of new ways of business as e-commerce and online advertising sales.

Point of discussion among the experts was, specifically, the lack of a causal link between the place where the profit is taxed and the place where the work is actually carried out and which up to now has allowed not only to large multinationals, to reduce significantly the tax base in countries like Italy.

A new business model in which up to now it did not follow an update of the fiscal rules. The document presented by the OECD addresses precisely the main problems to be overcome, such as the revision of the concept of permanent establishment, the importance of intangible assets and their impact on the transfer pricing policy, the possible inadequacy of the existing rules of taxation of controlled foreign companies, the possible policies of aggressive tax planning in the field of indirect taxes. The work should be completed before December 2015.

Some governments have already taken steps to align the considerations that emerged in the OECD, such as Italy with the so-called "web tax", introduced by the Law of December 27th 2013, n. 147[31].

With regard to VAT, had an obligation to purchase services online advertising and sponsored links only by holders of a VAT number issued by the Agency Revenue.

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[30] OECD Digital Economy Papers, *Electronic and Mobile Commerce*, July 2013.

[31] Stability Law for 2014.

This obligation, however, was eliminated by the Decree n. 16 of 2014.

The G20 has also approved the implementation plan of the global standard for the automatic exchange of tax information, developed in conjunction with the OECD to combat tax evasion, and it has recognized the significant progress achieved in the implementation of the plan to combat erosion of the tax base and the transfer of profits (base erosion and Profit-Shifting Beps) based on the first set of recommendations published by the OECD on September 16th 2014.

In relation with the digital economy, the spread of e-commerce has enabled more awareness for users in the purchase on the Internet. Missing, however, this awareness on the VAT treatment of purchase that changes depending on the place of residence of the seller.

It should then be verified that the operator (Ebay, Amazon, Apple, etc.) is or is not established in Italy. In these cases, when the customer economic subject to tax purchases on internet, VAT should not be exposed in the bill because the tax is due in Italy and must be paid by the buyer; the obligation to reverse charge will work even if the seller is directly registered for VAT in the State or through a tax representative.

Following the Law no. 228/2012 for goods moved within the EU, the system applies the reverse charge depending on the place of establishment of the supplier. Where the supplier is established in an EU country diverse than Italy, the purchaser must pay VAT with the process of integration and registration of foreign bill scheduled for intra-Community transactions.

Only purchases made by the subjects enrolled in the VIES are made to fall in the reverse charge, the rest apply the discipline of distance sales, with the result that the tax paid in Italy is not, for the latter, deductible.

For Vies means the VAT Information Exchange System, which is the system of VAT Community that flow into one system to track all subjects Iva working or living in the European Union, in order to counter any fiscal evasion internationally.

In the absence of registration to Vies, VAT is paid directly by the seller charging the tax. The latter is not deductible because for these sales online, assimilation to those for correspondence implies the exemption from the obligation of billing and from that certification through receipt voucher (resolution Inland Revenue 5 November 2009, n. 274).

So the private consumer and the buyer subject to VAT registered VIES are treated the same way, that is by charging them the tax.

2.5. TAXABLE AMOUNT AND RATES IN DIGITAL ECONOMY

Since January 1st 2015 came into force in the new EU regulations governing e-commerce, which is mainly engaged in non-material goods, from app to software streaming ending with subscriptions to various services. Until last year who purchased services abroad paid service with the VAT of the country of the supplier, from January instead is applied VAT in the country of residence. Last December, many companies have reported their clients variations to the terms of service and also some costs: Skype, for example, has applied to increase at 7% since now the calculation is made of the Luxembourg VAT of 15%.

The legislation also applies to rentals by *AirBnb*: if up to December 31st, the VAT was calculated at 23%, being the headquarters site in Dublin, from January 1, Airbnb will automatically recalculate the VAT based on the country of residence of the guest.

They fall under the law even the smartphone and tablet apps: buying an app of the Italian AppStore pays the VAT at 22%, but as a matter of rounding off the perception of any changes is minimal.

There are also new regulations for those who sell services and applications: in that case, VAT must calculated depending on the country of the buyer.

The new European legislation is applicable solely to B2C transactions, so and by companies to final consumers, and not by companies to companies or freelancers.

Morever, regarding the e-books, in Italy, the Law 190/2014[32], paragraph 667 provides that "*for the purposes of Table A, Part II, number 18, attached to the DPR of 26 October 1972, n. 633, as amended, are to be considered books all publications identified by ISBN code and conveyed through any physical medium or by means of electronic communication*".

At the outset, it should be noted that a recent intervention of the tax authorities had clarified that the marketing of electronic publishing products, including e-books and periodicals on line, are to be considered for VAT purposes, operations within the direct electronic commerce; consequently, these assets are considered "services"; Thus the VAT is due in the ordinary manner with application in the standard VAT. With the intervention of the legislator, it established to extend the reduced rate, as of 1 January 2015, to the books (but not the other editorial publications, without the ISBN code) conveyed by means of electronic communication, that is disseminated on line.

To analyze the effects of the new provision of the law we cannot avoid to consider the new criteria of territoriality for their services through electronic services. We remember that the Directive 2008/8/EU of 12 February 2008 amended Articles 58 and 59-*bis*, Directive 2006/112/EU with consequent modification of the criteria of

[32] Stability Law for 2015.

territoriality for the services of e-commerce to EU private consumers. The new rules provide that, from 1 January 2015, the above provision made to a private consumer Community must be regarded as the place where the user of the service is established.

Consequently, the rate of 4%, that from 1 January 2015 is applied to electronic books under Italian law, covers of course only the performance territorially relevant in Italy, namely services rendered by companies established everywhere, to private consumers established in Italy. Electronic books supplied to private consumers located elsewhere, however, discount the VAT at the normal rate of supply of services provided in the country of establishment, with the exceptions of France (reduced rate of 5.5%) and Luxembourg (rate reduced by 3%).

In general, the effects will be positive for Italian consumers. To highlight that the new measure is contrary to Art. 98, par. 2 of Directive 2006/112/EC. The above provision allows Member States to apply reduced rates only to transactions in certain goods and services specifically listed in Annex III to the Directive. That list does not include e-books. Presumably, therefore, the opening of an infringement procedure by the European Commission, as was done for France and Luxembourg.

2.6. E-REGISTRATION

Enterprises of any legal nature, can open the VAT online free through the Institute of Unique Communication of the Registrar of Companies, which with a simple electronic procedure and a free software, called “ComUnica” Company, can be guided step by step in each phase compilation[33].

This communication, therefore lets you open the VAT but also to make subsequent changes and cancellations, as it is valid in all respects for tax purposes, social

[33] Chamber of Commerce of Florence, http://www.fi.camcom.it/comunica.

security and insurance. Once the compilation of the practice, the Companies Registry automatically sends the address of Certified Mail PEC provided by an applicant company, the receipt of the Single Communication Protocol, valid for the start of the company and shall divide, between the various bodies involved, the Communication.

After that, the Chamber of Commerce of competence, within 5 days, notify the inscription at PEC of the enterprise and within 7 days of the individual institutions shall report the results of both the undertaking and expertise to the business register, and the new company is open.

In order to open the VAT online and for free with ComUnica, the neo individual enterprise or company, before moving to the compilation with the software, should wear two important tools that are:

- Digital Signature: To request a Digital Signature, National Services Card or CNS, you must appear in person at their Chamber of Commerce (or other accredited institution as Agency of errands, accountants and / or brokers, who have previously signed a contract with the Chamber of trade) arious presenting documents.
- Telemaco Credentials[34]: Enter the credentials for the Telematic Practices Request more Certificates disbursement conditions and costs, are essential in order to send the ComUnica to register. For issuing credentials Telemaco you can apply: at professional associations and trade associations, or by registering on the website of the register of companies with credit card or other banking systems, to be used for the payment of duties and taxes.

[34] http://www.registroimprese.it/consultazione-dati.

Once you are in possession of the Digital Signature and credentials Telemaco, you can proceed to download the free software made available to the Registrar of Companies, and install it on your PC and run the installation file ComUnica.

On the other hand, in Italy, a service of electronic registration has not yet activated, like it is not active a service for the electronic delivery of documents.

2.7. E-INVOICING

In Italy the Electronic Invoice is equivalent to the paper invoice, and it is characterized by sending electronic medium. It has the same legal value of the paper bill with new security features[35].

In order for an Electronic Invoice is considered valid as the original document is required to implement a process that takes into account three basic requirements:

- Format of the bill: you need an electronic bill of more or less complex: EDIFACT, XML, PDF, X12.
- Electronic transmission: it is necessary that there should be an electronic transmission that starts from a computer and be received from another computer.
- Integrity and authenticity: this electronic format and its electronic transmission must keep the document unalterable, ensuring integrity and authenticity.

Generating, sending, receiving, and mechanization in the management system are carried out in an immediate and automatic. This will reduce the time of issuance and delivery, you avoid processing errors and simplifies the consultation and recovery archive invoices.

Issue costs, sending and storing invoices are reduced enormously, both by the issuer and the addressee. Studies carried out in different areas, show that these

[35] http://www.agenziaentrate.gov.it/wps/content/Nsilib/Nsi/Documentazione/.

savings can reach 90% compared to traditional billing processes. The efficiency and immediacy of the processes of emission and reception as well as the substantial elimination of errors generation and accounting of invoices help reduce collection times.

The ability to manage the sending of invoices through communication systems such as VAN (Value Added Network) ensures proper sending and receiving these. At the same time, the processes of electronic signature to allow the sender and recipient to ensure the integrity, the origin and authenticity of the invoices.

Receiving bills electronically automates the process of validation and verification from the data contained in the document. The origin of the electronic document allows the automatic integration in the system and, therefore, its accounting so that it is ready for the management of payment almost without any human intervention.

2.8. E-RECORDS

The electronic conservation, that replacemes paper documents, allows companies to reduce costs of paper archives and soazi company dedicated to the warehouse of the administration as well as rental costs that are sometimes supported by aizende who do not have enough spaces available. Furthermore the rule, for most of these documents, forces to the conservation for 10 years.

The electronic conservation of e-documents is the storage on optical media of any document and the creation of a fingerprint and ending with electronic signature and affixing marking time (ie a sequence of bits subject of computer processing) containing the prints of documents or sets of them as defined in Art. 3, co. 2, of the Ministerial Decree of January 23rd, 2004.

The electronic filing instead is the "*process of storing, on any suitable support, electronic documents, also undersigned, (...), uniquely identified by a reference* *code, prior to the possible preservation process*” as defined by Art. 1, co. 1, letter. g) Resolution Cnipa[36] (a ruling requested to the Italian Tax Authorities among the alternate conservation of analogue documents) and that there is a passage normatively governed and defined by obligations. The basis in fact there is only a process of processing a file in pdf and storage.

What becomes crucial for uniqueness is the use of digital signatures and affixing marking time doing it crystallizes in time become unchangeable dating it so so sure. The choice of the format in which to proceed electronic archiving of tax documents such as journal, book inventories, VAT records, invoices, shipping documents, tax returns, the shareholders’ register of meetings and shareholder resolutions etc. to switch from electronic paper to digital format requires compliance with the following requirements:

- The format must not be owner, that should not be necessary to have a software company that produced it but it must be enjoyed by all user fiendly and must be open, ie its technical specifications must be publicly available and well documented;
- The format should be a standard, ie to be approved by international standardization bodies, such as the ANSI (American National Standards Institute), the ISO (International Organization for Standardization).

In this way it is possible to transfer the contents of a paper document on a computer medium using a particular digital format.

The digital format of electronic documents provides for the processing of the electronic document on paper but also work in a sequence of zero and one (the “bit”), which, combined with each other according to a specific coding, make it readable documents by the end user.

[36] Cnipa Resolution, Ital Tax Authority (“*Agenzia delle Entrate*”), August 13th, 2009, n. 220/E.

The main tax documents that we can keep using the digital format are journal, book inventories, VAT records, invoices, shipping documents, tax returns, the shareholders' register of meetings etc. (provided by the Presidential Decree 600/1973 and 633/1972).

The PDF document is as if it were crystallized in form, content and time through the use of digital signatures and time stamping.

It is possible to store electronic documents in electronic format, both the preservation of electronic records and books and records available for tax purposes as VAT registers journal or depreciable assets etc. etc. provided they are transferred onto optical media for its storage eliminating ctotalmente conserve paper documents in compliance with the corresponding technical rules defined by Cnipa Resolution 19.2.2004, n. 11 *ex* AIPA Resolution of December 13th 2001, n. 42.

The process is realized in the generation of the file in pdf from accounting programs, for example, take the example of the journal and the signature of the legal representative through their smart card. Subsequently always through the smart card the legal representative must insert the timestamp that is the time frame in which the journal was signed and the generation of an imprint of unique document that sets it apart and makes it unique and unchanging over time.

It is important that the document may not be modified in time (Art. 1, paragraph 2, letter *a)*, D.M. January 23, 2004); the digital document must not contain any macros or executable code.

The format that currently meets all requirements of the legislature for the electronic storage of electronic tax documents in the long run is the format PDF/Acrobat (Portable document format for archiving) that currently meets the standard ISO 2005.

2.9. TAXPAYERS' E-PORTAL

The ATM Taxpayer[37] was founded with the purpose of securing legal protection for the taxpayer frequently mistreated and defenseless against the abuses that can perform to his injury, the Tax Authorities.

There are many objectives that the door is designed to achieve and in particular: the creation of a dynamic communicative relationship with the taxpayer, reduce evasion by leveraging the cultural growth, invoke the application by the Judges and the Guarantors of the Statute of taxpayer rights, all in order to get the full recognition of the rights and freedoms of citizens.

The ATM operates to protect taxpayers with branches of information and assistance, in agreement with local authorities, such as municipalities, provinces, regions, online through the portal www.contribuenti.it side and on the premises of the Association present in Italian Contributors throughout Italy.

The ATM Taxpayer exerts its activity is through the use of more traditional means (phone, fax, mail) that through the modern services (web, e-mail, contact center). It makes use of the work of the professionals participating in KRLS Network of Business Ethics and hundreds of volunteers.

[37] Italian Association of Taxpayers, "Sportello del Contribuente©", Associazione Italiana Contribuenti, http://www.contribuenti.it.

CHAPTER 3

OTHER (INDIRECT) TAXES AND DIGITAL ECONOMY

3.1. EXCISE DUTY

During its history, each EU member state has decided to apply tax on the manufacture of certain consumer products. In Italy they are tapplied to alcohol and all products made from it (wine, beer, spirits, etc.) or to oil and all its derivatives for the production of energy (gasoline, diesel, methane, butane, kerosene etc .) or from tobacco and all its derivatives, on the other hand it is not established an excise duty on digital goods like CDs, DVDs, Notebooks etc[38].

The term commonly used to describe this type of tax is excise. Excise duties are applied by each member state on its territory independently and according to many different criteria. These duties are applied on the raw materials and the products obtained in the territory of that particular member state and also on raw materials/products introduced from outside.

Excise duties are duties but when involving imported goods are considered customs charges and are then collected at the time of the customs operation. Some years ago the excise duty applied to trade in alcoholic beverages have been regulated within the EU.

Italy has adopted a consolidated law on excise transposing Community legislation. In particular, the legislation provides that all alcohol products are accompanied by a document called document DAA (Document Accompanying Excise). The legislation provides that the excise duty is not applied to the goods leaving the territory of the state and, to prove the exit, you issue a document, the document DAA, whose operation is very similar to that of the Transit (NCTS).

[38] I. MANZONI, G. VANZ, *Il Diritto Tributario*, Torino, 2011.

Regarding its operation, the tax is calculated by applying the rate (which can be fixed or proportional) to the tax base (amount of product released for consumption). Tax depositors are required to pay taxes (producers and custodians of assets) from which is made the release for consumption or parties against whom is realized the condition for chargeability of the tax.

These persons have the right to claim against the consumer, in the amount of tax paid. Given the importance of such charges, the tax authorities have planned a series of formal obligations for the activation of tax warehouses, duties of preparation of gauges and counters technicians at tax warehouses, constant checks on tax warehouses, the transport of goods and the quantity and quality of products imported or manufactured.

3.2. GAMES TAX

Firstly we can say that from a tax point of view there is no distinction between the various types of online games, and that, in the face of victories, we can have different tax treatment depending on several parameters[39].

Winnings can result in credits to a bank account or supplies of money that only later will be credited or periodically or at the request of the person concerned.

The earnings from the various types of winnings form the taxable income for income tax the entire amount unless, as we shall see below, some are subject to withholding tax as tax, or cash, or in the year in which they are actually received.

The current tax is expected that the proceeds from the winning national lotteries, raffles and games of the charity serving a withholding tax at 10% if paid by holders of VAT withholding.

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[39] A. GANDOLFO, V. DE BONIS, *Il modello italiano di tassazione del gioco d'azzardo: linee guida di politica fiscale per lo "sviluppo sostenibile" di un mercato importante e controverso*, Università di Pisa, Discussion Paper, 2013.

In the case of game shows that you see on TV, or even sports tournaments based on the ability/risk as respectively also could be assimilated poker in the first case or the casino in the second, the withholding tax rate is 20% the proceeds losers.

In other cases the proceeds are taxed with withholding tax amounting to 30%, such as trade shows or beauty contests.

From a fiscal point of view the income generated from winnings online gives rise to a "*different income*", namely the residual category than most known arising from rents, from employment, self-employment, and framed by Art. 67, TUIR, lett. *d)*, par. 1.

If in the face of this it has already been taxed in Italy in the form of withholding tax (which you can learn about requiring the regulation of the game) or if it is suffered taxation in another foreign country is properly separated, such withholding taxes payable in Italy , always with the Convention against double taxation between Italy and the country where you played.

Unfortunately, whether you are playing online, whether you are headed in foreign territory (classic destinations such as Las Vegas or Monte Carlo remember), or choose to play from the couch at home using a laptop, the amounts won must be declared in what governs the principle of WWT, namely the Word Wide Taxation according to which, in principle, individuals pay taxes for income products anywhere in the world.

It is not true that you do not pay taxes if you play abroad, but we must always be based on the basic principles of taxation, see if there are conventions against double taxation, read what is written on the websites of the major players the sector.

We make a distinction between income earned in Italian casinos and income earned in foreign Casinos. The firsts, thanks to the principle of replacement tax, receive a withholding tax for which the amount won is already "cleansed" of the Italian taxation.

A suggestive question is to examine the possibility of giving a VAT identification number to poker players online. Starting from the objective fact that the winnings over the border and those not subject to tax in Italy are to be attracted to taxation in Italy for the entire amount, the question is if in theory the online poker players can not have a VAT ID because the costs of the exercise of that fully deductible “activities” (for some people it has become a usual and continuous occupation, around which revolve sponsorship contracts in addition to the earnings from the winning and running costs).

However by the reading of Art. 69, TUIR, concerning the deduction of costs relating to the activities of the player to participate in tournaments, so it would not seem. In view of the same, however there are no deductions for expenses such as the cost of registration for the tournament, the huge costs of travel, food and lodging, incurred to participate in various tournaments and championships. In the event that you could consider this as a professional freelance work the speech could change and it would be interesting also to note the different developments also in terms of deduction of, for exmple, the costs of registration and travel expenses.

Regarding Deductions for those who play from home online, the costs incurred for the players online are buying PC, modem, TV, Internet, and maybe even the premises for its own to the game from home. These expenses are related and deductible.

However, at present prevails what is written in the TUIR, Art. 69, para. 1, that excludes any deductions.

Regarding the deduction of poker player-traveler instead expenditure would, again in theory, those for travel, accommodation, food transfers and registration fees. The same applies to income earned from sponsorship contracts, which will be taxed in the tax return.

The question then for those who have decided to go against the law intentionally or not knowledge of the matter: they are faced with the choice of doing black, declare the amounts as other income or open a VAT least starting to discharge the costs incurred (still not possible because there is a real activity code that frames this activity, in fact).

The tax office is of the opinion that these revenues are to be reported as other income but, perhaps needless to say, many poker players have made poker a real profession exercised continually and habitually, and that gives rise to income streams relevant.

According to this reflection becomes convenient to consider the opportunity to open the VAT in order to infer the costs incurred in order to get the most benefit tax, save on taxes and sleep serene night for not breaking the law.

For what concerns the winnings on line, whose phenomenon although it might seem like it is expanding visibly especially after the liberalization of the market, does not enjoy more favorable because the winnings will be taxed at 100% in Italy, being the same nature as those won on the gaming tables. For minimum amounts, i.g. less than 25,82€, the revenue authorities believe that you will not be subject to tax deducted at source and however you will be forced to declare in the appropriate model.

3.3. TRANSACTION TAXES

Since March 1st 2013 is taken in Italy the Tobin Tax, the tax on financial transactions, which is named by the American economist James Tobin, awarded a

Nobel Prize for his theory on the taxation of market operations to combat world poverty[40].

The tax, equivalent to 0.12 % on the value of the transactions of the day (0.1% in 2014), applies to transfers of securities and equity instruments issued by companies on the Italian territory.

It is applied all transactions (to load the soloist Buyer, wherever resident) on actions of Italian companies with capitalization of more than 500 million euro Regardless of country of origin of the order. If the operation is Made “over the counter”, outside of markets, the sales tax rate raises to 0.2%.

On the other hand the tax on derivatives entered into force from July 1 2013, but the rate varies according to the type of instrument (future, covered warrants, options, etc.) and is staggered on the value of transactions. The Tobin Tax applies both on transactions of purchases and sales, in a day.

The charging of the case, in fact, the net balance of order sitting on the Financial Instrument used. So is applied only on transactions that after the session will have generated a positive balance from the previous day. The tax does not affect the speculators and day traders: to reduce the operation of “high frequency trading” aimed only to direct the share price was thus introduced a rate of 0.2% on the value of orders canceled (or modified) when they exceed 60% of those completed.

They do not pay the Tobin Tax on operations funds, Sicav, bonds, Exchange Trade Founds, Exchange Traded Commodities and currencies (Forex), in addition to the transfer of property as a result of death or donation. Excludes all transactions in foreign companies and Italian companies with capitalization of less than 500 million: capitalization will be announced every year.

[40] N. BARONE, M. NOBILI, *Tobin Tax, arriva il decreto. Come funzionerà il prelievo sulle transazioni finanziarie,* Il Sole 24 Ore, 2013.

3.4. INTERNET TAXATION

At the end of the year 2013, it was introduced by Law n. 190 of 2013 what was commonly called “web-tax” or “Google tax”.

In March 2014, however, the same has been repealed by Decree n.16 of 2014[41].

The project included a tax not intended for consumers, for whom nothing changes, but for the online companies - such as Facebook, Amazon or Google - which intended to change the rules so that the revenues of these companies, that are generated thanks to Italy (selling advertising, etc.) would evolve in part in fees payable to the Italian tax authorities. At the moment this is not happening, because European laws allow these companies to have a single registered office in Europe and to record all their revenues at those meetings, without having to open one in every European country in which they are present.

Because states as Ireland or Luxembourg, have much more favorable tax regimes, all the offices of large online companies are in these nations. In 2012, Facebook has paid to the Italian tax authorities € 192.000,00 Google € 1.800.000,00. Paltry compared to what these companies earn thanks to the operations on the italian “ground”. The web tax included an obligation, for all companies that buy and sell advertising and services such as those related to e-commerce, to have a italian VAT number. In doing so, the advertisement could be sold only to companies with an italian VAT. Preventing that italian advertising traffic was purchased abroad by foreign operators who in turn sold abroad bypassing entirely Italy and its tax.

This law, however, hid many dangers and controversial aspects that have meant that many have either generated discontent. First, the EU could decide to fine Italian state, since such a law seems to go against EU rules, according to which “the people who perform independent activities and professionals or legal persons who

[41] N. COTTONE, *Decreto Salva Roma. Abrogata la Web Tax*, Il Sole 24 Ore, March 6th, 2014.

operate legally in a Member State may perform an economic activity in another member State on a stable and continuous basis or offer and provide their services in other Member States on a temporary basis while remaining in their country of origin " as stated by Artt. 49 and 54, TFEU[42].

Forcing Google, which is based in Ireland, to open a VAT in Italy seemed to be in direct contradiction with the present requirements of the EU. Other criticisms concerned the risk that such a tax would take away foreign investors and would very complicated running advertising globally[43]. There would be possible retaliation by other states, which could have forced all small italian businesses that export via e-commerce to open offices in other countries of the world, penalizing therefore trade, the growth of the digital market and also Italian companies operating in this sector. Another amendment aimed to tax the profits on the basis of the costs incurred by the Italian branch of the giant of the web (which often are low, having few employees), but based on other parameters that reflect more accurately the turnover.

Trade between a private company and were excluded from everything. While they were included among those companies and persons in possession of a VAT. Which meant that the obligation to invoice in Italy did not exist when you bought a book on Amazon.

After a difficult passage through Parliament, which had halved the scope (initially it was intended to tax the entire e-commerce, then passed the light version would apply only to online advertising), the web tax was approved in late December as part of the Law 190/2013, and was intended to take effect from January 1 2014. But at the end of the year it was decided to postpone it to July 1 2014, with a norm - limited to only reference - inserted in the so-called decree "Salva Roma", which in

[42] M. PENNISI, *L'iter della Web Tax*, Il Corriere della Sera, Milano, November 21st, 2014.
[43] A. CHERCHI, *Riparlare di Web Tax. In Europa*, Il Sole 24 Ore, July 16th, 2014.

fact was modified with the Law Decree 16/2014.

The word on the subject, however, has gone to the government that would have to enact, in the exercise of “tax delegation” a legislative decree which contained the web tax. The measure assigned, in March 2014, to the government 12 months to enact legislative decrees, so the time to bring the matter in the EU. The rule, therefore, was not directly operational, because the tax delegation is a law that, in fact, the government delegation to launch within a year a series of legislative decrees implementing the principles set.

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Procedural aspects

Marco Masi

TABLE OF CONTENT

Chapter 1

Tax Authority and taxpayer communication

The Italian revenue agency, the *Agenzia delle Entrate* (hereafter in the paper the *AE*), has set up one of the richest and most efficient cluster of online services a public administration offers in Italy.

One of the first act recognizing a certain space for the use of a strong equipment of online services in the relationship between fiscal administration and taxpayers is the Law 212/200, best known as the “Charter of the rights of the taxpayer”. It enacts, as its article 1 paragraph 1 states, the articles 3, 23, 53 and 97 of the Italian Constitution[1] and contains the general principles of the fiscal system.

Among those principles: non-retroactivity (article 3 paragraph 1), openness and transparency of the fiscal rules (article 2); parliamentary prerogative (a law decree, lacking of a deliberation of the Parliament, cannot introduce a new tax or extend the application of an existing one) (article 4); openness and motivation of the fiscal administrative acts (article 7); protection of the reliability and good faith in the relationship between the fiscal administration and the taxpayer (article 10); right of a tax ruling[2] (article 11).

The article 5 paragraph 1 of the Law 212/2000 provides the duty of the fiscal administration to take all the appropriate steps to grant a complete and easy knowledge of the legislative and administrative rules in force. It clearly states that the administration shall take action to ensure the free digital information, real-time updated, of the taxpayers.

[1] Both the Constitutional Court (41/2008) and the Supreme Court of Cassation (2221/2011) have always specified that the rules of the Charter are not constitutional provisions and cannot be taken as parameters for a judgement of unconstitutionality of fiscal rules.

[2] The tax ruling of art. 11 of the Charter gives the opportunity to the taxpayer to ask, proposing his solution, the opinion of the *AE* concerning an objectively uncertain rule applicable to one of his own specific, concrete situation. The administration may deliver its opinion within 120 days, otherwise the silence indicates approval of the taxpayer’s solution. The opinion of the fiscal authority binds it, thus the non-compliant administrative acts adopted are void.

The Centre of economic and fiscal research and documentation *(CeRDEF)*[3] owns for the Ministry of Economy and Finance the website *def.finanze.it*, working as the official database of the relevant fiscal legislation (both primary and secondary legislation), jurisprudence, practice of the fiscal agencies and doctrine.

In addition, also the *AE*'s website, although less pretentiously, mainly for a broader public, is shaped with that intent and hosts a section, *L'Agenzia comunica* (the Agency communicates), containing videos and pdf guides on the most interesting and common fiscal themes, the *AE*'s newsroom, the possibility to subscribe the *AE*'s newsletter and *FiscoOggi*, the online review of the *AE*.

Article 6, dealing with the knowledge of the acts and the simplification, instead contains two provisions of a more tangible importance.

The last paragraph explicitly prescribes that, before recording a taxpayer in the list of debtors, if relevant uncertainties persist in the tax return, the *AE* shall invite him to forward, also by electronic means, clarifications and the necessary documentation within an appropriate period.

However, even if there is no explicit reference to the use of digital and online resources, is the provision of paragraph 3 that takes on a capital importance. It requires the models of tax returns, their instructions and other communications to be freely accessible and understandable by taxpayers lacking in confidence with the fiscal rules, and it specifically provides that the *taxpayers shall be put into the condition to fulfil their fiscal obligations with fewer operations and in a cheaper and easier way* (emphasis added).

The most fruitful outcome of that provision are the *AE*'s online services which currently represents the safest, quickest and most efficient way to fulfil all the fiscal duties and obligations accruing to the taxpayers, from their arising until the moment of the possible tax assessment.

On March 2014 the Parliament passed the Law 23/2014 delegating the Government to issue legislative decrees for a fairer, more transparent and growth-oriented fiscal system. The area of intervention is very broad: Cadastre; tax

[3] The *Centro di Ricerca e Documentazione Economica e Finanziaria (CeRDEF)* is part of the Higher School of Economics and Finance (SSEF), a governmental body, included in the Ministry of Economy and Finance, in charge of the training activities essentially dedicated to the officials of the Ministry and of the *AE*. The SSEF is under the direct supervision of the Ministry of Economy and Finance.

evasion, tax avoidance, abuse of right and base erosion; simplification of duties and obligations of the taxpayers; fiscal judicial procedure; rationalization of business tax, VAT and other indirect taxes; energetic and environmental taxation.

It is too early to evaluate the consequences of the legislative intervention. Thus far, its most remarkable result is the Legislative Decree 175 of November 2014 that introduced the pre-filled tax return with which we will deal later in the paper.

The next pages are dedicated to a general overview of the most relevant online services available to the taxpayers through the website of the *AE*.

1. FISCOnline

FISCOnline is the platform for all the taxpayers, natural persons, including Italian citizens resident abroad, companies and entities, who do not have to submit the withholding agents' return (*modello 770*) for more than 20 persons and who have not been already certified to use Entratel, with which we will deal after in the paper.

In the last five years, FISCOnline has shown a constant growth in the number of its users. They are mostly natural persons, both private citizens and professionals. The legal persons, instead, are mainly small enterprises, condominiums and non-profit organizations.

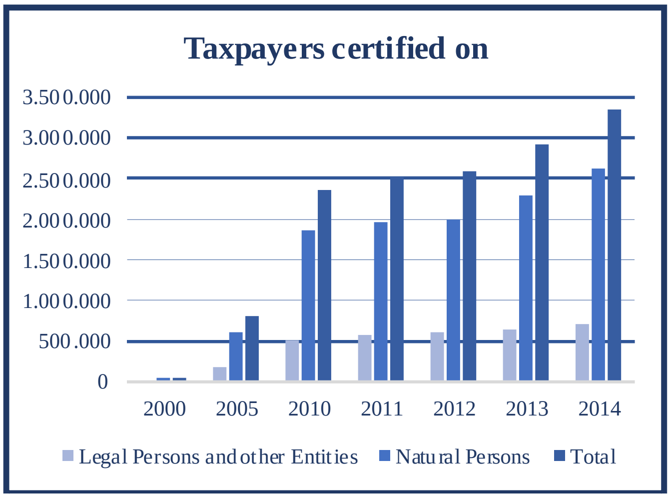

Image 1 Source: Agenzia delle Entrate, Digital Services-Statistics

For the access to the online services the taxpayer needs to register himself. He has to require to the *AE*, directly at the local offices, online or by phone, a personal identification number (pin code). At the moment of the request the taxpayer receives only the first part of the pin (4 figures), the second and last part (6 figures) is delivered, along with password for the first access, to his fiscal residence within 15 days.

If a citizen resident abroad is concerned, the procedure shall involve the competent Consulate.

An easier access, instead, is given to the holders of a smart card having all the requisites of a *Carta Nazionale dei Servizi (CNS)*, a sole card for the access to the online services and resources of all the Public Administrations (hereinafter PAs) on the entire national territory. Inserting the card into the card reader, indeed, the system immediately generates the whole pin and the password. The following accesses take place with the simple use of the smart card.

For security reason the system advices to change the password at the first access.

The legal representatives of legal persons shall, through a specific written form or, when registered, online, indicate the natural persons acting as appointed manager or appointed persons who accede to and operate on FISCOnline on behalf of the legal persons. For every digital seat, up to 4 appointed managers may be nominated. They keep the list of the other appointed persons and may themselves act as appointed persons, while it is not possible the other way round.

Appointed managers and appointed persons shall be already registered in FISCOnline as natural person because they accede with their own data, choosing the appropriate working session (as natural person or as appointed by the legal person).

When the user has made his first access, he has to configure the "work environment" by verifying the requisites of his post, configuring the Internet browser, downloading and installing Java Virtual Machine (JVM)[4].

FISCOnline allows the transmission of various documents, i.e. every tax return, motion and communication supported by the system.

The tax returns that is possible to submit are:

- *modello 770*: it is the withholding agents' return. It concerns the withholding taxes levied on fees, salaries and pensions;

[4] JVM is the software that assures the functioning of the other software for the insertion, the control and the dispatch of the data (FileInternet). All the software are downloadable from the website of the *AE*, but the taxpayers may use other commercial software. The Fiscal Administration has recently updated its software, making the product easier to use and more reliable.

- *modello Unificato Compensativo (Uni.Co.)*: it is used for the joint transmission of more tax returns, generally income tax and Vat returns.

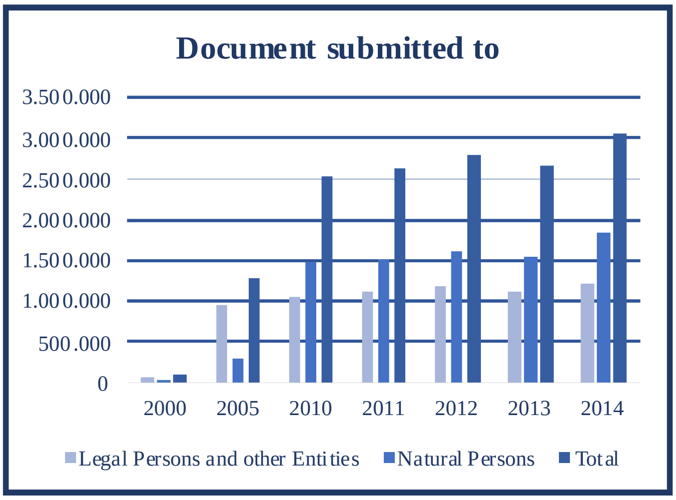

Image 2 Source: Agenzia delle Entrate, Digital Services-Statistics

Natural persons (*Uni.Co. PF*) who have to submit more tax returns (income tax, VAT, *IRAP*[5] or *modello 770*), partnerships (*Uni.Co. SP*), companies (*Uni.Co. SC*) and non-commercial entities (*Uni.Co. ENC*) can use it;

- *Uni.Co. IRAP* for PAs;
- VAT return[6];
- consolidated balance sheets.

The article 1 paragraph 641 of the Law 190/2014 (so-called budget law for 2015) eliminated the possibility, starting from 2016 (with reference to the taxable year 2015), to submit the *Uni.Co*. The new provision has been already modified by the Law Decree 192/2014, which deferred its effectiveness for a year. From 2017 the taxpayer, therefore, shall file the income tax return, the VAT return and the IRAP return separately.

The platform permits to send also an enormous quantity of communications. Remarkable are those concerning the Intrastat list[7], the *Anagrafe Tributaria*

[5] The *Imposta Regionale sulle Attività Produttive (IRAP)* is a local tax, whose revenue belongs to the Regions, levied on the habitual exercise, within the territory of the Region, of autonomously organized activities for the production or exchange of goods or to the supply of services. Also the PAs have to pay *IRAP*.

[6] Both the taxpayers who have to do that autonomously and who use the *Uni.Co*. use the annual VAT return.

[7] Since 2010 the VAT subjects are obliged to form an online list of all the goods and services sold or purchased, rendered or received within the EU.

(hereinafter *AT*) (fiscal registry)[8] and the option for alternative regimes of taxation (transparency or consolidation regime).

Until the *AE*'s resolution no. 4 of 19th January 2015, the communication of the so-called "imprint" of digital documents and archives was compulsory.

On October 2010 the Director of the *AE* implemented a Decree of the Minister of Economy and Finance of January 2004 on the fulfilment of fiscal obligations related to electronic documents and their reproduction on different devices. The act of 2010 bound the interested persons (i.e. accounting managers) and the responsible for the stewardship of the documentation or the person delegated by them to send electronically, within 4 months from the expiring of the period for submitting the tax return, the digital "imprint" of the archive of the fiscally relevant documents and their temporal mark.

A digital archive is composed of the fiscally relevant documents or digital evidence of their digital "imprint". The "imprint" is nothing else that a string of types obtained with the application of a mathematic function, namely the *hash function*, to a file already digitally signed. The digital signature assures the origin of the data from the person who has transmitted them, the *hash function* grants the privacy of the information. The temporal mark guarantees the date of existence of the documents and their signature. The communication, therefore, had the function to extend the validity of the documents for the entire period in which the obligation to preserve them for fiscal purpose persisted, eliminating the problem of the expiring of the certificate of the digital signature and the temporal mark after 3 years.

The resolution of January 2015 clarifies that, since the aim of the communication was the extension of the validity period of the documentation and the President of Council Decrees 30th March 2009 and 22nd February 2013 extended the validity of the temporal marks from 3 to 20 years, the communication of those "imprint" is no longer necessary.

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[8] The *Anagrafe Tributaria (AT) was* created in 1973 by the Presidential Decree 605/1973. It is the database where are stored all the data and information coming from tax returns, tax assessments and fiscally relevant communications from entities, institutions, PAs, public enterprises related to the information of the persons with whom they deal (e.g. concessions, authorizations and licenses; public procurements; enrolment in, variation of, cancellation from the register of professional associations; data concerning the ownership of cars, boat and aircraft; assurance contracts; social securities).

Other communications that can be submitted are motions concerning benefits, tax credits, tax refunds and communications related to the VAT (assignment and termination, variation of the VAT number, VAT annual report and VAT declaration of intent). The budget law for 2015 eliminated the duty to file the VAT annual report[9] and provided that the VAT returns shall be filed in February.

A significant possibility is given to landlords and tenants to regulate electronically their contractual relationship. FISCOnline, indeed, allows registering, deferring, transferring and terminating the leases. The use of the electronic platform is not compulsory, but it becomes as such for the owner of at least 10 properties and for estate agents by which the contract has been concluded. The dedicated software are at disposal of the registered users, without necessity of installation.

Finally, it is possible to pay taxes online through the *modello F24*[10] if the taxpayer is owner of a bank account in one of the credit institutions agreed upon with the Fiscal Administration.

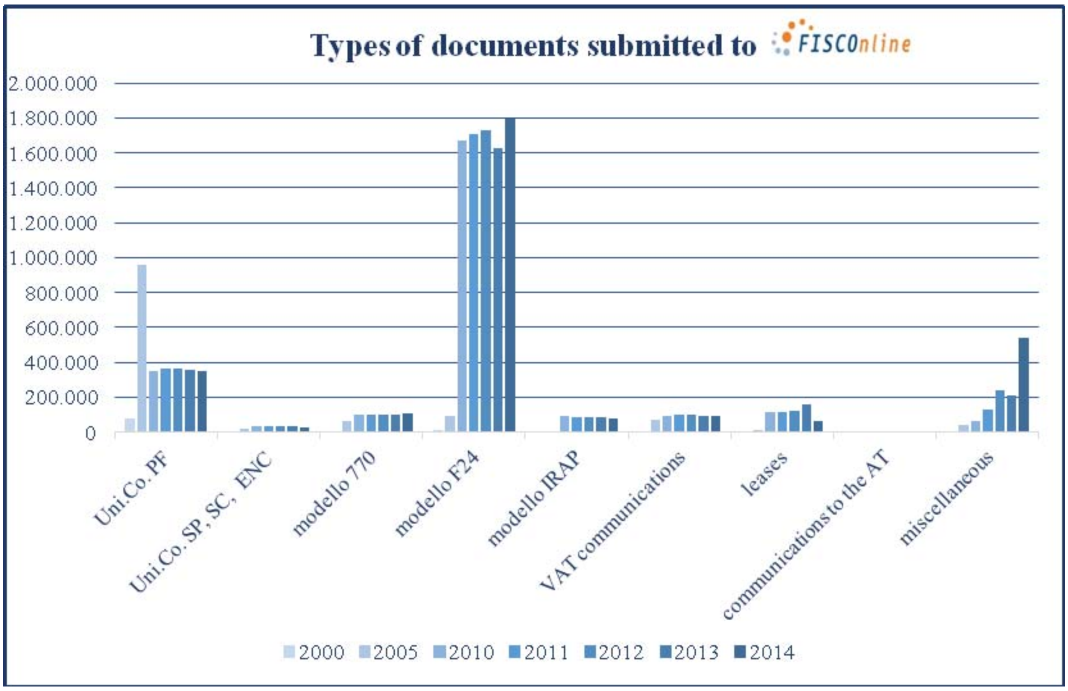


Image 3 Source: Agenzia delle Entrate, Digital Services-Statistics

[9] The VAT annual report is a communication, containing the list of VAT, intra-EU, exempted and non-taxable operations, the VAT due and detracted, used to calculate the own resources of each Member States to be paid to the EU balance sheet. It is not a tax return, its omission entails, indeed, only administrative sanctions.

[10] The *modello F24* allows especially the payment of income tax, withholding tax, VAT, IRAP, stamp duties, registration fees, sanctions, sums due sums due in force of instruments for the containment of litigations. It permits to compensate tax credit and debts, even in the occurrence of credits and debts arising from different taxes.

The *modello F24* shall only be submitted online by VAT taxable persons since 1st of January 2007 and by the other taxpayers if the payment exceeds € 1000 or a credit is used for compensation and the amount is still positive. That is one of the reason why, as shown in the image 3, the *modello F24* is the most transmitted document in FISCOnline.

The procedure of dispatching the file, after its compilation and control through the dedicated software, is composed of the moment of authentication of the document to be sent and its subsequent forward.

The authentication requires uploading the file on FileInternet and inserting the pin code and the tax identification number (TIN) to grant certainty of the origin of the documentation sent.

The forward needs the access to the platform of the website of the *AE*, where the authenticated files can be sent.

When the files have been sent, the system starts to process the file and verify whether an error occurred. If the files are correct, they are registered and a positive receipt is sent to the taxpayer, otherwise a receipt of rejection is issued. In the former circumstance the receipt includes a list of the documents submitted, in the latter the motives of the rejection are communicated. It may happen that more than one receipt are forwarded at a later stage if the definitive acceptance of the file needs more phases of processing (e.g. *modello F24*). The taxpayer has the possibility to monitor in every moment the status of his forward.

Only some of the files sent can be revoked (e.g. tax returns and tax payments).

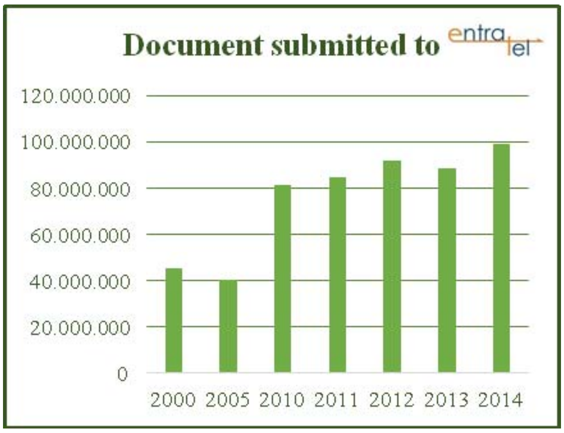
The revocation is the *extrema ratio*. A taxpayer may revoke a document accepted by the *AE* only if a serious mistake has been committed (e.g. wrong TIN, wrong taxable period, same file submitted more than once), not in case of mistake in typing.

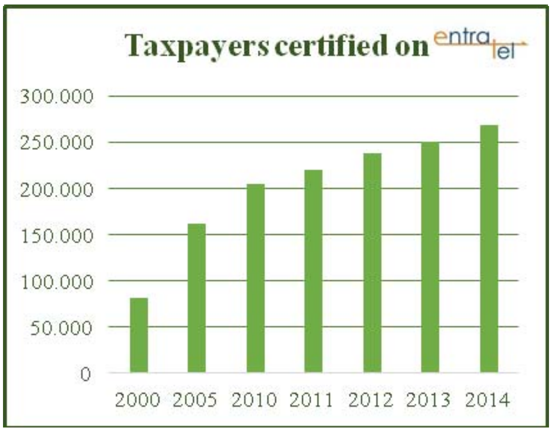
Furthermore if it is possible to remedy submitting a new file containing the correct documentation (e.g. corrective or supplementary tax return), such procedure shall be preferred.

The platform gives also the possibility to sign up to a service of sms and e-mail communication. It allows receiving, without any cost, information on the online services available and updates on the status of the documents sent. The option of validating the documents submitted by specific codes sent via sms or e-mail is also given to the taxpayers registered for the service. It contribute to assure a higher degree of certainty of the identity of the users.

2. Entratel

Entratel permits the electronic forward of documents, tax returns and acts of all the taxpayers, natural persons, companies and entities who have to submit the withholding agents' return for more than 20 persons, PAs and intermediaries for the electronic submission of tax returns and other documents and for the





Images 4 and 5 Source: Agenzia delle Entrate, Digital Services-Statistics

electronic registration of the leases.

Even if Entratel has evidently a lower number of users than FISCOnline, it is the most used platform the *AE* makes available. As the histograms show, the amount of the flows of information transmitted on Entratel is very remarkable, especially compared with the number of the users certified. The data should not surprise. If we consider the Entratel’s users, we will find PAs, *Centri di Assistenza Fiscale (CAF)* (centres of fiscal assistance), accountants, professionals and other intermediaries. They all communicate to the *AE* a huge amount of fiscally relevant information or are charged with the transmission of the tax returns and other communications on behalf of their clients. A lot of private citizens, professionals and small enterprises, indeed, ask for the assistance of those intermediaries to discharge their fiscal duties and obligations, either because their lack of confidence with the new technology or to be sure of the accuracy of the data forward to the fiscal authority. We should never forget that the fiscal regulation is often very complex and hard to understand and the risks of litigations with the revenue agency, so cumbersome for the taxpayer, are thus high.

The user has to be firstly enabled to use the platform.

At the end of the qualification phase he obtains the data necessary for the first access. The procedure starts with the online request of the data of pre-registration, which has a 30 days validity, continues with the compilation of the specific form and its attached and the presentation of both the data of pre-registration and the filled form to the competent office of the *AE* within the aforementioned 30 days. After the appropriate controls, the office releases the qualification for the first access and the number of the virtual file that contains the data for the subsequent accesses.

If the taxpayer requiring the registration has a certified e-mail address (*PEC*), all the procedure takes place via *PEC*.

The legal representatives of a legal persons shall declare in the attached of the form filled the natural persons acting as appointed manager or appointed persons who accede to and operate on Entratel on behalf of the legal person.

The first time a taxpayer accedes to Entratel he has to recover the data needed for the future accesses and other relevant data. The TIN of the taxpayer and the data obtained during the qualification phase (i.e. numbers of the request, pre-registration code and number of the "virtual file") are necessary to accede to the procedure of recovering; if the taxpayer is a legal persons also the TIN of the appointed manager and the code of the digital seat (000 = head office, 001 = secondary seat, 002 = second secondary seat,…) are required.

After the insertion of those information, the system shows the "virtual file". It is composed of three sections:

- section I contains the data to activate the private net;
- section II contains user and password for the access[11];
- section III contains the pin to create the security environment.

[11] When the taxpayer is a legal person, the section II is empty. The appointed manager and the appointed persons, indeed, accede with their own user and password.

At that point a taxpayer is able to access to Entratel with the information given in the section II .

As in FISCOnline, the access is granted also to owner of a smart card, possessing all the requirement of the *CNS*, by the mere insertion of the card into the specific reader.

Before using the services of Entratel the user has to configure his "work environment" by verifying the requisites of his post, configuring the Internet browser, downloading and installing Java Virtual Machine (JVM) and the Entratel software[12].

The most important step of that phase is the generation of the "security environment" using the information of section III of the "virtual file".

With "security environment" is meant the system of personal data for the access granting the identity of the users and the integrity and privacy of the documents submitted through Entratel.

The creation of the "security environment" consist mainly in the generation of two couple of keys with a validity of 3 years, always one private (known by the user only) and one public (known by both the user and the *AE*) per couple, which are used one for encrypting and the other for signing the file to be transmitted. The mechanism is almost the same used for the digital signature of a document.

The "security environment" so generated has to be stored in a floppy disk or, more frequently, in a USB driver.

It is necessary to create a new "security environment" if the keys have been expired, the mass storages lost or damaged, or the password lost.

The documents, communications, motions that can be forwarded through Entratel are the same of FISCOnline (*modello 770, Uni.Co. PF, Uni.Co. SP, Uni.Co. SC, Uni.Co. ENC, Uni.Co. IRAP* for PAs, VAT return and consolidated balance sheet; communications concerning the Intrastat list, the *AT* and the so-called "imprint of digital documents and archives"; motions related to benefits, tax credit, tax refund and communications related to the opening, variation, closure of the VAT number; registration, deferral, transfer and termination of the leases; payment through *modello F24*).

[12] The Entratel software has functions similar to FileInternet; it controls, authenticates and forwards the documentation and subsequently visualizes the receipts from the *AE*.

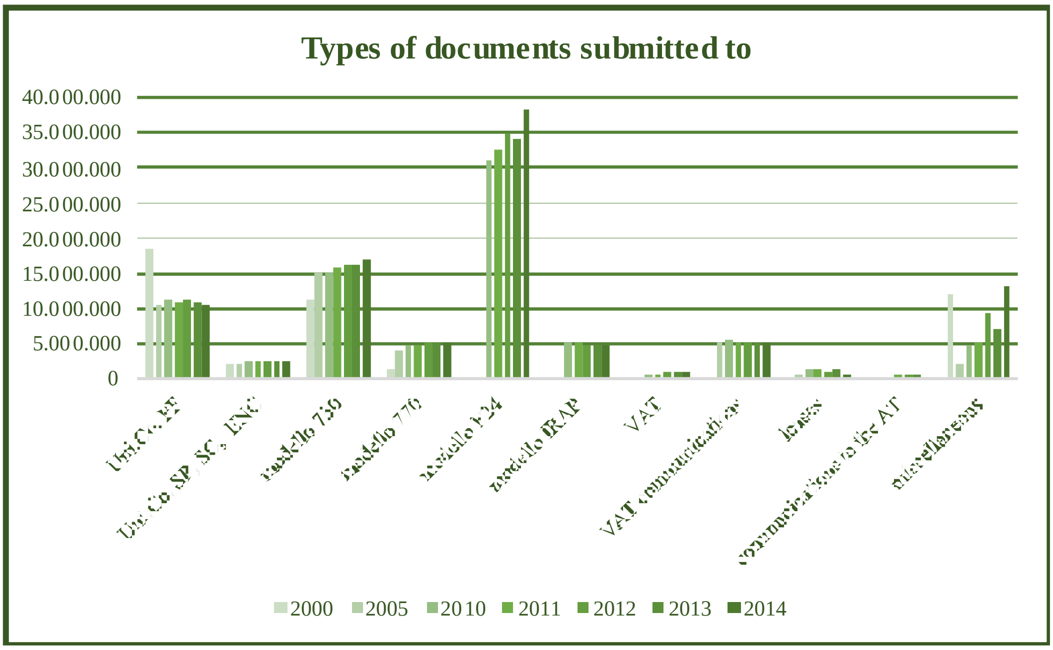


Image 6 Source: Agenzia delle Entrate, Digital Services-Statistics

As made clear by the histograms, the second most transmitted document in Entratel is the *modello 730*, whose submission through FISCOnline is, instead, negligible (few tens). That is a further demonstration of what we stated in the previous pages, a huge amount of the data forwarded to Entratel belongs to the intermediaries' clients. The *modello 730*, indeed, is the tax return of the employees and pensioners who do not have to declare relevant incomes, other than those perceived mainly from the employment or pension and from the real estate; it is submitted to the *AE* through the employers, *CAF*s or other professionals and intermediaries. The scheme has not been changed after the introduction of the pre-filled tax return we will deal with later.

For the other functions of Entratel reference can be made to what has been said about the functioning of FISCOnline.

3. Cassetto Fiscale and Civis

The *Cassetto Fiscale* (fiscal box) is a digital space where a taxpayer may consult his information concerning personal data, tax returns[13], tax amnesty and agreement with the *AE*, tax refunds[14], payments made through *modello F24*, his

[13] The tax returns consultable are those submitted since 1998.
[14] Only tax refunds enjoyed since 1994 can be visualized.

real estate data[15], and his status of the registration in the VAT Information Exchange System (VIES)[16].
Since 2015 the Fiscal Administration makes available in *Cassetto Fiscale* the pre-filled *modello 730* within each 15th April.
The taxpayer may delegate, online or with a written document, up to two other persons (generally accountants or fiscal lawyers) to consult his *Cassetto Fiscale*.
Users already registered on Entratel can consult the information about their clients, who have delegated them, signing a specific protocol with the *AE*.

Civis is a channel supplying two services related to the so called "automatic" and "formal" controls provided in the articles 36-*bis* and *ter* of the Presidential Decree 600/1973 containing the general rules governing income tax assessment.
Both articles, introduced in 2005, enshrine a phenomenon in between the "substantial tax assessment" (henceforward assessment) of and the tax collection. The fiscal administration, indeed, does not have to conduct audits, inquiries or research of information nor it is required to make complex evaluations of the fact to correct, if it is the case, the amount due by the taxpayer.
Those activities are without prejudice of a possible tax assessment[17], which is, therefore, always possible.
The "automatic control" (article 36-*bis* and its VAT homologous, article 54-*bis* of the Presidential Decree 633/1972) highlights possible errors or miscalculation in the phase of settlement of the sum due using the data and information contained in or inferable from the same tax return or resulting from the *AT*. Typical examples are clerical errors in the calculation of the final tax or the taxable base, in the application of the tax rates, the indication of deductions and tax credits for an

[15] The information available are those related to documents registered in the fiscal offices from 1986 onward.
[16] The VIES is the European digital archive concerning VAT. Every taxable person willing to carry out taxable operation within the EU shall register himself in the VIES. The system allows undertakings to check the existence of and confirm the VAT numbers of their clients and makes easy for fiscal administrations to monitor the flows of intra-EU operations relevant for VAT purpose.
[17] Art. 36-*ter* para. 2 explicitly clarifies that further activities aimed to assess higher sum due are possible. In the case of art. 36-*bis*, lacking an explicit legislative provision, the Supreme Court of Cassation intervened to state that in 2004 (SS.UU. 23826/2004).

amount higher than that established under the applicable legislative provision or not due by any means.

The control is carried out on every single tax return within the beginning of the period when it is possible to submit that related to the following fiscal year.

The period available to discharge the “formal control” (article 36-*ter*) is instead longer. Within 31st December of the second year following the forward of the tax return, indeed, the competent offices may[18] verify the compliance of the data and information rendered by the taxpayer in his tax return with the documentation stored by the taxpayer and with those information contained in the *AT* or deducible from the tax returns of other taxpayers (withholding tax agents), social security bodies, banks and assurance companies. In that case a reduced inquiring activity is, therefore, discharged. The fiscal authority may exclude, after such control, wholly or partially, withholding taxes, tax credits, deductible items to which the taxpayer is not entitled.

The outcome of the checks is then communicated to the taxpayer. If an error is recorded, the taxpayer may accept the correction made by the *AE* and regulate his position paying the higher tax due, interests and reduced sanction, or may give evidences of the validity of his tax return submitting the appropriate documentation.

Civis offers to the taxpayers reached by a communication of errors, highlighted under an “automatic control”, the opportunity to ask clarification, regulate their position or forward the reasons according to which they do not believe the higher payment due.

The system allows to monitor the status of the practice. A new feature makes available in pdf the pre-filled *modello F24* to put the taxpayer in the possibility to pay the amount still due after the control without waiting for the correspondent printed documentation to be sent by mail.

The second service supplied by Civis is the possibility to submit electronically the documentation required by a communication *ex* article 36-*ter*. As said before, the

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[18] Unlike the control ex art. 36-*bis*, which is made extensively to cover all the tax returns submitted, the one provided in art. 36-*ter* is carried out taking into account the selective criteria, annually identified by a Decree of the Minister of Economy and Finance governing tax assessment.

"formal control" implies certain activities, albeit not so sophisticated, as verifying the documentation supporting the declaration of the taxpayer or crosschecking the data already available.

Both *Cassetto Fiscale* and Civis are available for the taxpayers registered in FISCOnline or Entratel[19].

4. Pre-filled tax return

The article 1 paragraph 1 letter b) of the Legislative Decree 175 of November 2014 introduced, starting from the 2015 (with reference to income belonging to the fiscal year 2014), on an experimental basis, a new formula for the self-assessment of the income by the taxpayers. The *AE* makes available online, through its online services, the pre-filled *modello 730* using the information at its disposal on the *AT*, the data submitted by third persons and the *Certificazione Unica (CU)*[20]. The implementing acts[21] were issued on January and February 2015 and received the clearance of the Data Protection Authority on 19th February.

The pre-filled return represents a "Copernican revolution" in the relationship between the *AE* and the taxpayers. The framework of that change is an enhanced tax compliance, which inspires the entire mandate of the Parliament[22], of the taxpayer natural person[23]. The advantages consist, for the taxpayer, in the reduction of the costs and possible error related to the filling of the return and in the decrease of the risk concerning possible audits, assessments and litigations; the Fiscal Administration gains in terms of fidelity of the taxpayer, improved

[19] The data for the access are the pin for FISCOnline and the content of section II of the "virtual file" for Entratel.
[20] From 2015 the *CU* has substituted the *Certificato Unico Dipendente (CUD).* While the *CUD* was a certification, released by the employers or the pension entities, of the incomes from employment, withholding taxes levied, pensions and assimilated items, the *CU* is a richer documentation, modified to accommodate the pre-filled return. The most noticeable change is the certification of the withholding taxes levied in the hands of self-employed persons.
[21] Acts of the *Agenzia delle Entrate* of 15th January, 16th and 23rd February 2015.
[22] The Parliament delegated in March (Law 23/2014) the Government to issue legislative decrees for a fairer, more transparent and growth-oriented fiscal system.
[23] The mandate of the Parliament provides the adoption of measures to improve the tax compliance of other category of taxpayer (e.g. so-called cooperative compliance for large taxpayers or the extension of the tax tutorship program to small-medium enterprises, both provided by art. 6).

reputation and diminution of tax evasion and costs of audits, controls, assessments and litigations.

The fiscal authority is charged with the collection and processing of the information and the compilation of the tax return, while the taxpayer has only to check the exactness and the completeness of the data. Previously the tax return submitted by the taxpayer was subject to subsequent controls of the *AE;* from the current year if the taxpayer does not find anything wrong with tax return and accept it paying the tax, only a limited control by the *AE* will take place.

The taxpayers concerned by the new regime are employees, pensioners and workers gaining income assimilated to the formers. It is estimated a public of around 20 million people. Generally, those persons own other income, mainly from real estate, and deduct costs related to their everyday life (e.g. family allowances, mortgages, assurances, medical and educational expenses, property renovation and Eco-save expenses)[24].

Within each 15th April the *AE* makes available the pre-filled return online, in *Cassetto Fiscale*. The taxpayers, therefore, should be registered in FISCOnline or Entratel to withdraw the tax return. It cannot be denied that most of the interested persons are either not registered in those platforms nor acquainted whit the new technology (i.e. pensioners); other methods thus have been established. The access to the services is granted, indeed, also by mean of the access credentials

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[24] The range of the phenomenon is shown by the following table (*Table 1*) (Source: Agenzia delle Entrate, Digital Services-Statistics).

Main deducible items	
	%
Tax returns containing deductions	85 %
Tax returns without deductions	15 %
	Frequency
Passive interests on mortgages	3,2 million
Assurance prizes	4,2 million
Medical expenses	11,5 million
Property renovation and Eco-save expenses	2,5 million

used for online services supplied by other entities (e.g. INPS, the most important Italian social security entity). Furthermore the possibility to submit the tax return as usual still stands.

To make possible the compilation of the pre-filled *modello* 730, the withholding agents shall submit to the *AE* the *CU* (listing the amount of sums paid to the taxpayer, the withholding tax and the social security contributions paid and the deductions recognized) within 7th March, on pain of sanctions. Sanctions are provided also in case of omitted, late or wrong transmission of data, within 28th February, by other entities obliged to transmit fiscally relevant information to the *AE* (e.g. banks, assurance companies, *Poste Italiane*, Social Security entities). Other information come from the database of the Cadastre and the tax returns of the previous years.

As from 2016 it will possible to take into account the medical and other expenses through a procedure of rationalization of the sources of information. In particular, the data concerning medical expenses will be taken from the information registered through the health insurance card[25].

In 2015, as experimental year, the *AE* has taken measures to avoid the recognition of non-due deductions or the inserting into the pre-filled return of incorrect data communicated or deducible from the information given by third persons.

Passive interests on mortgages, passive interests and assurance prizes and social security contributions are detected by reference to the data available in the previous tax returns or in the withholding agent's return and by reference to possible exclusion of the items declared as result of a previous control *ex* article 36-*ter*. If the data communicated by third persons do not find validation by the information available or have been already modified *ex* article 36-*ter*, they are not inserted into the pre-filled *modello 730*, but the taxpayer may subsequently still integrate the tax return.

The taxpayers may accept the pre-filled document, correct or integrate it[26]. After the verification by the taxpayers, the tax return shall be forward electronically,

[25] The health insurance card is the sole device where the fiscally relevant medical information (e.g. medical prescriptions, medical performances and services enjoyed) are stored.
[26] In this first year, because of the lack of the information regarding mainly the medical expenses, it is estimated that the 70% of the pre-filled returns need at least such an integration.

directly by them or through their withholding agents, *CAF*s and other professionals and intermediaries.

The precautionary regime finds his ratio also in the limitations of the Administration's power of control contained in the article 5 of the Legislative Decree 175/2014. While the automatic control *ex* article 36-*bis* has not undergone any change and it is still applied. The control *ex* article 36-*ter*, instead, is no more applicable to the items included into the pre-filled return by the *AE*, accepted by the taxpayers and submitted directly by them or through their withholding agents (article 5 paragraph 1). If the taxpayers have modified the return, the formal control applies as usual (article 5 paragraph 2). Finally, when the return is forward to the Fiscal Administration through a *CAF* or a professional, under paragraph 3, the formal control is made toward those intermediaries, no more toward the taxpayer. The adoption of that solution is due to the duty of the intermediaries to authenticate the conformity of the data contained in the tax return with the documentation held by the taxpayer. In case of unfaithful authentication, they are, therefore, liable for a sum equivalent to the tax, sanctions and interests due by the taxpayer, except for the case of taxpayer's malice.

The outcome of that radical and ambitious change in the current relationship between the fiscal authority and 20 million taxpayers will be soon under our eyes. Foreign experiences (e.g. Denmark, Sweden, Finland, Norway, France, and Lithuania) show that the efficacy of the tool depends upon the efficiency of the fiscal-administrative system supporting it[27].

5. Mini One Stop Shop (MOSS)

The 1st January 2015 a new regime[28] concerning VAT place of supply in B2C contracts for the supply of telecommunication, television and radio broadcasting services and other electronically supplied services entered into force. Those services are now taxed in the country where the customer belongs, regardless of whether the customer is a business or a natural person and whether the supplier is based in the EU or outside.

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[27] DE VITO P. and MENNELLA E., *E-Tax: con la precompilata la sfida fiscale diventa globale*, in FiscoOggi, 2nd March 2015.

[28] Directive 2008/8/CE and its implementing regulations.

The mini One Stop Shop (MOSS) is a web portal that allows taxable persons supplying the aforementioned services to non-taxable persons in Member States (Member States of consumption - MSCON) where they are not established to account for the VAT due on those supplies in the Member State in which they are identified (Member State of Identification - MSID).

The scheme represents a simplification measure, without the MOSS, indeed, the supplier would be required to register in each Member State in which he supplies services to his customers. The European Court of Justice (ECJ) stated on 26th October 2010 (C-97/2009) that special VAT schemes for small undertakings entailing VAT exemptions operate only with references to activities of small enterprises established in the territory of the Member State. It does not apply to activities discharged in other Member States. The MOSS may be applied, therefore, also by such entities for the supply of telecommunication, television, radio broadcasting and other electronically supplied services, territorially relevant in other Member States.

The MOSS is available to both taxable persons established (Union scheme) and not (non-Union scheme) within the EU. The regime is optional; however, the choice to use it makes it compulsory in all relevant Member States. The taxpayer, therefore, cannot opt to use the scheme on an individual Member State basis.

The taxpayers who choose the MOSS are required to register in the MSID.

For the Union scheme, the MSID is the Member State where the taxable person has his residence or, if not an EU resident, a permanent establishment (PE). In case of more than one PE within the EU, he is entitled to choose one of those Member States to be the MSID. That selection is binding for 3 calendar years.

The non-Union scheme is reserved to taxable persons who have neither the residence, nor a PE, nor are registered or otherwise obliged to register, in the EU. They can choose any Member State as their MSID. That Member State will provide an individual VAT number (using the format EUxxxyyyyyz).

To register themselves and accede to the MOSS it is necessary to be registered in FISCOnline or Entratel.

The registered taxpayers electronically submit from his MSID the quarterly MOSS VAT returns detailing the services supplied to non-taxable persons in other

Member States and the VAT due. Those returns, along with the VAT paid, are subsequently transmitted by the MSID to the corresponding MSCON through a secure communications network.

The taxable persons have been able to register for MOSS with effect from October 2014, after the implementing internal Act of the *AE* (30th September 2014). Those, already registered in the V@t on e-services (VOES)[29] and not excluded until 31 December 2014, migrated to the MOSS scheme automatically. They have not to send any request for the assignment of an UE ID and/or a VAT number; they will be registered, indeed, with the VAT number already used for the VOES. The *AE* sends them an UE ID and further instructions to use the new platform. The MOSS requires further information compared to those collected under the VOES, the taxpayer, therefore, will complete all the missing data through the update task available online[30].

6. Sistema d’Interscambio flusso Dati (SID)

The SID (System of data exchange) is the infrastructure dedicated, in the services that envisage its use, to the automatic exchange of a flow of information between the *AE* and the PAs, companies, entities and firms. Its use is mandatory or elective depending upon every single service supporting it.

The SID is a milestone in the process of enhancing the accurateness of the *AT* and, consequently, the correctness of the pre-filled *modello 730*.

The infrastructure requires the users to be already registered in FISCOnline or Entratel.

The SID allows the users registered to transmit the information by *PEC*, only if the file does not exceed 20 Mb, or through the FTP channel. For the use of the FTP channel the user has to certify its own knot or use another knot, already certified by other persons offering theirs for the transit of the data. In that latter

[29] The VOES has been the platform used by non-EU commercial operators, not identified within a Member State for VAT purpose, who render certain services by means of electronic equipment in favour of any consumer whatsoever resident in the EU, since the introduction of the relevant regime by the Directive 2002/38/EC.
The VOES stopped its activities for registration on the 31st of December 2014, but it will remain active for any other task regarding VAT returns related to previous quarters until the 31st of December 2017.
[30] Annex I of the Regulation 2012/815/UE.

case the knot works only for the transmission, it has no active role in the creation of the file transmitted.

For the use of the SID, the user has to download the software, working with open java, that generates the certification and encrypt, compress and electronically sign the file.

he software permits to exchange the file according to the security protocol indicated by the specific service, supporting the SID, used.

Three types of security protocols are used:

- guarantee of the authenticity (not alteration) of the data and of confirmation of the sender
  - level A10: it is used to exchange files without any security protocol (files which have been already secured in other way) and files authenticated through certificates released by the *AE*:
    - level A20: it uses the format PKCS#7 “detached”, which gives as output two different file to be both sent to the *AE*;
    - level A21: it opens the SID to other kind of signature, other than the digital signature;
  - level A30: it allows to exchange file signed with digital signature;
- compression of the file
  - level B10: it compresses the file with significant dimension;
- cryptography
  - level C10: it encrypts the data in the format PKCS#7 to grant their secrecy.

We will come back to the SID later in the paper, dealing with the services supporting it.

7. Services without registration

The *AE* provides on its website also online services to be used without any registration. Those services permits to better plan or discharge the fiscal relationship among the taxpayers and between the taxpayer and the *AE*.

The fiscal services available are:

- calculation of the car tax and control of payment executed[31];
- calculation of the state surtax of the car tax[32];
- calculation of the instalments to pay after the control *ex* articles 36-*bis* and *ter* of the Presidential Decree 600/1973;
- calculation of taxes due on the judicial acts;
- control of European VAT numbers through the VIES;
- control of revenue stamps' barcodes;
- request for the duplicate of the TIN badge or of the health insurance card;
- control of TINs[33];
- control of the VAT numbers[34].

The *AE* website offers also a pack of cadastral services:

- consultation of the cadastral value of the real estate;
- online correction of the cadastral data[35];
- research of non-registered cadastral unit[36];
- control of the status of a cadastral practice;
- research of mortgages pending on the properties[37].

[31] The service of control of the car taxes paid is available only for the payments to the benefit of Marche, Valle d'Aosta and the Regions where the *AE* is in charge of the collection of the tax (Friuli Venezia Giulia, Sardegna and Sicilia). The car tax is, indeed, a local tax to be paid to the Region of residence of the owner of the vehicle.

[32] The surtax shall be paid to the State for every kilowatt more than 185 kw (art. 16 para. 1 of the Law Decree 201/2011).

[33] The possibility to verify the existence and the conformity of the TIN with the personal data of a taxpayer according to the information stored in the *AT* is provided in the art. 38 para.6 of the Law Decree 78/2010 to grant the validity of the TIN as mean of identification of a taxpayer.

[34] Since 2011, according to art. 35-*quarter* of the Presidential Decree 633/1972, the Fiscal Administration makes available, in order to hinder VAT frauds, the possibility to check the existence of a VAT number, its status and the name of its owner.

[35] If a taxpayer identifies an error in the cadastral data of his properties (generally related to the owner of the unit, the data of the unit, incoherence in a non-registered unit), he can ask the correction through the online service "Contact Centre". If the practice cannot be discharged online, it is forwarded to the competent office. In any case the taxpayer is informed of the outcome of his request.

[36] The person who realizes a new cadastral unit or enlarges an already existing one shall denounce it to the Cadastre within 30 days from the moment when the unit has become habitable or suitable for the foreseen use.

The *AE* periodically checks the presence of new constructions comparing the aerial images with the cadastral map. If the new constructions have not been already denounced, the *AE* attributes an estimated cadastral value and, if the owner of the unit continues not to fulfil his obligations, it gives a definitive one at the owner's expense.

The service permits the research of non-registered units to, eventually, begin the procedure of attribution of a cadastral value.

All the natural persons, registered on FISCOnline or Entratel, are also able, without any kind of payment or fee, to accede to the database of the Cadastre and of the mortgages concerning the real estate whose ownership or other rights they are entitle to (so called *Consultazione Personale* – personal consultation). The access makes possible to withdraw present and historic cadastral and mortgage certificates[38].

Those services apart, other cadastral services (e.g. Docfa and Pregeo[39]) are available in the platform SISTER. It is not a free resource, the taxpayers, both natural and legal persons, shall sign a convention whit the *AE* and pay the amounts provided under it. The law provides specific exemption from the payment of the services offered by SISTER (e.g. for Municipalities, PAs).

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[37] The service covers the entire national territory, except the area of Trento, Bolzano and Gorizia where a different system is used (i.e. *sistema* tavolare). It was used during the Austro-Hungarian Empire and it is still in use in some of its former territories. Its fundamental principle is the transfer of the ownership at the moment of the registration in the cadastral books, the so called *intavolazione*, in lieu of the moment of the manifestation of the consent as provided in art. 1376 of the Civil Code.

[38] See footnote no. 34.

[39] Docfa is a software for the compilation and forward to the competent office of cadastral documents related to urban properties, while Pregeo concerns the cadastral documentation of the acreages.

Chapter 2

Detection of the hidden and "non-observed" economy

The first legislative intervention of the Government lead by Mr Mario Monti in 2011 was the so-called "Salva-Italia", a Law Decree[40] containing severe measures to limit the public expense and strengthen the public revenues. Considering that tax evasion and tax avoidance are both bitter enemy of public revenues, the Decree intervened energetically modifying procedurally and substantially the previous framework. The present section of this work deals with two of those modification, the reduction of the limitation of cash payments and the widening of the scope of the obligation to communicate to the *AT* the financial operations of the taxpayers.

1. Limitation of cash payments

A significant *vulnus* for the monitoring of financial flows and transactions could be originated by the use of cash. The use of cash, other bearer instruments and the making of *extra*-account operations entail serious risks of escaping taxation, money laundering and financing of criminal activities. Such operation, indeed, are either not traced by the competent authorities or, often, carried out without one or both parties of the operation being identified.

The intervention of the Regulators has always been focused on reducing the possibility to pay cash and extending the data, related to financial operations, banks and financial operators have to communicate to the *AT*.

The provision regarding the limitation of the use of cash to make payments has undergone continuous change in the last years.

[40] Law Decree 201/2011.

Notwithstanding the diffusion of the credit cards and other prepaid debit cards[41], they are mostly used to withdraw money from ATMs, not to buy goods and services[42]. Italian people, therefore, still prefers by far to use cash as primary mean of payment.

Since 2008 the limit has been object of continuous changes. From April 2008 to August 2011 it was changed five times (€ 12.500, € 5.000, € 12.500, € 5.000, € 2.500). It is from December 2011 that the current limit of € 1.000 entered into force. The Government in charge declared to be willing to reduce further the limit, but that intention has remained only a declaration of intent. Article 12 of the Law Decree 201/2011 thus forbids the transfer of cash and bearer saving accounts between different subjects if the amount transferred exceeds € 999,99. The prohibition persists also in the case of smaller payments artificially fractioned. If the splitting up of the payment is not artificially made, but required by the commercial practice or contractually provided, it remains possible to correspond a sum, on the whole higher than € 999,99, but fractioned in more than one payment, each lower than € 999,99. A fractioned transfer may be, in any case, executed through banks, electronic money institutions (EMIs) or Poste Italiane; those entities, indeed, are obliged to identify the parties of the transfer and to communicate the data of the operation to the *AT*.

The Law Decree 16/2012 introduced an exception to the present provisions. Retail sellers and tour operators may sell their goods and services to non-EU or EEA citizens against cash payments up to an amount of € 15.000. Sellers and operators join the scheme with a communication to the Fiscal Administration containing the bank account used to deposit the payment received. At the moment of the operations covered, they shall immediately identify the purchasers and, the day after, deposit the money received for payment along with a copy of the adhesion to the scheme.

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41 The Italian data per capita (1,1) concerning the possess of credit cards is extremely lower than the data of the UE-27 and the BRIC area (1,5) and the USA (3,8) (Source: Assofin, CRIF and GfK Eurisko, *Osservatorio sulle carte di credito*, 2012).

42 The number of operations per capita not involving cash payments were, in 2012, 72, while the data of the UE-27 was 187 (194 in the Euro zone) (Source: Ministry of Economy and Finance, *Rapporto statistico sulle frodi con le carte di pagamento n. 4*, Ch. III, 2014).

The violation of the provision of article 12 entails an administrative sanction ranging from 1% to 40% of the sum transferred, in any case the sanction shall be at least € 3.000; the sanctions increase when the sums transferred exceed € 50.000.[43] The sanction are inflicted by the competent local offices of the *Ragioneria dello Stato*[44] upon warning of the competent inspective authorities. Those authorities shall communicate the violations also to the *AE* that activates the specific control for assessing a higher income.

The Circular of the Department of Treasure of the Ministry of Economy and Finance issued on 4th November 2011 clarified that operations of withdrawing or depositing money are not covered by the prohibition of article 12. No obligation of warning exists in the head of financial intermediaries, except for the case of elements inducing to deem that the prohibition is violated. Article 41 of the Legislative Decree 231/2007[45] laid down two elements allegedly suggesting that an activity constitutes money laundering or terrorist financing, namely the frequent and unjustified operations with cash and the withdrawing or depositing sums exceeding € 15.000. The warning to the *Unità di Informazione Finanziaria (UIF)*[46] is not automatic, the financial operators, indeed, shall evaluate the operation in the light of the financial profile of the parties involved.

The Decree prescribes that bank and postal cheques used for payment exceeding € 999,99 shall compulsory indicate the name of the beneficiary and the non-transferability clause. Generally, bank and postal cheques contain, indeed, such clause, but clients may require in writing free cheques. Also the violation of those provision are punished under article 58. In contrast with the discipline of cash payment, as clarified in the Circular of the Ministry of Economy and Finance 281178 of 5th August 2010, the limit applies to each cheque; the fractioned payments rule does not apply.

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[43] Article 58 of the Legislative Decree 231/2007.

[44] The *Ragioneria dello Stato* is the general accounting department of the Ministry of Economy and Finance, it supports the Parliament and the Government on budget policies, processes and procedures. Its primary tasks is to guarantee the correct administration and the rigorous planning and programming of public resources.

[45] The Legislative Decree 231/2007 implemented the Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

[46] The *Unità di Informazione Finanziaria (UIF)* is an intelligence unit of the Bank of Italy created by the Legislative Decree 231/2007 with the task of combating money laundering and terrorist financing.

The budget Law for 2014[47] introduced the obligation to pay the rents of whatever amount with means of payment that could be traced (e.g. cheque, bank transfer, postal bulletin). A Note of the Ministry of Economy and Finance[48] clarified that the sanctions provided by the Legislative Decree 231/2007, being directed to the prevention of money laundering and terrorist financing, are not applicable in the present case if the limit of € 999,99 is not exceeded. For the purpose of such provision it is necessary to show a written evidence of any kind, unequivocal and able to demonstrate that the transfer of money is aimed at fulfilling the contractual obligation.

Finally, shortly before the Law Decree 201, the Law Decree 138/2011 repealed some paragraphs of the discipline regulating the money transfer. The provisions terminated prohibited the transfer of cash exceeding € 2.000 through payment service providers when they made use of agents. If the sums were lower than € 5.000, the operation was allowed, provided that the person ordering the operation delivered a specific documentation to guarantee its congruency. The effect of the abrogation has been the applicability of the € 999,99 limit to the money transfer.

2. Archivio dei rapporti finanziari

We have already made reference to the obligation of financial operators to communicate routinely certain kind of data to the *AT*. Financial operators are not the sole entities to have such duty. The obligation is laid down by article 7 of the Presidential Decree 605/1973, establishing the *AT*. Data communicated under article 7 flow in a specific section of the *AT*, called *Archivio dei rapporti finanziari* (Archive of financial relations).

The subjective and objective scope of the obligation has been progressively enlarged. Currently, the subjects obliged to submit the reports are public offices; Chambers of Commerce; Professional Associations; undertakings, companies and entities; banks, Poste Italiane, financial intermediaries, investment companies, collective investment undertakings (CIUs), asset management companies (AMCs) and other financial operators. Those private and public operators shall communicate the data identifying the persons (e.g. TIN) who have enter in

[47] Law 147/2013.

[48] Note of the Ministry of Economy and Finance no. 10492 of 5th February 2014.

relations with them. Specifically, financial operators shall transmit the data related to operations and clients and persons, both resident and non-resident, with whom they deal, not only on a continuous basis, but also who carry out, on their own behalf or on behalf of third parties, other financial operations. According to the Act of the Director of the *AE* of 29th February 2008, indeed, the objective scope has been enlarged to encompass also *extra*-account operations (e.g. the operations not settled in a bank account). The definition of relations, as contained in article 7 with reference to financial operators, is laid down by the Circular of the *AE* 32/E of 19th October 2006: every activity carried out on a continuous basis (to be read as a congruous time lapse) discharged by the financial intermediaries or services offered to the clients in the framework of a complex and enduring specific contractual formula.

Financial operators shall also communicate to the *AT*, under the Law Decree 201/2011, with reference to the aforementioned relations, the amount of the operations and all the information necessary to discharge tax controls. That innovation has represented a turning point. The data collected in the Archive are no more used only during the assessment phase to reconstruct the income of the targeted taxpayers, but also, and especially, as source of selection of the taxpayers showing high fiscal risk.

The Law Decree 98/2011, as enacted by the Act of the Director of the *AE* of 6th December 2011, introduced the obligation for assurance companies to communicate to the *AT* data concerning unit-linked and index-linked policies.

The monthly and annual reports of financial and accounting information collected since the 1st January 2016 shall be processed under the Act of the Director of the *AE* of 10th February 2015. The Act provides that, starting from 2016, the only platform used to submit the data will be the SID, which assures high standard of security and compliance with the indications of the Data Processing Authority[49]. Nowadays, only the annual reports are submitted through the SID, the monthly communications are forwarded using FISCOnline or Entratel.

3. Financial investigations

[49] See the following Chapter.

The establishment and strengthening of the *AT* infrastructures, in addition to its benefit in order to prevent money laundering and terrorism financing, is functional to an effective activity of detection of possible income mismatches and, consequently, assessment of higher income to be taxed[50].

In the context of inspective powers of the Fiscal Administration, the financial investigations represent a specific tool, which has acquired an increasing importance in hindering tax evasion and tax avoidance.

Until the 90s banks and financial operators shall disclose data and information related to their clients only in particular and serious cases of evident tax evasion, upon a double authorization from the competent administrative office and the President of the competent Tax Court of first instance. As clarified in the Government's report on the Presidential Decree 600/1973, the bank secrecy was considered an instrument of protection of a public interest, i.e. the protection of saving in all its form (article 47 of the Constitution). The point of view expressed by the Government in the 70s changed when the Law 413/1991 generalized the access to bank and financial information, subject to the sole authorization of the administrative office hierarchically higher than that in charge of the investigations. The Government's report on that law stated that the bank secrecy is a private interest. The Constitutional Court endorsed that statement in 1992, the bank secrecy is expression of economic freedom, protected by the Constitution, but it can be ignored when a public interest arises. The limit to the waiver lays in the principle of legality[51] (the law shall prescribe and regulate the waiver of bank secrecy, not arbitrarily or indiscriminately). A similar result was reached with regard to fiduciaries companies, which, by their nature, create a fiduciary screen

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[50] With the aim of improving the functioning of the *AT* and fostering the introduction of the pre-filled tax return, the Director of the *AE* announced on 24th September 2014, during her audition before the Parliamentary Supervisory Commission on the *AT*, that the Administration is planning a rationalization of the infrastructure aimed at enhancing the quality of its data and eliminating the duplication of information (the *AT*, indeed, is currently composed of 128 different databases). See MOBILI M. and PARENTE G., *Il Fisco "pulisce" l'Anagrafe Tributaria*, in *Il Sole24Ore* (Italian financial newspaper), 25th September 2014.

[51] The same provision deemed the legal source of the bank secrecy, art. 7 of the *TUB* (the Italian bank law), contains an exception with regard to the judiciary authority. It states, indeed, that information, elements and data possessed by the Bank of Italy in virtue of its supervisory activity are covered by professional secrecy, but that secrecy cannot be opposed to the Ministry of Economy and Finance and to the judiciary authority.

between the client and the company[52]. The Regulator has recognized that the fiduciary scheme deserves a positive evaluation of its activity and functioning, but it has also concluded that the fiduciary screen may be overcome. A sound confirm came from the Ministerial Decree of 16th January 1995 that highlighted the subjection of fiduciary companies to the provisions restricting the fiduciary secrecy in order to prevent criminal phenomenon.

An important turning point of the discipline under examination was the Law 311/2004 (budget Law for 2005). The Regulator created three main clusters of information the Administration may request. The AE may require:

- PAs and non-economic public entities to communicate the data and information related to subjects indicated individually or by category;
- economic operators (banks, Poste Italiane, financial insurance companies, financial intermediaries, investment companies, collective investment undertakings (CIUs), asset management companies (AMCs) and fiduciary companies) to submit data, information, documents related to any kind of relations and operations, included *extra*-account operations, concluded with their clients and third parties;
- fiduciary companies to communicate the personal details of subjects on whose behalf they have managed properties, as long as those subjects are unequivocally identified.

Before starting the financial investigations, the *AE* shall ask the authorization of the Regional Director of the *AE* or the Regional Commandant of the *Guardia di Finanza*[53]. The lack of the authorization implies the unlawfulness of the investigations and of the possible tax assessment, if the taxpayer demonstrates a concrete prejudice accruing to the outcome of the procedure, not concerning his privacy or his right of defence[54]. The Court of Cassation (16874/2009), highlighting the necessity of the existence of a previous authorization, stated that its exhibition to the requested operators is not necessary because the financial

[52] A fiduciary company, indeed, is assignee of the property, which it manages, in its name and in its clients' interest, entrusted by the clients. The fiduciary company keeps the secret of the identity of its clients and the clients have the right to claim back the property entrusted.

[53] The *Guardia di Finanza* is a special police corps, part of the Italian armed forces, depending from the Ministry of Economy and Finance, with a general competence in the financial and economic area. It discharges the function of fiscal police.

[54] Supreme Court of Cassation, ordinance 16579/2013.

investigations aim at a mere control of payments and tax returns and do not require a motivation to be shown. It is important to bear in mind that the authorization cannot be challenged before a Tax Court, its vices may be challenged together with the tax assessment when issued.[55] The jurisprudence has always been resolute in denying the access to administrative documents during a fiscal proceeding. Article 24 paragraph 1 letter b) of the Law 241/1990, indeed, expressly excludes, pending a fiscal proceeding, the right of access to administrative documents. Article 24 itself, under paragraph 7, grants in any case the access to administrative documents necessary to look after and defend personal legal interests. The Council of State[56] (4046/2014) clarified that the restriction of the right of access is limited to the phase when the proceeding pends, being unnecessary to keep the secret for the period following the issue of a tax assessment. The Court observed also that the access is necessary to permit the taxpayer, who has receive a tax assessment, to defend before a court his legal position.

Coming back to request of information the Administration forward in order to start its financial investigations, the entities required to provide the requested information shall notify the taxpayer that an investigation has started in order to allow him to exercise the rights recognized by the law. However, the lack of such notification does not entail a vice of the tax assessment because the obligation accrues to the entity requested and not to the Fiscal Administration that issues the tax assessment.

3.1. The so-called “bank presumptions”

The evidence collected during the financial investigations maybe used to assess a higher taxable income under article 32 paragraph. 1 number 2) of the Presidential Decree 600/73. The provision prescribes, indeed, two presumption. The first one allows the *AE* to base its assessment on deposits, emerged during the fiscal investigations, if the taxpayer does not demonstrate that the related income has already been taxed or is exempted. The second one provides the same with regard

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[55] Agenzia delle Entrate, *Circular 32/E*, para. 4.2, 19th October 2006.

[56] The *Consiglio di Stato* (Council of State) is the court of second and last instance of the Administrative Judiciary System.

to the withdrawals; they are deemed to constituted income or payment received if the taxpayer does not disclose the beneficiary or are not registered in the accounting. Similar presumptions are laid down by article 51 paragraph 2 number 2) of the Presidential Decree 633/1972 with regard to the VAT.

The provision has been object of ample criticism, especially the part related to withdrawals. The presumption is based on the assumption that the money withdrawn are used to buy goods and services producing not declared income. The Constitutional Court intervened in 2005 clearing such presumption. It found that such presumption is a legal one, which can be challenged by the taxpayer disclosing the identity of the beneficiary of the withdrawals. It is not unreasonable indeed, as observed by the Court, to deem that unjustified withdrawals by an entrepreneur are used in the exercise of his business. Finally, the Court specified that the Administration, calculating the allegedly black-income, should recognize also the deduction of the correspondent costs, if the taxpayer proves them.

The scholars agree that, before issuing a tax assessment, the Administration should necessarily cross-examine the evidence collected with the taxpayer. In most cases, the withdrawals are perfectly licit. The jurisprudence[57] of the Court of Cassation instead has always unexplainably seen the previous cross-examination as a faculty of the *AE* to exercise discretionarily; in its view the Court, indeed, has always deemed satisfactory the possibility for the taxpayer to challenge the Administration's findings during a judicial proceeding. Other interventions[58] of the Court have clarified that the nature of those presumptions is reversing the burden of proof. Therefore, it is up to the taxpayer to demonstrate analytically that the bank operations are not fiscally relevant (ordinance of the Court of Cassation 1236/2015), being possible for the *AE* to issue a tax assessment based only on the outcome of the financial investigations. The possibility for the taxpayer to fulfil its burden of proof using presumptions is discussed. The jurisprudence of the Supreme Court of Cassation itself is conflicting. Recent jurisprudence seems to overcome the previous tendency (Court of Cassation, 25365/2007); in the judgement 25502/2011, indeed, the Court found that, due to the principle of the

[57] Supreme Court of Cassation, 25142/2009.
[58] Supreme Court of Cassation, 16096/2011, 25502/2011 and 625/2012.

freedom of the means of proof and to the lack of contrary legislative provision, the presumptions shall be deemed an adequate mean of proof.

The jurisprudence has intervened also in order to clarify the subjective scope of the "bank presumptions". The Constitutional Court (judgement 318/2011) agreed with the previous jurisprudence of the Supreme Court of Cassation concerning the applicability of the presumptions not only in the determination of business income, but also of self-employed income. The scope of the presumption regarding the deposit of money is even larger. The Court of Cassation has ruled that the presumption may be used not only to assess higher business or self-employed income, but also with the aim of demonstrating the existence of possible hidden activities (both of a business and of self-employed nature)[59]. However, with reference to the unjustified withdrawals, with the important judgement 228/2014, the Constitutional Court stated that it is unreasonable to equate the position of entrepreneurs and self-employed persons. The activity of a self-employed person is characterised by the prevalence of the personal contribution among the organization, which, for some self-employed activities, is almost inexistent. Furthermore, the Court remarked the simplified nature of the accounting of self-employed persons that entails, by its nature, a certain promiscuity of personal and professional revenues and expenses. After the intervention of the Constitutional Court, therefore, the presumption concerning the withdrawals is applicable only to businesses.

Article 32 paragraph 1 number 7), as article 51 for VAT, allows the *AE* to conduct investigations also on the bank accounts in third persons' name if it deems that they are connected with the taxpayer's income. The Court of Cassation (20449 and 21132/2011) found lawful to ascribe to a taxpayer the operations executed on the relatives' bank accounts, due to the kinship. On the same trend, the Court (14785/2011) enlarged the spectrum of the financial investigations concerning a company to the bank accounts of its shareholder and members of the board of directors if the Administration demonstrate the fictitious ownership. Sometimes the relationship between the associates and the business is so tight that it creates almost an identity of subjects (e.g. partnerships). In such cases the Court of

[59] Supreme Court of Cassation, 21132/2011 and 625/2012.

Cassation (26410/2005) justifies the automatic applicability of the presumptions, save the possibility of the taxpayers to challenge its results.

Chapter 3

Taxpayer Privacy

The discipline on personal data protection was introduced in 1996 by the Law 676, enacting the European Parliament and Council Directive 95/46/CE. Since 1996 other legislative interventions had been made on specific area of data protection creating the necessity of a comprehensive normative *curpus*. The reorganization of the legislation originated the current consolidated version of the data protection legislation contained in the Legislative Decree 196/2003, so-called Data Protection Code (hereinafter DPC).

The DPC states clearly that *"everyone has the right to protect his personal data"* (article 1). Article 4 paragraph 1 letter b) defines the personal data as *"any information relating to natural persons that are or can be identified, even indirectly, by reference to any other information including a personal identification number"* (e.g. TIN). The definition was modified by the Law Decree 201/2011, which eliminated the reference to legal persons. The provisions of the DPC regarding data subjects[60] and data processing, therefore, are applicable only with regard to individuals. However, as pointed out by the Act of the Data Protection Authority (hereinafter DPA) of 20th September 2012, the legislative intervention has not completely eliminated any form of protection of legal persons' data, remaining applicable the Chapter 1 of Title X concerning "Electronic communication services".

The DPC applies, according to article 5, to the processing of personal data, including those held abroad, where the processing is performed by any entity established either in the State's territory or in a place that is under the State's sovereignty. Data processing, performed by an entity established in the territory of a non-EU Country with the use of equipment, whether electronic or otherwise, situated in the State's territory, unless used only for purposes of transit through the territory of the EU, shall fulfil DPC provisions. If the DPC applies, the data

[60] Data subject, as defined by art. 4 para. 1 let. i), is any natural person that is the subject of the personal data.

controller[61] shall designate a representative established in the Italian territory with the aim of implementing the provisions concerning processing of personal data.

The definition of data processing[62] is very wide, it encompasses seventeen actions covering any kind of treatment applicable to a personal data. It is worthy to remark that it is not necessary to process the data electronically, a treatment, therefore, may take place also "without the help of electronic or automated means"; furthermore, processing data does not entail exclusively operations on database.

Any kind of data processing shall be performed in respect of the principle laid down by the DPC. Data processing shall ensure *"respect of data subjects' rights, fundamental freedoms and dignity, particularly with regard to confidentiality, personal identity and the right to personal data protection"* (article 2 paragraph 1). In order to achieve such result it shall be assured simplification, harmonisation and effectiveness of the mechanisms by which data subjects can exercise their rights and data controllers can fulfil their relevant obligations. Other important principles are the principle of minimization, legality and fairness, data accuracy and proportionality (articles 3 and 11)[63]. Those principles constitute the core of data processing and protection; they are thus frequently restated by DPA's interventions. The *Autorità Garante per la Protezione dei Dati Personali* (Data

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[61] Data controllers, defined by art. 4 para. 1 let. f), are "*any natural or legal person, public administration, body, association or other entity that is competent, also jointly with another data controller, to determine purposes and methods of the processing of personal data and the relevant means, including security matters"*.

[62] Data processing shall mean, according to art. 4 para. 1 let. a), "*any operation, or set of operations, carried out with or without the help of electronic or automated means, concerning the collection, recording, organisation, keeping, interrogation, elaboration, modification, selection, retrieval, comparison, utilization, interconnection, blocking, communication, dissemination, erasure and destruction of data, whether the latter are contained or not in a database"*.

[63] Art. 3 words: "*Information systems and software shall be configured by minimising the use of personal data and identification data, in such a way as to rule out their processing if the purposes sought in the individual cases can be achieved by using either anonymous data or suitable arrangements to allow identifying data subjects only in cases of necessity"*.

Art. 11 instead states that: "*Personal data undergoing processing shall be:*

a) processed lawfully and fairly;

b) collected and recorded for specific, explicit and legitimate purposes and used in further processing operations in a way that is not inconsistent with said purposes;

c) accurate and, when necessary, kept up to date;

d) relevant, complete and not excessive in relation to the purposes for which they are collected or subsequently processed;

e) kept in a form which permits identification of the data subject for no longer than is necessary for the purposes for which the data were collected or subsequently processed".

Protection Authority – DPC) was created in 1997 as an independent authority to protect fundamental rights and freedoms in connection with the processing of personal data and to ensure respect for individuals' dignity. Paragraph 2 of this Chapter gives some examples of cases where the DPA dealt with such matters, those principles, indeed, are particularly challenged by the use of electronic processing and telematics data transmission.

1. Taxpayer confidentiality

Under article 68 of the Presidential Decree 600/1973 it is considered a violation of the professional secrecy every information or communication concerning tax assessments disclosed, without a judicial order and outside the scope of a legal provision, to subjects other than Fiscal Administrations, *Guardia di Finanza* and interested taxpayers and their accounting and legal advisors. Possible exceptions to that provision, as envisaged by the wording of the article, are expressly laid down by the law. The communication, made under article 69 of the Presidential Decree 600/1973[64], of the data contained in the tax returns submitted is not considered a violation of professional secrecy. On that regard, the Note 7/1304 of 8th February 1985 of the Directorate for Direct Taxation of the Ministry of Economy and Finance clarified that violation of the professional secrecy exists only when information and communication concern a tax assessment. The Note specified that, as a consequence, article 68 does not hinder the disclosure of information contained in tax returns to persons other than those specified in the same article[65].

The violation of the professional secrecy laid down by article 68 constitutes a criminal offence. Article 326 of the Criminal Code[66], indeed, punishes by imprisonment, for a period between 6 months and 3 years, the public officer who, in violation of his duty or abusing of his position, disclose professional

[64] Further details on the disclosure regime of the lists of taxpayer published under art. 69 are provided in Sub-paragraph 2.2 of this Chapter.

[65] The case, in relation to which the Directorate was asked to deliver its opinion, concerned the request of Mr R.I. to check the income declared by Mr S.S.. Mr R.I. had been victim of an accident, for which S.S. was found responsible. Because Mr S.S. had declared to be unable to pay damages, Mr R.I. claimed the possibility to check his tax return. After the refusal of the competent office, the question was taken before the Directorate.

[66] Royal Decree 1398/1930 as further amended.

information covered by professional secrecy or facilitate its diffusion. The crime is punished, even if less strictly, also in case of negligence. The object of the disclosure shall be information concerning tax assessment. In case of disclosure of personal information of the taxpayers, the criminal provision applicable is article 622, which disposes a minor period for imprisonment (up to 1 year) or, alternatively, a fine ranging from € 30 to € 516. Furthermore, the disclosure is punished, in that case, only if it is likely to originate damages and it is conditional upon taxpayer's legal action.

2. Cases

The present paragraph deals with three of the cases in which the DPA intervened in order to protect taxpayers' personal data.

2.1. Financial investigations

On May 2005, the DPA was requested to issue an Act giving, if necessary, specific advice on the relevant aspects concerning treatment of personal data with reference to the innovations introduced by the Law 311/2004[67].

As seen in the previous chapter, the Regulator extended the objective and subjective scope of the financial investigations. The Administration acquired the possibility to request information to a larger on a wider range of operations (both account and *extra*-account operations and operations with third parties).

The DPA highlighted possible criticism with respect to information requests addressed to economic operators (banks, Poste Italiane, financial insurance companies, financial intermediaries, investment companies, CIUs, AMCs and fiduciary companies) and fiduciary companies. In those two cases it was necessary to adopt precautionary measure and provide safe transmission protocols.

The DPA clarified that, bearing in mind that *"everyone has the right to protection of personal data"* (article 1 of the DPC), the processing of data shall *"respect data subjects' rights, fundamental freedoms and dignity, particularly with regard to confidentiality, personal identity and the right to personal data protection"*

[67] See Ch. 2, para. 3.

(article 2 of the DPC). Those milestone of the data protection legislation are applicable also with regard of treatment of data for public interest, as it happen in the case of fiscal investigations. The DPA specified that addressees of its Act are both the proceeding Administration and the financial operators requested.

The DPA pointed out that the more efficient system of data communication based exclusively on telematic means has to respect the principle of data minimization (article 3 of the DPC), necessity and proportionality (article 11 of the DPC).The data, indeed, shall be used under the framework of the current relevant legislation, especially in the information flow between *AE* and requested entities, paying regard to the possibility to access and interconnect information stored in other database. The DPA went further explaining that information requested through telematics shall be addressed to targeted verification concerning cases specifically individuated, always provided that the request is necessary and proportionate.

Another statement of the DPA is remarkable. It found that the violation of the provisions concerning data protection implies the impossibility to use the data collected[68]. That possibility entails a subsequent illegitimacy of the tax assessment based exclusively on those data. As recognized by the Joint Sections of the Supreme Court of Cassation, indeed, evidences collected in violation of the relevant provisions cannot be used to support a tax assessment; therefore, if the tax assessment does not have other legally collected basis, it is void.[69]

The Act of the Director of the *AE* of 22th December 2005 received the indications of the DPA, which had previously cleared the act without remarks because it was in line with the principle of necessity, relevance and proportionality.

2.2. Publication of taxpayers' lists

During the night between 30th April and 1st May 2008 the *AE* made available on its website the nominative lists of taxpayers that had filed the income tax or VAT return for the year 2005. The lists encompassed the name, surname, date of birth, prevalent category of income, taxable income, net tax applied, amount of business or self-employed income, total business turnover and tax return model filed of

[68] Accordingly, art. 11 of the DPC words *"any personal data that is processed in breach of the relevant provisions concerning the processing of personal data may not be used"*.
[69] Supreme Court of Cassation, Joint Sections, 16424/2002.

each taxpayer. The lists could be also downloaded from the websites. In few hours, the number of accesses overcharged the website of the Fiscal Administration. The intervention of the DPA was timely. The same day, after a preliminary assessment of the non-conformity of such posting with the relevant legislation, the DPA urged the Administration to terminate the posting forthwith and to provide further clarifications of its conduct.

For the purpose of better understanding what happened during that night and why the DPA intervened so promptly, we shall refer to the provisions of article 69 of the Presidential Decree 600/1973. The current wording of the article, modified by the Law Decree 112/2008 in relation to the facts we describe, prescribes the publication of different lists of taxpayers and their disclosure regime. It individuates two types of lists. The first one (paragraphs 1 and subsequent) contains the names of the taxpayers assessed by the *AE* or whose tax assessment is ongoing and those of the taxpayers who omitted to file any tax return. The list shows the status of the tax assessment and the higher amount due, if it exceeds € 5.164,57 or the 20% of the amount declared (in any case if higher than € 25.822,24). Paragraph 4 instead provides a second list of "virtuous" taxpayers, commercial undertakings and professionals that have regularly submitted income tax and VAT returns. The list is drawn up annually and deposited for 1 year in each Municipality and territorially competent office of the *AE* in order for anyone to browse them.

The most relevant difference between the two lists, and the one we are interested in, lays in the disclosure regime. The first list is public, open to consultation; the second may be accessed under articles 22 and subsequent of the Law 241/1990, requiring a direct, concrete and current interest of the person willing to browse it. Information, therefore, is not available to general public, but only to persons who have a qualified position, legally protected, connected with the information for which the access is requested. The communication and diffusion of the lists in violation of the law is to be punished with a sanction ranging from € 5.000 to € 30.000, which might be tripled.

The *ratio* of the different disclosure regime has to be clarified; the publication of those lists entails, indeed, a serious risk of violation of taxpayer's privacy and safety (financial information may be used to individuate possible targets of criminal actions). The processing of such data is likely to present specific risks to data subjects' fundamental rights, freedoms and dignity (see article 17 of the DPC), as confirmed by the ECJ judgement 16th December 2008 (*Satakunnan Markkinapörssi and Satamedia*, C-73/07) that, soon after DPA's decision, aligned with it, endorsing its findings[70]. On one hand, the publication of the assessed taxpayers' list aims for a transparent administrative action and a moral suasion effect (taxpayers should be discouraged by the possibility to incur public contempt); on the other hand, it shall not be underestimated the aspect of giving economic operators a useful tool to ascertain the situation of possible economic and commercial partners. With regard to the second list, it represents an instrument of public control of the fulfilment of the tax obligations and a useful way for local administrative offices to facilitate the planning of the assessment action, while implementing an effective evaluation of the tax risk related to the taxpayers.

Coming back to our case, the clarifications given by the *AE* upon DPA's invitation were substantially based on the articles 69 and 66-*bis* (the VAT homologous of article 69) that prescribed the disclosure of income related information as a measure of public control of the fulfilment of the fiscal obligation. The choice of diffusing the lists via Internet was, in the Fiscal Administration's view, the implementation of the Legislative Decree 82/2005 (so-called *Codice dell'Amministrazione Digitale*, Code of the digital Administration) that provides to use digital means for the ordinary usability of information.

After its injunction to terminate the posting of the lists, as soon as the clarifications of the Revenue Agency had been given, the DPA issued a Decision

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[70] The Court stated that: *"an activity in which data on the earned and unearned income and the assets of natural persons are:*

– *collected from documents in the public domain held by the tax authorities and processed for publication,*

– *published alphabetically in printed form by income bracket and municipality in the form of comprehensive lists,*

– *transferred onward on CD-ROM to be used for commercial purposes, and*

– *processed for the purposes of a text-messaging service whereby mobile telephone users can, by sending a text message containing details of an individual's name and municipality of residence to a given number, receive in reply information concerning the earned and unearned income and assets of that person,*

must be considered as the 'processing of personal data".

on 6th May. It declared the action of the *AE* unlawful. The first critical point raised was the lack of legal basis; an Act of the Director of the *AE*, indeed, could only have laid down the terms and arrangements for drawing up the taxpayers' lists, but the access to such lists was in fact specifically regulated by the law. The law prescribed that the lists should have circulated only within the territory of the Revenue Agency's competent offices and should have forwarded, either on magnetic media or via electronic networks, exclusively to the Municipalities concerned; in both cases, the lists should have only included the taxpayers resident in the respective geographic areas. The procedure was aimed at ensuring the deposit of the lists for one year in order to be browsed, not copied, by anyone (paragraphs 4 and subsequent of the article 69 and article 66-*bis*).

Furthermore, the DPA contested that the Code of digital Administration, evoked by the *AE* to support its decision, although it did foster the use of IT in the processing of data by the PA, it did not jeopardize any limitations on access to the data established in laws and regulations. In the present case, those limitations were set forth by articles 69 and 66-*bis.*

The posting of the data in question on the Internet resulted also into a disproportionate dissemination of that information with regard to the purpose of the disclosure regulation. Instead of a limited geographic diffusion, indeed, it resulted into a free availability throughout Italy and abroad. The Fiscal Administration allowed an undefined, and undefinable, number of users to access, download, copy, create databases, modify and process a great quantity of taxpayers' data, circulate them further on the network and/or sell them. That resulted in diminishing the accuracy of the data and in extending their accessibility beyond the term of 1 year and beyond the geographically boundaries laid down by the law. Moreover, no one of those treatments was mentioned in the information notice provided to taxpayers in the models of tax return for 2005.

Finally, the DPA remarked that it had not been previously consulted by the *AE*, which is a legal obligation when regulations and administrative measures regarding personal data protection are to be adopted (article 154 paragraph 4 of the DPC).

The DPA thus confirmed the order for the Revenue Agency to block the publication of the lists and to diffuse them further. The inhibition was extended to the years following 2005 because of the lack of legal basis for such an action. The DPA finally recommended to grant the widest publicity to its decision in order to draw the attention of the entities, which had obtained, also indirectly, taxpayers' data from the Agency's website, to the circumstance that they may not circulate such data further.

2.3. Redditometro

A DPA more recent intervention was registered on November 2013 on the so-called redditometro. The DPA was asked to preliminary verify the compliance of the new discipline, introduced in 2010, regarding the synthetic assessment of income with the DPC.

The synthetic assessment is based on the idea that the spending power (better the employment of a sum of money or the power to dispose of goods and services acquired with such expense) constitutes a presumption of possessing income. The *AE*, starting from a well-known fact (i.e. the expense), retraces an unknown fact (i.e. the possessing of income), having in mind the assumption that a normal man does not spend more than the income possessed. The present method aims at reconstructing the net total income regardless of its source. Before the 1991's legislative modification of article 38 of the Presidential Decree 600/1973, the method was deemed conditional upon a vain exam under the analytical method, but, after such regulatory statement, no more doubt exist. The synthetic method may be used independently of the use of other assessment methodologies.

The paragraphs involved by the 2010's regulatory intervention were paragraphs 4 and 5. The first of them disciplines the so-called pure-synthetic assessment. It allows the *AE* to quantify the relevant income making reference to the expenses of any kind, when the gap between the income declared and the income reconstructed by the Administration exceeds 1/5. The expenses aimed at increasing the patrimony (e.g. real estate, cars) can be demonstrated to be paid with savings, declared and taxed in previous years. Even if the wording of the former paragraph 4, containing a presumption of use of income earned during that year and the 4 previous ones, was not replayed, the implementing Ministerial Decree 24th December 2012 provides a 4-years period of monitoring the disinvestment of increasing. The Fiscal Administration seems willing to take into consideration also a longer period[71].

Paragraph 5 contains the *redditometrico*-synthetic assessment. It prescribe the creation, through a Ministerial Decree, of a “*redditometro*” (instrument for measuring the income) through the analysis of samples of taxpayers, differentiated in relation to the family unit and the geographic area they belong to, and updated every 2 years. That form of assessment is easily applicable by the competent offices of the *AE*. The offices shall only demonstrate the availability of goods and services in the hands of a taxpayer, the method to quantify the income to be taxed, indeed, is already contained in the Ministerial Decree. In the case enshrined in paragraph 4 instead, the Administration shall both demonstrate the expenses of the taxpayer and quantify the corresponding income. The critical assumption backing the *redditometrico*-synthetic assessment is the connection between possessing an adequate income and the expenses related to the purchase and maintenance of certain individuated goods. Also in the present case the gap between the income declared and the income reconstructed by the Administration shall exceed 1/5 for the provision of article 5 to be applicable. The nature of the presumption is discussed; along with the traditional thesis of the jurisprudence[72] that deems the *redditometrico*-synthetic assessment a legal presumption (that may be overridden by contrary evidence provided by the taxpayer), recent jurisprudence[73] envisages a simple presumption that has to be supported by other serious, precise and concurring elements of proof.

As already said, the methodology followed to quantify the taxable income differs depending on homogenous group of family units and geographic area. Where the expenses of the taxpayer are higher than his income, an incoherence emerges that, depending on how wide the gap is, might be symptom of tax evasion. The Ministerial Decree defining the possible inferences to make in respect to each expense or index of possible higher income was issued on 24th December 2012.

[71] Agenzia delle Entrate, *Circular 24/E*, para. 3.6.7, 31st July 2013.
[72] Court of Cassation, 19252/2005, 16284/2007, 12197/2009 and 14168/2012.
[73] Court of Cassation, 13289/2011, 10661/2012 and 23554/2012.

The Decree contained two Tables (A and B); Table A listed the relevant expenses and indexes with the corresponding inductive content, Table B defined the average expenses of every cluster of family unit as resulting from the annual survey of the National Statistical Program, carried out by the *ISTAT*[74].

The clearance of the DPA was necessary for two main reason. First of all, the Revenue Agency made use of automatic processing of personal data, served in the *AT* or otherwise known, to select the taxpayers for the assessment and determinate their income on the basis of information communicated by the taxpayers themselves in their tax returns or other act subject to registration, by third parties as consequence of a legal provision, or deduced by the *AE* itself during its periodical assessment campaign. Secondly, the mechanism of the *redditometro* imposed to profile the taxpayers in order to collocate the taxpayers in the correct cluster and afterwards calculate possible mismatches between expenses and income. The DPA highlighted that the elaboration of criteria to analyse the taxpayers' behaviour, especially when carried out on the basis of numerous categories of data contained in the *AT* and through a profiling activity, directly triggered the data subjects' fundamental rights, freedoms and dignity. The remark is even more important when reference is made to the guarantees the DPC laid down in articles 14 and 17. According to those articles, no judicial or administrative act or measure involving the assessment of a person's conduct may be based solely on the automated processing of personal data; the data subject may challenge such an act or measure, unless taken on the basis of adequate safeguards laid down either by the DPC or in a Decision issued by the DPA under article 17. Particular concern raised the quality and accuracy of the data (see specifically article 11 paragraph 1 letter c) of the DPC), challenged by the profiling activity and, generally, by the automatic processing of the data.

The DPA found two orders of criticisms in the new discipline.

[74] The *Istituto Nazionale di Statistica (ISTAT)* is the the Italian National Institute of Statistics. Present in Italy since 1926, is the main producer of official statistics in the service of citizens and policy-makers. Since 1989, *ISTAT* has been performing the role of directing, coordinating, and providing technical assistance and training within the *National Statistical System (SISTAN)*, whose mission is rationalization of the production and publication of information and the optimization of the resources allocated to official statistics.

The first set of problems concerned the profiling activity. Errors emerged in the individuating the correct lifestage of the taxpayers. The correct assignation of the geographic area and family cluster is essential for the exact processing of the data and the determination of the income. The first error remarked is the mismatch between the “fiscal family” and the “family of the Civil Register”. The *AE* took into account the “fiscal family”, as defined in the specific line of the tax return, which may not encompass all the people effectively living together (“family of the Civil Register) and economically dependent from the taxpayer submitting the tax return. For the purpose of the *redditometro*, the persons not included in the “fiscal family” constituted a different family, but their number was higher than the real one[75]. A connected problem was the attribution to such mono-person families, also if composed of underage persons, of a fictitious rent, if they did not own or rent a dwelling in the Municipality where they resided. That fictitious rent was attributed, for example, to more than 2 million minors who, for several reason (e.g. impossibility to enjoy family allowances because of high income, lack of deducible items referred to the minor), had not been included in their parents’ tax return. In most cases those subjects did not have income other than the fictitious rent and did not present an high level of tax risk. The DPA obtained from the *AE* that the fictitious rent would have been attributed only at the moment of the possible cross-examination, if no convincing explanation had been given by the taxpayer under examination. It implies that the fictitious rent is no more processed automatically in the phase of selection of the taxpayers to be assessed.

Identical fate had the so-called *ISTAT* expenses, i.e. the expenses referred to the average consumption of a family. Because of the difficulty to attribute those expenses to a specific taxpayer, being indistinctly aimed at the sustenance of the whole family, their use entailed a considerable margin of inaccuracy and error. The Fiscal Administration, therefore, shall not take them in consideration at the moment of the selection of the taxpayers to be assessed, but only if, after the cross-examination, it is impossible to individuate the correspondent well-definite expense.

[75] It emerged that the mono-person families registered in the *AT* were 34 million out of 48 million families. The data of the 2011 census showed that real families were only 25 million.

The criticisms express by the DPA resulted in the obligation of the Administration, in order to profiling the taxpayers, to use only well-definite expenses and expenses entailing definite elements of income (e.g. possess of goods and services and expenses for their maintenance). No presumptive expenses, therefore, such as the *ISTAT* expenses, can be used for such purpose.

The DPA expressed concern also in relation to the lack of a specific information note and the lack of precise and legally prescribed information during the cross-examinations. A clear information notice, contained in the model of tax return and publicised on the website of the Revenue Agency, should have contained a precise warning that the information and data declared would have been used for the purpose of the *redditometrico*-synthetic assessment of income. The DPA remarked that a similar transparent approach should be used also during the cross-examinations with the taxpayers. When the *AE* requires the taxpayer to give further information and explanations, it shall indicate the powers used in processing his data and shall advise him against the consequences of his possible refusal to provide the AE, wholly or partially, the required data as laid down by article 13 paragraph 1 letters b) and c).

3. Taxpayer privacy in the context of the international exchange of information

One of the exception to the applicability of the professional secrecy (article 68 of the Presidential Decree 600/1973) is contained in the provision of article 31-*bis* of the same Decree. Paragraph 5, indeed, specifies that the communication of information useful for the assessment of higher income and estate tax to Authorities of other Member States shall not be considered a violation of the professional secrecy as laid down in article 68.

The necessity of avoiding tax evasion and tax avoidance and the increasing amount of international socio-economic relations challenge the States, more and more interested in preventing the erosion of their taxable base. As expressed in 2013[76] by the declaration of the G20 Leaders: "*in a context of severe fiscal consolidation and social hardship, in many countries ensuring that all taxpayers*

[76] G20 at St. Petersburg on 5th and 6th September 2013.

pay their fair share of taxes is more than ever a priority"[77]. The possibility to dispose of information concerning taxpayers' foreign activities and properties hugely helps the Fiscal Administrations of taxpayers' residence States to assess more precisely the relevant income which might escape from taxation.

Italy, along with other jurisdictions, has implemented an enormous number of international instruments, both bilateral and multilateral, that regulate the exchange of information. The exchange of information may be:

- automatic, when the communication of the relevant information is made on a routinely basis;
- upon request, when the transmission of the information follows a specific and justified request of another State;
- spontaneous, if a State of its own motion decides to forward relevant information to another States.

3.1. Article 26 of the OECD Model Convention and TIEAs

The most common instrument for the implementation of the exchange of information is a double taxation convention (DTC). Article 26 of the OECD Model Convention prescribes to the Competent Authority of the Contracting States to exchange information *"as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind…(omissis)…in so far as the taxation is not contrary to the Convention"*. All the three modalities exchange are allowed under paragraph 1 (Commentary on article 26, paragraph 9).

A different approach is followed by the Tax Information Exchange Agreements (TIEAs). They allows only to communicate information upon Contracting State's request (article 5 of the TIEA Model)[78]. The TIEAs are an interesting instrument of tax cooperation, specifically used in the case where no DTC exists between the Contracting States. Generally, TIEAs are signed with the so-called "fiscal heavens" with which the States do not have interest in entering in negotiations for

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[77] BEPS Action 1, *Addressing the tax challenges of the digital economy*, Ch. 1, p. 25.

[78] Para. 39 of the Commentary on TIEA Model clarifies that *"Paragraph 1…(omissis)…makes clear that the Agreement only covers exchange of information upon request (i.e., when the information requested relates to a particular examination, inquiry or investigation) and does not cover automatic or spontaneous exchange of information"*.

a DTC. In 2014 Italy ratified the TIEAs signed with Cook Islands, Gibraltar, Guernsey, Isle of Man and Jersey, those with Bermuda and Cayman Islands are still waiting for ratifications. Very recently Italy has entered in an Amending Protocol to the DTC with Switzerland (23rd February) and in TIEAs, Liechtenstein (26th February) and Monaco (2nd March). Those agreements allows Italy to require information on individual taxpayers or group of taxpayers, who show a pattern of behaviour suspected of evading tax, without the Contracting States opposing a refusal based on bank secrecy[79]. Some of those States have committed to start a wider ongoing program of increasing cooperation in the fiscal field[80].

Both the DTCs and the TIEAs contains a provision to protect the confidentiality of the information exchanged, respectively in article 26 paragraph 2 and in article 8. Both the wordings prescribe to treat the information received as secret in the same manner as information obtained under the domestic laws. The disclosure shall be made only to persons or authorities (courts and administrative bodies) concerned with the assessment, collection, enforcement or prosecution in respect of taxes. Such persons and authorities shall use the information only for the aforementioned purposes. The use of the information received for other purposes may be authorised by Competent Authority of the supplying State, when the used for such other purposes is allowed under the laws of both States.

Common to both the instruments are also the cases where the requested information may not be exchanged. The requested Competent Authority shall not be required to obtain or provide information that the applicant would not be able to obtain under its own laws for purposes of the administration or enforcement of its own tax law, to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, and information whose disclosure would be contrary to public policy.

[79] Bank secrecy is no more a valid ground for refusal of providing the requested information under art. 18 para. 2 of the Council Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation, repealing the former Directive 77/799/EEC.

[80] e.g. the *Roadmap on the way forward in fiscal and financial issues between Italy and Switzerland*, signed along with the Amending Protocol; the document contains the commitment of the Contracting States to activate, starting from 2017, an automatic exchange of information scheme.

3.2. Towards the automatic exchange of information: European effort

The worldwide trend in the exchange of information goes definitely towards the automatic exchange. The EU has been a pioneer in that field. Currently two main instruments assuring a routinely exchange of information are in force: the Council Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation and the Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments (so-called "Saving Directive").

The 2011 Directive provides the exchange of *"information that is foreseeably relevant to the administration and enforcement of…(omissis)…taxes of any kind levied by, or on behalf of, a Member State or a Member State's territorial or administrative subdivision"* (article 1 paragraph 1 and 2 paragraph 1). The directive regulates all the forms of exchange (upon request, automatic and spontaneous). The State requesting information shall communicate, in order to avoid so-called "fishing expeditions", the identity of the person under examination or investigation and the tax purpose for which the information is sought (article 20 paragraph 2). The requested State shall convey the requested information within 6 months (2 months if information is already available) and may rely only on the grounds of refusal laid down in article 17, which substantially matches with those contained in DTCs and TIEAs. The automatic exchange (article 8) has to be implemented since 1st January 2015. It is important to remark that, even if generally the Directive applies to all taxpayers (therefore, also if neither nationals nor residents of any Member State), the automatic exchange is applicable only with regard to information concerning residents of a Member State. The initial categories of income subject to automatic exchange of information (income from employment, directors' wages, assurance product, pensions and real estate) has been enlarged by the recent Council Directive 2014/107/EU (point 10) to comprise financial income (dividends, interests, royalties, accounts balance and income from the sale of financial assets).

Article 16 prescribes the so-called national treatment of the information, it means that it *"shall be covered by the obligation of official secrecy and enjoy the protection extended to similar information under the national law of the Member State which received it"*. The possible use of the information exchanged covers the administration and enforcement of the domestic taxes, duties and social security contributions and the judicial and administrative proceedings involving penalties, if defence rights are respected. Information and documents received may be used for other purposes, upon consent of the requested Competent Authority as far as such use is legal in both the applicant and requested Member State. The provision, therefore, is similar to its homologous contained in DTCs and TIEAs. It is remarkable the conclusion reached by the ECJ in 2013[81]. The Court was required to deliver its opinion on the applicability of the right to cross-examination, recognized by the internal legal system, to information conveyed by a requested Member States under the Directive 77/799/EEC. The taxpayer claimed *"not to have been informed of the request for assistance to other authorities, so that he had not been able to take part in formulating the questions addressed to those authorities and that he had not been invited to take part in the examination of witnesses in other Member States, in contrast to the rights he enjoys under Czech law in similar domestic proceedings"*. The Court found that *"European Union law, as it results in particular from Directive 77/799 and the fundamental right to be heard, must be interpreted as not conferring on a taxpayer of a Member State either the right to be informed of a request for assistance from that Member State addressed to another Member State, in particular in order to verify the information provided by that taxpayer in his income tax return, or the right to take part in formulating the request addressed to the requested Member State, or the right to take part in examinations of witnesses organised by the requested Member State"*. Moreover, it pointed out that *"the taxpayer may challenge the information conveyed to the requesting Member State in accordance with the rules and procedures applicable in the Member State in question"*. The conclusion reached by the ECJ is applicable also with reference to the Directive 2011/16/EU. The rights of the taxpayers contained in the former directive, indeed, were not modified by the new instrument; furthermore, the new directive cannot assure a lower level of protection compared to the former.

Another European instrument that provides an automatic exchange of information scheme is the Saving Directive, which constitutes a sort of *lex specialis* in respect

[81] ECJ, *Sabou* , C-276/12, 22nd October 2013.

of the Directive on Mutual Assistance[82]. It sets up a system of automatic exchange of information between the Competent Authorities of the Member States involved, related to cross-border interest payments on savings, in order to ensure the effective taxation in the resident State of the beneficial owner of those payments.

The internal provisions that allow Italian Fiscal Administration to exchange information with the Competent Authorities of other Member States according to the Directive 2011/16/EU are contained in article 31-*bis* of the Presidential Decree 600/1973. It prescribes that the Administration shall collect information to be exchanged under the same provisions governing internal fiscal proceedings. A specific prohibition to forward information is laid down, in line with the corresponding provision of the international instruments examined, with reference to information which would disclose trade, business, industrial, commercial secret or trade process, or information whose disclosure would be contrary to public policy. A further ground for refusal is constituted by the lack reciprocity, article 31-*bis* specifies for both legal and factual reasons. Article 17 paragraph 3 of the Directive 2011/16/EU considers only legal ones. Paragraph 4 of article 31-*bis*, instead, refers integrally to the Chapters IV and VI of the Directive with reference to the treatment of information exchanged. On May 2014, Italy created, with a view of implementing the Directive 2011/16/EU, a Central Office (the Directorate of International Relations of the Department of Finance of the Ministry of Economy and Finance) with the task of coordinating and managing the Connection Services (e.g. the Central Directorate for Tax Assessment of the *AE*, the International Unit of the *Guardia di Finanza*), which are in charge of collecting information under the Presidential Decree 605/1973 or with the use of the powers enshrined in articles 32 and subsequent of the Presidential Decree 600/1973 and exchanging it.

The last paragraphs of article 31-*bis* deal with joint audits. It allows Fiscal Administration to involve other EU Member States Administrations when the

[82] LANG M., *Introduction to European Tax Law: Direct Taxation*, Wien, Spiramus, 2013, p. 226. The author asserts that such nature could be inferred from the provision of art. 9 para. 3 of the Saving Directive precluding the application of art. 8 of the old Directive 77/799/EEC, which dealt with the limits to the exchange of information.

situation of one or more taxpayers shows a common or complementary interest and the joint audit seems more effective than a single State investigation. The Italian Fiscal Administration selects the taxpayer eligible for a joint audit and informs the other Authorities indicating the reason of its choice. In case of proposal of joint audit coming from other jurisdictions, the Fiscal Administration communicates its consent or justified denial. If the joint audit is activated, the Administration appoints a representative to direct and coordinate the investigation.

The very last paragraph specifies that the implementation of the article shall not entail new and higher costs; the Administration, therefore, shall discharge its activity with the economic and human resources available.

3.3. Towards the automatic exchange of information: international effort

The recent international effort towards an enhanced automatic exchange of information has received an outstanding contribution by the Foreign Account Tax Compliance Act (FATCA). The FATCA is a US federal law, adopted in early 2010, that requires United States persons, including individuals who live outside the United States, to report their financial accounts held outside the United States, and requires foreign financial institutions (FFIs) to report to the Internal Revenue Service (IRS) about their US clients. The most important provision of the FATCA legislation regard to the present theme, is the one requiring FFIs to sign up in the IRS website and to identify their US clients and disclose the account holders' name, TIN, address and transactions, except for some types of accounts (e.g. retirement savings and other tax-favoured products) that may be excluded on a country by country basis. A withholding tax is levied on the gross payments, with source in the USA, to non-compliant FFI.

The Directive 2014/107/EU has clarified that the Countries that have already concluded or will conclude a FATCA with the USA shall provide, under article 19 of the Directive 2011/26/EU, a wider cooperation to any other Member State.

Italy signed an Intergovernmental Agreement (IGA) with the USA enacting the FATCA scheme on 10th January 2014; the agreement is currently under examination by the Senate, after having been approved by the Chamber of

Deputies on 18th December. It will introduce, as soon as ratified, an automatic exchange of information between Italy and the USA. Starting from 2012, Italy, along with France, Germany, Great Britain, and Spain, has shown interest in the US project, signing with the USA a first Model IGA (Model 1 IGA). That Model creates a partnership between the USA and the jurisdictions involved, aimed at automatically exchanging information. Furthermore, it grants simplified administrative burdens and other benefits to the financial institutions of the Contracting Parties (e.g. relaxation of deadlines and simplified due diligence requirements). Italy, therefore, enjoys the simplified scheme laid down by Model 1 IGA; its FFIs shall only sign up in the IRS database, but report information directly to their own national Fiscal Administrations, which in turn reports to the IRS. The registration in the IRS database also exempts from the withholding tax levied on American sourced payments. The Annex II of the IGA signed by Italy specifies Italian Institutions exempted from the communication obligations are Governmental and Administrative Bodies, International Organisations, *Banca d'Italia* (the Italian Central Bank), certain retirement funds, local financial institutions meeting certain requirements, certain collective investment vehicles and non-profit organizations.

The FATCA legislation has constituted the base on which OECD developed its Standard for Automatic Exchange of Financial Account Information in Tax Matters, released on 21st July 2014. The Standard consists of two parts: the Common Reporting Standard (CRS) and the Model Competent Authority Agreement (CAA). While the former contains the standard of communications and due diligence on which the periodic exchange of "bulk" of taxpayers' financial information is based, the latter works as tool linking the CRS to the juridical source on which the exchange obligation is based (e.g. article 6 of DTC of the Convention on Mutual Administrative Assistance in Tax Matters, bilateral instruments for fiscal cooperation). The Standard aligns with the FATCA, enlarging its objective (no exempted thresholds are specified) and subjective scope (also foundations' and trusts' accounts are object of exchange of information and also local financial entities are obliged to report information). The Standard does not prescribe any withholding tax to be levied.

The urgency of the implementation of an effective mechanism of automatic exchange of information is confirmed by the fact that 44 Countries (so-called early adopters), including Italy, issued on 19th March 2014, before the release of the Standard, a joint statement to implement the CRS according to an ambitious timetable. The 44 jurisdictions, indeed, committed themselves to exchange information related to new (opened from 1st January 2016) and high-value individuals' pre-existing accounts from 2017 and that related to low-value pre-existing individuals' accounts and entities' accounts from 2018.

On 29th October 2014, 51 jurisdictions, including Italy, signed a Multilateral Competent Authority Agreements, based on article 6 of the Convention on Mutual Administrative Assistance in Tax Matters[83]. The instrument specifies, as set out in the Standard, the kind of information exchanged and the timing and method of such exchange. The first information exchange should take place for most of the signing parties, including Italy, on September 2017.

[83] The Convention on Mutual Administrative Assistance in Tax Matters was signed in 1988 and amended by a Protocol in 2010. Currently more than 60 jurisdictions have signed the Convention, which has been extended to more than 10 other Countries.

Chapter 4

Collection of Taxes

The present chapter analyses three different phenomena, both purely internal and with international relevance, connected with the improvement and potentiation of tax collection. The instruments described acts in two directions. They either lay down the criteria to individuate the cases in which activities are considered to be taxable in Italy (e.g. notion of PE) or supply a simplified scheme to fulfil the fiscal obligation, reducing at the same time compliance costs and errors in the determination and payment of the taxable amount (e.g. digital billing and MOSS).
Other solutions aimed at similar purposes are touched in different parts of the paper. It is worthy to remind in the present context the possibility given to the taxpayers, owning a bank account in one of the credit institutions agreed upon with the Fiscal Administration, to fulfil the fiscal obligation directly with an online payment filing *modello F24.* Taxpayers may pay in such way income tax, withholding tax, VAT, IRAP, stamp duties, registration fees, sanctions and sums due in force of instruments for the containment of litigations. The form allows also to compensate tax credit and debts, even if they arise from different taxes. The use of online means to file *modello F24* is compulsory for VAT taxable persons and, for all the other taxpayers, when the payment exceeds € 1.000 or a credit is used for compensation and the amount due is still positive.

1. Digital billing

The article 1 paragraphs 209 and subsequent of the Law 244/2007 (budget law for 2008) introduced, in order to simplify the procedures and assure timely payments, the obligations for the suppliers of the PAs to issues only digital invoices (paragraph 209). Correspondingly, the PAs shall receive, process and pay exclusively invoices digitally produced (paragraph 210).
The aim of the new regime is to achieve an enhanced transparency of procedures that might be source of fraud or tax evasion. The suppliers enjoy a reduction of

compliance time and costs and a diminution of the errors and the length of the procedure, so as to obtain the payment of the correct sums owed.

Possible inconvenient may rise with respect to small-medium size business, which do not have the appropriate structure to comply with the new discipline. Specific provisions[84] are addressed to those kind of business. The Ministry of Economy and Finance puts on their disposal, free of charge, the IT resources necessary to produce digital invoices or to develop dedicated open source software.

Under the new scheme, the submission of the invoices takes place though a specific system called *Sistema di Interscambio* (SDI). The budget law for 2008 referred to a Ministerial Decree for a specific regulation.

The Ministerial Decree (55/2003) was issued on April 2013. It established a differentiated timetable for the implementation of the regime conditional upon the type of PA involved. After 6 months from its adoption, the PAs could implement, on an elective basis, the new regime upon conclusion of specific agreements with their supplier. The regime has been mandatory for Ministries, Fiscal Administration and National Social Security Entities since 6th June 2014, and for all the other PAs included in the consolidated balance sheet of the State from 31th March 2015[85].

The Decree lists also the elements the invoice shall contains. It shall indicate the code (so-called IPA code) of the PA to which the invoice is addressed (article 3) and the CIG or CUP code (article 25 of the Law Decree 66/2014). Those codes indicates respectively invoices referring to public procurements (it is the code of the public tender) and invoice referring to public works, extraordinary maintenance works or works financed by European funds.

An important point touched by article 2 paragraph 4 is the moment of the billing. The invoice is deemed transmitted according to the provision of article 21 of the Presidential Decree 663/1972. The article, dealing with the normal billing procedure, states that the invoice is issued when delivered by hand, send, transmitted or put on the counterparty's disposal. In the present case, the suppliers shall transmit the digital invoices to the SDI, which, after checking their

[84] Art. 4 of the Ministerial Decree 55/2013

[85] The deadline was anticipated by art. 25 of Law Decree 66/2014. The original deadline was 6th June 2015.

correctness, forwards them to the PA according the IPA code inserted. The possible outcome of the control of the SDI on invoices submitted may be a positive one, if they comply with the technical requirements, or a negative one, if they do not comply with the requirements or in any case of possible problems. In both cases the SDI sends to the issuers of the invoices a message with the outcome of the invoices' processing. However, only when the supplier receives a positive message from the SDI, it is possible to prove that the invoice has been issued and received by the PA. The Circular of the Ministry of Economy and Finance 1/DF of 31st March 2014 clarified that both in the case of positive and negative outcome from the SDI the invoiced can be deemed issued because it is demonstrated that the SDI has in any case received the invoice. The solution of the Circular is not final. It is not ascertained that the date of the production of the message communicating the outcome of the control is the same in which the SDI received the invoice. The final satisfactory solution comes from an old Circular of the Ministry of Economy and Finance (no. 134 of 5th August 1994). It stated that the date written on the invoice is deemed to be the date when the invoice is issued, unless a contrary evidence is provided.

When the SDI cannot individuate a specific PA (e.g. lack of IPA code), it tries to process the information contained in the invoice in order to identify the PA. If no univocal PA is identified, the SDI produces a message, electronically signed, for the supplier certifying that the digital billing has been discharged and containing the invoice submitted. That procedure assures the supplier that the invoice has been issued. He may forward the invoice to the specific PA, which has the possibility to visualize the invoice contained in the message produced and electronically signed by the SDI. The PA cannot claim, in that occasion, the lack of a digital invoice to refuse to pay the amount billed.

2. Italian notion of Permanent Establishment: may a server or a website constitute a PE?

In 2004, the reform of the *TUIR*[86] drastically changed the concept of Permanent Establishment (PE), currently contained in article 162. Before the legislative intervention, the concept was opaque; the main source was the OECD Model, but jurisprudence and administrative practice contributed to define the concept often with inconsistent positions. That framework encouraged the Legislator to delegate the Government, charged with the 2003 reform, to clarify the notion of PE.

The article 162 substantially matches article 5 of the OECD Model, making some peculiar specifications. A PE is defined as *"a fixed place of business through which the business of an enterprise is wholly or partly carried on"*. It is useful to point out that, according to article 169, explicitly mentioned in article 162, in that respect domestic provision shall apply regardless of the treaty provisions, if the former are more favourable for the taxpayer than the latter. It is important when an activity is considered a PE under the applicable treaty, but not under the Italian law.

The new definition completely overcame the old administrative trend[87], already denied by the Court of Cassation in the Philip Morris judgement[88], that required a PE to be functionally autonomous from its headquarters.

Article 162, following the structure of the article 5 of the OECD Model, gives some positive and negative examples of what may constitute a PE. With a clear intent of widening the Italian taxable base, the duration of a building site, construction or installation project in order to constitute a PE is lowered to a minimum of 3 months (instead of a minimum of 12 months provided by the OECD Model). Similarly, article 162 refers, almost reproducing its wording, to the provisions of article 5 concerning the so-called "agent clause".

It is more interesting the provision of paragraph 5 of article 162, which prescribes that the availability of electronic processors and auxiliary equipment, allowing the

[86] The *Testo Unico delle Imposte sui Redditi (TUIR)*, Presidential Decree 917/1986, is the Italian Income Tax Code.

[87] Ministerial ruling no. 460196 of 13th December 1989.

[88] Supreme Court of Cassation, 10925/2002 (so-called Philip Morris case).

collection and transmission of data and information for the sale of goods and services, does not constitute *per se* a PE.

Italian Regulator decided to express in the wording of the article what the OECD highlights in its Commentary on article 5. Paragraph 5, indeed, is perfectly in line with the findings of the Commentary.

In order for an electronic processors to constitute a PE, the three main requirements of the definition of the PE (i.e. place of business, permanent, through which the business is wholly or partially carried on), laid down in paragraph 5, shall be met. The Italian definition of PE, therefore, makes possible to reach the same conclusion reached by the Commentary with regard to the possibility for a website or a server to be considered a PE. The Commentary remarks that *"a distinction needs to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment"*[89]. It comes from that distinction that software cannot constitutes a PE because of its lack of physical consistency. A website, being a "*combination of software and electronic data"*, does not have physical substance and *"location that can constitute a place of business as there is no facility such as premises or, in certain instances, machinery or equipment"*. Intangible properties thus cannot be considered a PE, because they lack of the very first requirement laid down by paragraph 1 of article 5 (and paragraph 1 of article 162), i.e. the place of business.

On the other hand, different considerations could be made in respect of servers. The Commentary states that a *"server…(omissis)…is a piece of equipment having a physical location and such location may thus constitute a fixed place of business of the enterprise that operates that server"*. It means that, if the other conditions are met, a server may constitute a PE. The requirement of being fixed is met when *"a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1"*[90]. With reference to the third and last requirement, paragraph 42.5 of the Commentary specifies that it shall be assessed *"on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal*

[89] Commentary on article 5 of the OECD Model Convention, para. 42.2.
[90] Commentary on article 5 of the OECD Model Convention, para. 42.4.

where business functions of the enterprise are performed". Another question to be examined on a case-by-case basis is the whether the activity performed through computer equipment at a given location has a preparatory or auxiliary character, "*having regard to the various functions performed by the enterprise through that equipment"*[91]. Examples of activities, generally regarded as preparatory or auxiliary, are: provision of communications link (much like a telephone line) between suppliers and customers, advertisements of goods or services, relaying of information through mirror servers for security and efficiency purposes, gathering market data for the enterprise and supplying information.

The last important clarification the Commentary gives concerns the unnecessary presence of personnel at the location of the allegedly PE. As it happens with respect of other activities where equipment operates automatically, "*the presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location"*.

The tenor of the Commentary's conclusions are confirmed by the Resolution no. 119 of 28th May 2007 of the *AE*. The Administration was requested to give its opinion on a specific case involving the sale of online videogame by a French company through a server located in Italy. The French company organized directly from France all the activity, from providing the videogames to managing the two servers the company had in Italy. The company asserted that no PE existed and the income produced should be taxable in France as business income. At that time, the *AE* could not rule on the qualification as PE of an activity carried out in Italy, but in its Resolution it laid down the conditions under which an electronic processor allowing the collection and transmission of data and information for the sale of goods and services constitutes a PE. It is useful to point out that, as we will describe in the following chapter, since the end of December 2013[92] it is possible to apply for an International Ruling in order to question the Administration on whether the activity carried out in Italy by a foreign enterprise is to be considered a PE. The Resolution is clear in its reference to the provisions

[91] Commentary on article 5 of the OECD Model Convention, para. 42.7.
[92] Art. 7 para. 1 a) of the Law Decree 145/2013 modified art. 8 of the Law Decree 269/2003 which introduced the International Ruling scheme. For further information, see Ch. 5, para. 3.

of the Commentary. The *AE* reminded the French company that, in order to constitute a PE, it should have had at its disposal, for a congruous period of time, so as to comply with the requirement of the fixed place, the servers through which it was unequivocally discharging direct electronic sale of goods and services (the core business of the company). Even if the *AE* did not rule on the case, it appears evident that the French company fulfilled all the requirements to be considered a PE, taxable in Italy.

3. The obligation of registering for VAT purpose

Non-resident subjects who want to carry out operations relevant for VAT purposes in Italy, fulfilling the obligations and exercising the rights arising from the direct application of VAT, may act in Italy in two alternative way.

The first one allows, according to article 35-*ter* of the Presidential Decree 633/1972, non-resident businesses, artists and professionals, who carry out activities in another EU Member State or third Country with legal instruments in place governing mutual assistance in indirect taxation, to register themselves, before starting the relevant operations, filing the specific form (ANR/3)[93] filled to the competent office of the *AE*. The office exclusively competent for non-residents VAT registration is the Operational Centre of Pescara. The form may be filed by hand, by registered post or electronically. After the registration process, the non-resident subject receives a VAT number.

Alternatively, under paragraph 3 of the article 17 of the Presidential Decree 633/1972, the non-resident subjects may appoint a resident fiscal representative. The representative is, with regard to the obligations arisen from the application of the VAT regulations, jointly and severally liable with the non-resident operators.

Article 17 clarifies that the alternative between direct registration and appointment of a representative is available only if the non-resident subjects do not have a PE in Italy. In that case, indeed, the VAT relevant operations made or received by a non-resident (headquarter) shall flow into the VAT accounting of its PE. When a non-resident sells goods or services to a resident VAT taxable person, the fiscal obligations are discharged by the latter applying the reverse charge (article 17

[93] The ANR/3 form is used also to communicate possible changes in the relevant data submitted at the moment of registration or in case of cessation of the activity.

paragraph 2 of the Presidential Decree 633/1972); if a PE is established in Italy, the reverse charge does not apply and the obligations are discharged by the PE. The PE therefore bills its own VAT relevant operations along with the operations carried out in its territory and referable to its headquarters. Moreover, the PE is liable to pay VAT with reference to taxable operations carried out in Italy by its headquarter, even if the operation is not attributable to it. Correspondingly, a non-resident subject may exercise the right of deducting the VAT paid in Italy upon purchase of goods and services only through its Italian PE[94]. It should be remind that the supply of services by an EU-resident headquarter to its foreign PE does not constitute an operation relevant for VAT. Quoting the ECJ, "*a fixed establishment, which is not a legal entity distinct from the company of which it forms part, established in another Member State and to which the company supplies services, should not be treated as a taxable person by reason of the costs imputed to it in respect of those supplies*"[95]. The Court specified that the supply of services by an EU-resident headquarter to its foreign PE constitutes a VAT taxable operation, only if a legal relationship, entailing a reciprocal performance, exists between the service provider and the recipient. In order to ascertain the existence of such relation, the Court found that "*it is necessary to determine whether the PE* (FCE IT in the case at hand) *carries out an independent economic activity*", i.e. whether it bears the economic risk of the activity.

It is of a capital importance to remind that the notion of PE, relevant for VAT purposes, is partially different from that described in the previous paragraph. It is relevant the sole concept of "material PE". The jurisprudence of the ECJ, indeed, has always stated that "*in order to be treated, by way of derogation from the primary criterion of the main place of business, as the place where a taxable person provides services, an establishment must possess a sufficient degree of permanence and a structure adequate, in terms of human and technical resources, to supply the services in question on an independent basis*"[96].

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[94] Articles 38-*bis*2 and 38-*ter* of the Presidential Decree 633/1972. They were introduced in 2010, after the blame of the ECJ (Commission vs. Italy, C-244/08, 16th July 2009) about the system by which Italy obliged non-resident operators having a PE in Italy to ask refund of the input VAT instead of granting the right to deduct it.

[95] ECJ, *FCE Bank plc*, C-210/04, 23rd March 2006.

[96] ECJ, *ARO Lease BV*, C-190/95, 17th July 1997.

Finally, it has been opened a further elective possibility for non-resident subjects to register themselves in Italy for VAT purposes. On 1st January 2015, indeed, the entry into force of the new regime concerning VAT place of supply in B2C contracts for the supply of telecommunication, television and radio broadcasting services and other electronically supplied services introduced the possibility for the suppliers of such services to register in only one Member States. Those services are now taxed, indeed, in the country where the customer belongs, regardless of whether the customer is a business or a natural person and whether the supplier is based in the EU or outside. The regime is, therefore, a simplification measure, without which the suppliers would be required to register in each Member State where they supply services. Using the web portal Mini One Stop Shop (MOSS)[97], taxable persons supplying the aforementioned services in all the EU have the possibility to account for VAT due on those supplies in the Member State in which they are identified. If the suppliers decides to use the MOSS, they shall register in their State of residence and, if not EU resident, the State where a PE exists. They are able to choose the State in which register themselves only if more than one PE exists or if the taxable persons do not have neither the residence, nor a PE in the EU.

[97] See Ch. 1, Para.5.

Chapter 5

Jurisdiction, dispute resolution and dispute avoidance

The staggering growth of the integration of the global economy, of the markets and of the enterprises engaged in transnational activities directly challenges the fiscal regulators, increasingly unable to manage the phenomenon without joint efforts with other international and supranational actors. That framework becomes even more complicated where attention is paid to the overwhelming importance of the digital products and services that, by their own nature, tend to escape from the traditional legal categories and jurisdictions.

States usually justify their income tax claims either by reference to personal attachment the recipient of the income has with the State or by reference to an economic link the income has with the State. States, indeed, including Italy, tax persons on their worldwide income if they have a personal attachment with the States. The most common personal attachment is the residence, but some jurisdiction adopt along with it or alternatively other criteria (e.g. domicile, nationality). Italy considers a person to be resident if he is registered for the greater part of the year in the Civil Registry or if he has the residence or domicile, as defined in the Civil Code, in Italy. When a person, having no personal attachment with a State, produces income, the State may levy tax on non-resident income with a domestic source. When two jurisdictions claim to levy tax on the same income, double taxation arises. In the international contest double taxation is meant to be juridical, i.e. the same person is taxed twice in respect of one item of income. The typical example is the taxpayer with an economic attachment to a State and a personal attachment to another; the first State levies tax on a residence basis and the second on a source basis. The problem could concern either the different interpretation by the States of the notion of personal attachment or, less frequently, the domestic source of an item of income under the law of both States. The pieces of the puzzle may not perfectly match; often the taxing rights arising under the internal law of two or more Countries overlap and sometimes leave gap open. If the increasing international dimension of the economic activities is taken into consideration, it is easy to imagine how the possibility of income taxed in more than one jurisdiction is extremely high.

Under International Law there is no rules to prevent double taxation, it is up to the State to provide remedies, unilaterally or, more plausibly, through a double taxation convention (DTC), by which the contracting States divide and balance their existing taxing rights. DTCs do not create new taxing rights.

Italy has signed 92 DTCs and it is still very active in leading negotiation to sign other treaties and amending protocol. Notwithstanding Italian effort and the ongoing process of improving and making more effective the provision of the OECD Model Convention, which represents the basic frame of the DTCs, double taxation may and does persist. In those cases taxpayer could ask the *AE* for relief, challenge the internal decision before the competent Tax Court, file a request for a Mutual Agreement Procedure (MAP) under article 25 of the OECD Model Convention (or correspondent provision of the applicable DTC) and, for transfer pricing issues, under the EU Arbitration Convention too.

The next paragraphs deal with the most relevant tools to settle or prevent disputes concerning problems of double taxation.

1. The jurisdiction of the Italian Tax Courts

The Italian Tax Courts are special judiciary bodies[98], fitting in the constitutional framework, that settle fiscal litigations in first *(Commissioni Tributarie Provinciali - CTP)* and second instance *(Commissioni Tributarie Regionali - CTR)*. It is possible to appeal a judgment of a *CTR* before the Supreme Court of Cassation[99]. The trial before the supreme tribunal takes place, with the appropriate adjustments, under the Civil Procedure Code. According to paragraph 2 of article 1 of the Legislative Decree 546/1992[100], indeed, the procedural rules followed by

[98] The judgements 287/1974 and 215/1976 of the Italian Constitutional Court stated the constitutionality of the Tax Courts as special judiciary bodies. The doubts arisen concerned the Constitution's prohibition of creating special judiciary bodies and the lack of impartiality and independence of the Courts. The former concern was easily overcome by reference to the pre-existence of the Tax Courts to the Constitution, the latter concern had been shared by the Court in the 60s. However, the Tax Courts' reform (1971-1973) changed the situation, receiving the approval of the Constitutional Court.

[99] Since 1999 a specific section (currently the V section, so-called fiscal section) of the Supreme Court of Cassation deals exclusively with the appeal against the *CTR*s' judgements.

[100] The Legislative Decree 546/1992 constitutes the Code of Tax Judicial Procedure.

Italian Tax Courts are those contained in such Decree and, for anything not provided therein, in the Civil Procedure Code.
Pursuant to article 2, Tax Courts have jurisdiction on whatever taxes, anyhow defined by the relevant legislation. It is thus helpful to bear in mind what is meant by tax, i.e. a definitive, compulsory, unrequited payment. The consequence is that payment substantially fulfilling those requirements, even if not formally defined as such by the provisions regulating it, shall be deemed a tax and, therefore, shall fall under the jurisdiction of the Tax Courts.
The fiscal trial has a "challenging" nature. In the great majority of the cases, it starts, indeed, with the taxpayer challenging an act of the Fiscal Administration.[101] That nature implies that, if the taxpayer's claim is sound, the main task of the judge is to cancel wholly or partially the act issued by the Fiscal Administration. Article 19 gives a non-exhaustive list[102] of acts that are challengeable before the Tax Court. They are all encompassed between the moment of the emergence of the tax claim and the last act of the tax collection; the enforcement of the tax due remains outside the jurisdiction of the Tax Courts, belonging to that one of the Civil Courts.
The nature of the fiscal litigation makes possible to go before the Tax Courts only if an act ("segment of taxation" as defined by the famous scholar Cesare GLENDI) has been actually issued by the Italian Fiscal Administration. The rules governing the jurisdiction of the Tax Courts, therefore, cannot provide an effective method to settle the dispute arising from cross-border operations, whose matter of concern is, indeed, often very complex and involves more jurisdictions. Settling the dispute only before the Italian courts cannot be entirely satisfactory. Double taxation may persist unless the competent authorities of the other jurisdictions involved make a corresponding adjustment, but a duty to recognize other jurisdiction's judgement does not exist.

[101] The request of precautionary injunction *ex* art. 22 of the Legislative Decree 472/1997 to deter the risk of losing the warranties of its credits is the only example of a fiscal trial started by the Fiscal Administration; see SCUFFI M., *La tutela cautelare nel doppio grado del giudizio tributario*, 2014.
[102] The Supreme Court of Cassation has always stated that acts not listed by art. 19, nevertheless possessing all the elements to assess the relevant tax and thus able to affect the taxpayer's estate, can be challenged before a Tax Court; see judgements 16293/2007, 21045/2007 and 7344/2012.

2. Mutual Agreement Procedure (MAP)

The Mutual Agreement Procedure (MAP) represents, being a supra-national solution, a more suitable tool to resolve disputes arising from cross-border economic activities. The provision of such procedure lays in the article 25 of the OECD Model Convention as the sole mean to settle possible disagreements between the highly contracting parties that result in double taxation of a taxpayer's income. The procedure involves directly the competent authorities of the Contracting States, generally at a ministerial level[103], and aims to achieve an agreement eliminating double taxation. The increasing interest of Italian taxpayers in MAPs is evident from the 2013's OECD statistics; the new procedures initiated in 2013 (the last year whose data are available) were 50, twice over those activated in 2010 (22). The number cannot be compared with that of MAPs initiated in Canada (123), France (198), Germany (251) or United States (403), but still demonstrate a change of mind, maybe compelled by foreign parent companies and foreign related enterprises, for approaching dispute resolution.

As van der BRUGGEN points out, "*a significant part of the legal doctrine acknowledges the need for or the advantages of supra-national solutions, and one of the solutions discussed is the use of international courts*".[104] The solution envisaged has found validation in the practice, in 1992 the German-Swedish tax treaty tax made reference to the International Court of Justice (ICJ) and the Austrian-German treaty to the European Court of Justice (ECJ). Nevertheless, that trend has not have further success, prejudice against the allegedly lack of expertise of such bodies to deal with the tax matter and the political nature of the evaluations contained in the DTCs seem to be hurdles too unsurmountable to be overcome. It is plausible, therefore, that the MAP will continue to rest with the competent authorities of the contracting parties.

The recent Public Discussion Draft on BEPS Action 14, released by the OECD in December 2014, does not make references to that aspect; it focuses instead on other widespread practices that are likely to hinder the effectiveness of the MAPs,

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[103] Italian competent authority is the Department of Finance of the Ministry of Economy and Finance.

[104] van der BRUGGEN E., *About the jurisdiction of International Courts to settle tax treaty disputes*, in LANG M. and ZÜGER M., *Settlement of disputes in tax treaty law*, Wien, Linde Verlag, 2002, pp. 501-531.

especially on the absence of mechanisms to ensure the resolution of those procedures. One of those mechanisms is the one provided in paragraph 5 of article 25, modified in 2008, introducing an arbitration clause in the case of failing to reach an agreement under paragraphs 1 and 2. The arbitration clause has the credit of ensuring, if activated by the interested taxpayer, a solution binding on the contracting States. The limit of the MAP, such clause wants to pass, is that, pursuant to paragraph 2, the competent authorities shall "*endeavour*" to reach an agreement. As clarified by the paragraph 37 of the Commentary to article 25, that provision *"entails a duty to negotiate; but, as far as reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavours and not to achieve a result"*. MAPs, therefore, do not grant a satisfactory outcome for the taxpayer, unless the applicable treaty contains an arbitration clause. To this day, only fourteen conventions[105] signed by Italy contain such a clause, no surprise, therefore, if the OECD suggests working for an increasing commitment of the States to consider arbitration in their tax treaty policy.[106]

Beside the so-called treaty or conventional MAP, another MAP could be activated, exclusively for transfer pricing issues, under the EU Arbitration Convention[107]. The instrument was signed in 1990, based on the former article 293 TEC[108], and thus constitutes an ordinary international treaty. That means that the ECJ has no jurisdiction to interpret the provision of the Convention and that the effectiveness of the Convention depends on the national constitutional law. It has no direct or self-executing effects and shall not be implemented, but rather ratified.

The Arbitration Convention provides a compulsory arbitration (articles 7 et seq.) in case of failure to reach an agreement under the MAP phase (article 6).

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105 Namely, the conventions signed with Armenia, Canada, Croatia, Georgia, Ghana, Kazakhstan, Lebanon, Moldova, San Marino, Slovenia, Uganda, United States and Uzbekistan.

106 OECD, *Public Discussion Draft on BEPS Action 14: make dispute resolution mechanisms more effective*, 2014, para. T, Ch. IV.

107 The EU Arbitration Convention 436/1990 was signed initially with a 5-years validity. In 2000 a protocol prorogued the validity of the Convention for other 5 years with an automatic time by time 5-years renewal.

108 Article 293 TEC stated: *"Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals…(omissis)…the abolition of double taxation within the Community"*. The article was not reproduced in the Treaty on Functioning of European Union.

Even if the EU Arbitration Convention grants, in any case, a definitive settlement of the dispute, its scope is limited twice. Firstly, it is applicable only if the disputes arise between EU Member States and, secondly, only if it concerns the violation of the arm's length principle for the determination of the transfer prices of the goods and services exchanged between related enterprises.

The following paragraphs deal with the most relevant issues raised by both types of MAP, paying particular attention to the national implications of the procedure.

The main national sources to make references to are the single laws of ratification of the DTCs and of the EU Arbitration Convention, and article 110 paragraph 7 (second part) of the *TUIR*. The provision of article 110 is the only one, in the entire *TUIR,* that mentions the MAP. It makes possible, in transfer pricing issues, to apply the arm's length principle also in cases from which a reduction of the income taxable in Italy derives, but solely as consequence of the implementation of an agreement reached with a Competent Authority of another State pursuant to a MAP.

On June 2012 the Administration released the Circular 21/E that gives, without being really exhaustive, the first, and actually the only available, clarifications concerning the most important aspects of MAPs.

2.1. Initiative

Paragraph 3 of article 25 of the Model Convention provides that the competent authorities of the Contracting States may start a MAP to resolve difficulties and doubts concerning the interpretation or the application of the relevant DTC. The competent authorities may also activate the MAP to eliminate double taxation in cases not covered by the DTC. Those MAPs, even if related to a specific case, have a general relevance. They highlight problems capable of affecting a broad number of taxpayers, it is thus recommended an adequate publicity of the agreement reached (Best practice no. 1 of the MEMAP[109]), e.g. memorandum of understanding.

[109] The OECD Manual on effective Mutual Agreement Procedure (MEMAP) (2007) is *"a guide to increase awareness of the MAP process and how it should function. It provides tax administrations and taxpayers with basic information on the operation of MAP and identifies best practices for MAP without imposing a set of binding rules upon Member Countries".*

It is commoner however that the taxpayer's request activates the MAP. Under paragraph 1, indeed, the taxpayer, deeming that the actions of one or both Contracting States result or will result for him in taxation not in accordance with the provisions of the applicable DTC, may file a MAP request to the competent authority of his State of residence. The objective scope of the MAP encompasses all the case that may create double taxation (e.g. double residence, incorrect withholding tax levied on dividends, interests and royalties, existence of a PE, transfer pricing)

The time limits to require a MAP are governed by each DTC. The OECD Model suggest a time limit of 3 years from the first notification of the action resulting in taxation not in accordance with the Convention, but Italy prefers a shorter limit (generally 2 years). As pointed out by the Commentary[110], the phrase *"first notification of the action resulting in taxation not in accordance with the provisions of the Convention"* shall be interpreted in the way most favourable to the taxpayer. It implies that, if the taxation not in accordance with the Convention derives from a tax levied or a withholding tax on source, the time limit starts to run from the notification of the denial of tax refund by the *AE* or after 90 days without the *AE* deciding on the refund. If the taxation arises from a tax assessment, the time limit runs from its notification. In any case, the taxpayer may file the MAP request, as suggested by the Best practice no. 8 of the MEMAP, before the notification of the tax assessment, e.g. notification of the tax audit report *(processo verbale di constatazione - pvc)*[111].

When the profits of an enterprise of a Contracting State are or may be included also in the profits of a related enterprise of another Contracting State in allegedly violation of article 4 or corresponding internal provision[112], the taxpayer's request is the only way to start a MAP under the EU Arbitration Conventions.

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[110] OECD, *Commentary on article 25 of the OECD Model Convention*, para. 21.

[111] The *processo verbale di constatazione (pvc)* is a tax audit report summarizing the audit activity discharged and the conclusion reached by the audit team. A copy of the document is given to the taxpayer. Pursuant to art. 12 para. 7 of the Charter of the rights of the taxpayer, the *AE* cannot issue, except in cases of urgency, the tax assessment before 60 days from the delivery of the copy of the *pvc* to the taxpayer. He has, indeed, the right to make observations and requests to the *AE* that shall evaluate them, before issuing the tax assessment.

[112] The Italian internal provision is art. 9 para. 3 of the *TUIR*.

The activation of the MAP in Italy does not require any contribution or fee, as suggested by the paragraph 6.1 letter e) of the Revised Code of Conduct (2009)[113]. In order to accelerate the activation of the procedure and not to delay the contact with the competent authority of the other State, the taxpayer filing the MAP request shall render to the competent authority as soon as possible all the relevant information (Best practice no. 5 of the MEMAP). Such information include the data identifying the taxpayer, an exhaustive description of the facts and circumstances of the specific case, the indication of the taxable periods involved, a detailed description of the judicial actions started and the remedies asked in both the jurisdictions, a copy of the acts allegedly resulting in a taxation not in accordance with the DTC and the indication of the article of the DTC allegedly violated. When a MAP under the EU Arbitration Convention is concerned, the taxpayer shall provide also information about the its economic and commercial relationship with the other enterprises involved, the motivation of the presumed violation of the arm's length principle, the indication of the compliance with the transfer price documentation required by article 26 of the Law Decree 78/2010[114]. Filing the request, the taxpayer undertakes to answer timely and satisfactorily to the requests of the competent authority and to make available all the relevant documentation necessary to the evaluation of the authorities involved.

The authority receiving a MAP request has to verify the admissibility of the taxpayer's claim. It means that it evaluates progressively whether the request of the taxpayer is justified and, if so, whether it is not able to grant a relief by its own means. The proceeding competent authority may ask further documentation and information. If both the conditions are met, the other competent authority shall be notified. The test of the admissibility may involve the *AE* to give assistance and clarifications to the ministerial offices, having generally already examined the case to assess the higher tax. Further, the *AE* may either eliminate unilaterally the

[113] *"The mutual agreement procedure should not impose any inappropriate or excessive compliance costs on the person requesting it, or on any other person involved in the case"*.

[114] Art. 26 of the Law Decree 78/2010 implemented the OECD's guidelines on transfer pricing documentation. Where such documentation demonstrating the compliance with the arm's length principle is exhibited during an audit, an exemption from sanctions (ranging from 100 to 200%) applied in case of assessment of higher tax under art. 110 para. 7 is provided.

double taxation revoking the tax assessment in self-defence[115] or recognize a tax refund to the resident taxpayer in case of evident conformity of the foreign act.

The competent authority requested shall inform the taxpayer of the admissibility of his request and of the valid starting of the procedure. The date in which the MAP starts corresponds with the date of the submission of the request, or, if further documentation has been required, with the date in which the taxpayer provided it.

Pursuant to article 8 the competent authority is not obliged to start the procedure or set up the advisory commission for the arbitration phase, when legal or administrative proceedings have resulted in a final ruling that, by actions giving rise to an adjustment of transfers of profits under article 4, one of the enterprises concerned is liable to a serious penalty. The Italian unilateral declaration to the EU Arbitration Convention defines serious penalties as *"penalties laid down for illicit acts, within the meaning of the domestic law, constituting a tax offence"*. In line with the recommendation of paragraph 3 of the Code of Conduct, Italian unilateral declaration limits the scope of article 8 to cases of fiscal fraud, actually not so recurring in transfer pricing issues.

Italy is aligned with the recommendations of the Code of Conduct concerning the ideal timetable[116].

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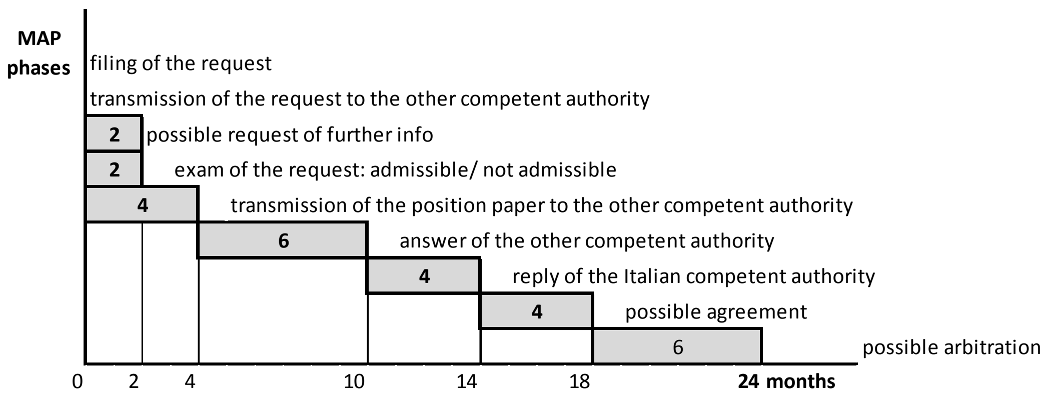
[115] The power of a *PA* to act in self-defence is the power to revoke its own acts when it recognizes that they have been issued in violation of the law or without the formal requirements.

[116] The following image summarizes the ideal timetable of a MAP (Source: Agenzia delle Entrate, *Circular 21/E*, para. 5.8, *AE*, 5 June 2012).



2.2. MAPs, internal litigations, instruments for the containment of litigations and tax collection

Paragraph 1 of the article 25 states that the MAP can be activated *"irrespective of the remedies provided by the domestic law.* The interpretation of that provision by most of the Italian DTCs shall be that the MAP is not an alternative to a judicial settlement of the dispute. It is furthermore coherent with the time limit to challenge the tax assessment issued by the *AE*; if the taxpayer does not challenge the act before a Tax Court within 60 days from its notification, its effects crystallize and the act becomes definitive. The judicial claim, therefore, is necessary to prevent that, pending a MAP, the act resulting in taxation not in accordance with the applicable DTC consolidates and thus becomes unmodifiable by a possible agreement reached by MAP. The prospective of a simultaneous activation of the procedures in question opens to possible conflicting outcomes. If an agreement is concluded before the *res iudicata,* the effectiveness of the agreement is conditional upon acceptance of its content by the taxpayer requesting the MAP and his concomitant waiver of the judicial remedy. An Italian PA, indeed, cannot act in contrast with a previous *res iudicata* concerning the specific case; the risk, therefore, is to conclude a MAP and be unable to act accordingly. As article 2 paragraph 2 of the Ministerial Decree 37/1997, regulating the power of the Administration to act in self-defence, clarifies, the Fiscal Administration cannot resort to that power if a *res iudicata*, favourable to the Administration, has intervened. In the opposite event instead, if the *res iudicata* intervenes before the conclusion of an agreement, the Italian Competent Authority shall communicate the outcome of the judicial ruling to the other Authorities involved. Where the wording of the ruling does not eliminate double taxation, the only possibility to eliminate it lays in the willingness of the other Competent Authorities to adjust their tax claim accordingly.

The taxpayer may require the suspension of the judicial proceeding. The recent developments have shown an increasing number of judges willing to grant such a suspension[117]. A different point of view should be adopted to analyze the relationship between the MAP activated under the EU Arbitration Convention and

[117] Agenzia delle Entrate, *Circular 21/E*, para. 4.2.5, 5 June 2012.

the internal judicial remedies. As we previously highlighted, the Italian administrative bodies cannot derogate from a judicial ruling. The paragraph 3 of article 7 of the EU Arbitration Convention clearly states that the advisory commission could be set up only if the associated enterprise has previously let expire the time limits to lodge a judicial claim or has waived it. It means that the procedures are alternative. If a MAP request is filed before the waiver, the 2-years period for the achievement of an agreement starts to run from the waiver. The problem do not arise where the procedures concern different issues.

Very common in the practice are the instruments to contain litigations, i.e. assessment by agreement[118], mediation[119] and conciliation[120]. They tend to settle the dispute between the taxpayer and the Fiscal Administration before resorting to a Tax Court, paying the amount agreed upon together with the Administration, interests and reduced sanctions. The taxpayer enjoys also other advantages; he is covered for other assessment on the same taxable period, the possible criminal penalties are reduced up to 1/3 and the criminal ancillary penalties do not apply[121]. Those instruments thus close the Administration's tax claim. Article 3 paragraph 2 of the Legislative Decree 218/1997 specifically states, with reference to the assessment by agreement, that it cannot be challenged before a court and cannot be integrated or modified by the Fiscal Administration, except for the assessment of higher sum due. It means that, even if an agreement pursuant to a MAP is concluded, the tax claim, as closed by such instruments, is not amendable. It

[118] The taxpayer receiving a tax assessment, by its own initiative or on Administration's invite, may activate a cross-examination to define jointly the tax due. Pending that phase the time limits to challenge the act are suspended for 90 days, they restart to run if the agreement is not reached. The agreement reached is deemed concluded when the taxpayer pays the sum agreed upon or its first instalment and produce to the Administration receipt of the payment. The sanctions are reduced to 1/3 of the minimum. Pursuant to art. 1 para. 637 lett. c) 1 and 2 and para. 638 of the Law 190/2014 (budget law for 2015), it will be no more possible to settle the *pvc* issued after the 31 December 2015 or to settle on invitation to a cross-examination by the Office within the same time limit.

[119] Art. 17-*bis* of the Legislative Decree 546/1992 provides that, if the value of the litigation does not exceed € 20.000, the judicial claim of the taxpayer activates a phase where the Administration evaluates the possibility to act in self-defense or to make a proposal to close the litigation. The mediation is mandatory, its absence implies that the proceeding cannot go ahead.

[120] Under art. 48 of the Legislative Decree 546/1992, in cases where mediation is not applicable, the *AE* or the judge itself may promote an agreement to terminate wholly or partially the litigation. It implies a reduction of the 40% of the sanctions, it entails a criminal extenuating circumstance and does not constitute a recognition of the Administration's claim. The conciliation can be activated only if the case is pending before a Tax Court of first instance and within the first judicial hearing.

[121] Law 74/2000, art. 13.

remains open, up to the foreign Competent Authority, the possibility to eliminate double taxation with a corresponding adjustment. The same result occurs to the MAP activated under the EU Arbitration Convention, even if other are the supporting argumentation. As we said, the assessment by agreement, the mediation and the conciliation, by their nature, close the Fiscal Administration's tax claim with a clear "compromise-settlement" intent. It thus prevents the possibility to seek, as alternative, an internal judicial remedy and, *a fortiori*, an international resolution. Those instruments, indeed, act as substitutes of an internal judicial proceeding and, therefore, paying regard to the alternative nature of the two procedures, preclude the access to the MAP[122].

Another problem connected with the pending of a MAP is the suspension of the tax collection. No *ad hoc* provision exists with reference to the MAP ex article 25. It implies that the taxpayer may use the normal tools, namely the administrative[123] and the judicial suspension[124]. A specific regulation instead concerns the suspension of tax collection, pending a MAP under the EU Arbitration Convention. Italy complies with the Code of Conduct, when it states: *"Member States are recommended to take all necessary measures to ensure that the suspension…(omissis)…can be obtained…(omissis)…under the same conditions as those engaged in a domestic appeals/litigation procedure"*[125]. Paragraph 2 of article 3 of the Law of ratification[126] of the EU Arbitration Convention prescribes, indeed, that the suspension of the tax collection and other executive acts may be authorized, on taxpayer request, by an Act of the Director of the *AE*. The suspension is closely related to the admissibility of the MAP request. It is commanded by the local Directorate of the *AE*, which evaluates also the opportunity to require an adequate guarantee for the Fiscal Administration's

[122] Agenzia delle Entrate, *Circular 21/E*, para. 7.2, 5 June 2012.

[123] Art. 39 of the Presidential Decree 602/1973 provides that the *AE* may exercise its discretionary power to suspend the tax collection on taxpayer's request, if a tax roll is challenged. The suspension is conditional upon the verification of the grounds of the taxpayer's claim *(fumus boni iuris)*. The suspension is revoked if a danger for the collection appears.

[124] Pursuant art. 47 of the Legislative Decree 546/1992, the taxpayer may request in his initial claim or other subsequent act to suspend wholly or partially the effects of the challenged act, if it might provoke a serious and permanent damage *(periculum in mora)*. The judge shall evaluate, together with the *periculm in mora*, the existence of the *fumus boni iuris*. The effects of the suspension cease when the judge publishes its ruling.

[125] Revised Code of Conduct, 2009, para. 8 a).

[126] Law 99/1993.

credit. If the case is pending before a court, the suspension is grant upon concomitant waiver of the judicial remedy. The solution is to be read in the light of the aforementioned alternative nature of the procedure, its aim, indeed, is to settle the dispute outside the judicial proceeding and its instruments (in the present case, the judicial suspension of the tax collection). The effects of the act authorizing the suspension decay as soon as the procedure is concluded.

2.3. The role of the taxpayer

The MAP is a tool of dispute resolution between States in the exercise of their own sovereign tax jurisdiction. The evaluations of the competent authority are, indeed, mainly political, intimately connected to the considerations leading to finalization of the DTC. A Convention is the product of a balance of different interests and of reciprocal concessions between the contracting States that might be determine to protect their interest during the procedure or might consider changing their position, both the approaches are political decisions. The competence accruing to the Department of Finance of the Minister of Economy and Finance confirms further the political nature of the procedure.

Apart from the initiative, the taxpayer, therefore, does not play an active role. The MAP is a government-to-government process, the taxpayer is a simple stakeholder. He has to use a cooperative and transparent behaviour and act in good faith and, if requested, he shall give all the information and evidences necessary to a complete and exhaustive development of the procedure. Best practice no. 14 of the MEMAP recommends assuring the taxpayer a timely and frequent communication regarding the *status* of the procedure in order to increase transparency and a clearer understanding of the case. Debriefing the taxpayer after each substantial MAP discussion and at the conclusion of a file is thus appropriate. The Code of Conduct (paragraph 6.3 letter b) provides the same. Paying due respect to the confidentiality of governmental communications and without making taxpayers involved in the negotiations, competent authorities are also encouraged to consider input from the taxpayer on factual and legal issues. Further suggestions, applicable also to the MAPs started under the EU Arbitration Convention, come from the Commentary (paragraph 40 letter c), they tend to grant a wider possibility to represent in transfer pricing cases, because of the complexity of the issues, facts and argumentation relevant for the case.

However, it is useful to highlight that the taxpayer does not have a specific procedural right to protect with a claim before a court. Granting the application of the recommendation of the guidelines is up to the willingness and the material possibilities of each competent authority.

3. International Ruling

The Law 326/2003, modifying article 8 of the Law Decree 269/2003, introduced a program of International Ruling, enacted by the Act of the Director of the *AE* of 23 July 2004. The program entered into only force in February 2005 after the clearance of the EU Commission. It addresses to enterprises engaged in international business willing to reach an agreement with the *AE* concerning complex transnational operations. The aims are clearly an enhanced tax compliance, the certainty of legal relations of the interested parties, the prevention of tax evasion, the deflation of litigations and, last but not least, the elimination of international double taxation. The success of the program is shown by the constantly increasing number of the requests to join it[127].The agreement reached,

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[127] The following table (*Table 2*) demonstrates the growing popularity of the International Ruling program (Source: Agenzia delle Entrate, *Bulletin of International Ruling – II edition*, 19 March 2013, para. 6 a).

Request of International Ruling submitted, pending and concluded								
	2004 2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**Total number**
Requests submitted	**28**	**6**	**6**	**12**	**16**	**29**	**38**	**135**
Unilateral	28	6	6	12	13	22	27	114
Bilateral or multilateral					3	7	11	21
Agreements concluded	**4**	**4**	**5**	**6**	**7**	**11**	**19**	**56**
Pending requests	**34**	**16**	**11**	**15**	**21**	**37**	**54**	
Unilateral	34	16	11	15	18	27	35	
Bilateral or multilateral					3	10	19	
Inadmissible requests	3	2	2	2	0	1	2	12
Requests waived	1	4	3	1	3	1	0	13

indeed, binds the *AE* and the requesting enterprise for 5 years[128], starting from the taxable year when the agreement is concluded. For the entire period covered by the ruling, the *AE* cannot audit the enterprise, and consequently assess higher income, in relation to issues constituting the object of the agreement.

3.1. Subjective and objective scope

The Act of the Director of the *AE* clarifies that by enterprises engaged in international business are meant:

- resident enterprises, qualified as such under the income tax regulations, that
    - enact operations with non-residents directly or indirectly controlling them, controlled by them or by a third undertaking controlling both enterprises;
    - holds participations in the capital of non-residents or whose capital is participated by non-residents;
    - has paid to or received by non-residents dividends, interests or royalties;
- non-resident undertakings carrying out their activity through a PE, as defined by the income tax regime.

The 84% of the taxpayers adhering to the International Ruling program are medium and large enterprises and the 68% has a turnover exceeding € 100 million (so called large taxpayers).[129]

The competent offices of the *AE* are the International Ruling Office of Milan for the northern Italy and Rome for the central and southern Regions.

The program covers a defined cluster of international tax matters:

- method of determination according to the arm's length principle of the transfer price of transactions between related enterprises;[130]
- qualification as PE of the activity performed in Italy by a foreign undertaking;

[128] Initially the period of validity of the ruling was 3 years, it was extended by the Law Decree 300/2013.
[129] Agenzia delle Entrate, *Bulletin of International Ruling – II edition*, 19 March 2013, para. 7.
[130] Operations of transfer pricing may concern supply of goods and services, cost sharing agreements or business restructuring.

- interpretation and implementation in concrete case of domestic and conventional provisions concerning the treatment of dividends, interests, royalties and other taxable income;[131]
- interpretation and implementation in concrete case of domestic and conventional provisions concerning the attribution of profits and losses to PE of foreign firms or to foreign PE of resident entities;[132]
- modalities to determine, in case of direct use of IP assets by their owner or in case of transactions with related parties, income deriving from that use.[133]

Type of transactions covered by the agreement					
Type of transaction	**2004 2009**	**2010**	**2011**	**2012**	**Total number**
Transfer pricing – production	11	3	2	6	22
Transfer pricing – distribution	5	3	4	7	19
Transfer pricing – services	3	1	3	4	11
Transfer pricing – royalties	1	0	3	1	5
Application to concrete case of provisions concerning the treatment of dividends, interests, royalties	0	0	0	1	1
Attribution of profits and losses to PE	2	1	0	1	4
Cost sharing agreements	1	0	1	0	2
Total	23	8	13	20	64

Table 3 Source: Agenzia delle Entrate, *Bulletin of International Ruling – II edition*, 19 March 2013, para. 8

The table clearly shows the preponderant prevalence of the transfer pricing issues that figure in the 89% of the agreement concluded. The data show also a decline of the traditional methods for the determination of the correct transfer price

[131] When the ruling concerns a specific case, the taxpayer in his request shall describe it, indicate the solution he wants to adopt, the relevant legal provisions and the reasons why the proposed solution is thought to compliant with the applicable rules.
[132] See the precedent footnote.
[133] The patent box regime has been introduced by the Law 190/2014 (budget law for 2015). Taxpayers may benefit, upon election, from a 50% exclusion (30% in 2015 and 40% in 2016) from the taxable base of income taxes and regional tax of income deriving from IP (i.e. use of copyrights of any intellectual work, trademarks, designs, models, plan, secret formulas or processes, or information from industrial, commercial or scientific experience). Taxpayer opting for such regime shall carry out research and development activities directly or through contract research with unrelated parted, universities or research centres.

between related companies (i.e. comparable uncontrolled price method, cost-plus method and resale price method), replaced in the 79% of the cases by the so-called transactional profit methods (i.e. transactional net margin method, by far the most used, and profit split method).

3.1.1. Advance Pricing Agreement (APA)

As pointed out in the precedent paragraph, through the International Ruling program the Regulator introduced in the Italian legal system, among the other tax issues touched, with reference to the regime of the transfer pricing, the Advance Pricing Agreement (APA). The APAs represent an instrument of advance fiscal policy, widespread in the OECD jurisdictions. They permit to determine for a defined period the method of calculation of the transfer price of the operations covered by the agreement and the critical assumptions upon which the method depends. The individuated method shall reflect the arm's length principle. Paragraph 7 of article 110 *TUIR* is the relevant provision concerning transfer pricing; it prescribes the use of the arm's length principle[134] in case of tax assessment for the evaluation of the value of goods and services acquired or sold between related enterprises, if derives an increase of the taxable income.

Bearing in mind article 110, the APA envisaged in the International Ruling program is what is internationally called a unilateral APA, binding, as we said, exclusively on the resident enterprise and the fiscal administration. The entity that remains aside is the fiscal authority of the State of the other enterprise involved in the international transactions covered by the unilateral APA. That remark has consequences, as highlight by the OECD[135], for the possible persistence of double taxation where the other administration does not recognize as valid the method defined or the critical assumptions indicated in the unilateral APA signed with the foreign competent authority. Italy, with the intent of preserving the integrity of its

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[134] The Italian provision codifying the arm's length principle is the paragraph 3 of art. 9 of the *TUIR*, but, due to the principle of speciality of the conventional rules, the applicable provision is the art. 9 of the OECD Model Convention, as interpreted by the Commentary which refers to the OECD documents concerning transfer pricing.
Other documents of practice are the Act of the Director of the *AE* of the 29 September 2010 and the Circular of the *AE* 58/E of 15th December 2010.

[135] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010, paras. 4.147 and 4.148, Ch. IV.

revenue, generally adopts a strict approach in the evaluation of the circumstances leading to the conclusion of an APA and it is not so incline in recognizing, without further (time- and resources-consuming) verifications, the reliability of APAs signed with a foreign authority.

In the view of eliminating all the risks of double or multiple taxation, the OECD suggests, therefore, that the APAs bind all the competent administrations of the foreign jurisdictions involved.[136] Most Countries prefer bilateral or multilateral APAs and some of them do not grant unilateral APAs (e.g. France[137]).[138] Since 2010 Italy has recognized the possibility to enter into bilateral or multilateral APAs[139]. The legal basis are the article 8 of the Law Decree 326/2003 and the paragraph 3 of the article 25 of the OECD Model Convention. Bilateral and

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[136] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010, para. 4.162, Ch. IV; OECD, *Public Discussion Draft on BEPS Action 14: make dispute resolution mechanisms more effective*, 2014, para. H, Ch. II.

[137] PATELLI L. and PORPORA F., *Advance pricing agreements to be implemented: commentary and comparative survey*, in *International Transfer Pricing Journal*, 2005, pp. 37-42.

[138] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010, para. 4.130, Ch. IV.

[139] The following table *(Table 4)* summarizes the bilateral APAs pending up to 31st December 2012 (Source: Agenzia delle Entrate, *Bulletin of International Ruling – II edition*, 19 March 2013, para. 3.1).

Pending bilateral APAs		
Contracting State		**APAs up to 31/12/2012**
	France	1
	Germany	3
	Japan	2
	Netherlands	2
	Spain	1
	Sweden	2
	Switzerland	3
	UK	1
	USA	4
total number		**19**

multilateral APAs are thus signed as result of a MAP activated by the competent authorities upon the request of the interested taxpayer directed to the competent International Ruling Office and to the competent office of the Ministry of Economy and Finance.

3.2. Pre-filing

On taxpayer's request the International Ruling Office, before entering in the formal *iter* of a unilateral APA procedure, may conduct preliminary meetings (so-called pre-filing) with the taxpayer and his representatives to give clarifications about the ruling request and define the general features of the procedure. The object of the meetings shall be general and cannot concern specific detailed issues. In contrast with the formality of the ruling procedure, the pre-filing is characterised by informality and may be conducted anonymously.

Pre-filing					
	2009	**2010**	**2011**	**2012**	**Total**
Disclosed pre-filing	9	25	27	30	91
Anonimous pre-filing	4	5	3	7	19
Total pre-filing	**13**	**30**	**30**	**37**	**110**
% of disclosed pre-filing	69%	83%	90%	81%	

Table 5 Source: Agenzia delle Entrate, *Bulletin of International Ruling – II edition*, 19 March 2013, para. 5.1

The statistics demonstrate an increasing interest of the taxpayers in the program and also a general trust in the procedure so as to disclose their identity during the pre-filing. The objects of the pre-filing's meetings, in line with what table 3 shows, are essentially related to transfer pricing issues.

3.3. International Ruling procedure

The International Ruling program is commenced on taxpayer's request and, unlike other Countries, is completely free of charges. The aforementioned Act of the Director of the *AE* mandates that the request shall contain the personal information of the taxpayer, the evidence of the subjective element prescribed for resident enterprises and all the relevant information related to the object of the ruling.

Within 30 days from the receiving of the request, the Office verifies the presence of those elements. The request lacking of such requisites is inadmissible. In case of lack of evidence concerning the subjective element requested to a resident undertaking, the request cannot be considered inadmissible when such evidence could be acquired through an audit activity. The 30-days period is suspended.

If the request is admissible, the procedure continues with meetings, requests of further documentation and inspections to have a direct understanding of the facts submitted to the Office and evaluate the risks connected.

Even if the procedure is prescribed to terminate within 180 days from the receiving of the request, the parties generally agree to extend the period because of the complexity of the issues dealt with. The time limit is, indeed, not peremptory[140].

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[140] The following table (*Table 6*) illustrates the length of the procedures concluded up to 31st December 2012.

Timing of the signature of an International Ruling (2004-2012)	
Months	**Agreement concluded**
less than 6	9
between 7 and 12	19
between 13 and 18	8
between 19 and 24	11
more than 24	9
Total	**56**
Avarage	**16 months**

The data record a reduction of the time spent to sign an agreement (in the period from 2004 to 2009 the average was 20 months). If we consider only the period from 2010 to 2012, it is register a further sensible reduction with an average of 14 months and 20 days. From the introduction of the program to 2012 the 83% of the procedures took less than 24 months to be concluded, improving the data related to the period 2004-2009 (73%).

The agreement concluded binds the *AE* and the requesting enterprise for 5 years, starting from the taxable year when the agreement is concluded. Within 90 days before the expiring of the agreement, the undertaking may request the extension of its validity. The Office evaluates the conditions of the renewal of the agreement, asking specific information and documentation and carrying out inspections.

During the validity of the agreement, the *AE* periodically monitors its respect and the supervening change of the factual and legal circumstances originating the agreement. The monitoring activity is conducted through a specific audit activity. The interested party shall make available to the audit team of the International Ruling Office all the relevant documentation and information and shall allow it to access the places where the activity is carried out. If the audit team ascertains a change of the conditions generating the agreement, the Office, jointly with the taxpayer, will modify it accordingly.

(Source: Agenzia delle Entrate, *Bulletin of International Ruling – II edition*, 19th March 2013, para. 6 b)

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